EXECUTIVE SUMMARY OF RECOMMENDATIONS

1. REACTIONS TO CONSULTATION PAPER : OUR RESPONSE

By and large the proposals contained in the Consultation Paper were appreciated. However, there was also constructive criticism in respect of some proposals, particularly relating to tax rates of some items. Suggestions for improvement of some other proposals were also received. This Report takes into account all responses received. An endeavour has been made to now make recommendations based on consensus, which reflect the concerns and aspirations of all concerned, while adhering to certain principles considered critical for having an indirect tax system and administration at par with the dynamic economies of the world. What follows in this Report are recommendations which, in the view of the Task Force, combine together to simplify and rationalise the tax system, effectively reduce transaction costs, encourage voluntary compliance and, in short, bring our indirect tax system and administration at par, if not better, than the best international practices.

2. MACRO-PERSPECTIVE AND APPROACH TO REFORMS

Our economy is at a critical juncture in its efforts to accelerate growth and employment in order to rapidly reduce poverty. Towards this, one of the key components of the strategy will have to be to exploit the opportunities afforded by more rapid globalization. While our economy has succeeded in maintaining one of the highest GDP growth rates in the world in the last decade with very low inflation, there are several areas where immediate improvements are required to sustain the growth momentum. The principal concerns are the deteriorating public finances, with the consolidated public sector deficit estimated to be over 11 percent of GDP, decline in investment dynamism and relatively weak performance of exports and FDI, the two pillars of trade and financial sector integration.

The most direct way to raise tax to GDP ratio is to remove most of the plethora of exemptions granted on import and excise taxes for a variety of

reasons, mostly for non economic considerations; widen the net by expanding the service tax base; and to improve taxpayers compliance. To boost exports and FDI, the government must sharply reduce the transaction costs associated with trade and doing business with India. Apart from maintaining a realistic market-driven exchange rate, and liberalization of imports, this will involve changes in policies and procedures involving improvements in trade logistics to allow exporters to compete in today's time-dependent markets. This will require a change in mindset away from controls rigidly administered, towards a more liberal policy environment in line with international standards. Trade facilitation revolves around the reduction of all the transaction costs associated with the enforcement of legislation, regulation, and administration of trade policies.

With the proposed reforms, it is estimated that the reduction in the transaction costs could be as much as 50%, the potential gains to the economy would be Rs. 4000-5000 crores per annum i.e. this large benefit would accrue to the economy every year. In a dynamic sense, in terms of exports foregone on account of high transaction costs, the reduction in costs will be several times higher. Reducing transaction costs and costs of doing business is important not only for boosting exports and FDI but even for creating an appropriate framework for vibrant domestic business.

It is the view of the Task Force that if the indirect tax administration frames its laws and procedures in adherence to the principles enunciated viz. Trust, Best International Practices, Simplicity, Transparency, Stability and Service coupled with the use of the full potential of information technology the net result would be beneficial to the trade, industry and the Government. There would be improved tax to GDP ratio through enhanced voluntary compliance at reduced costs, and less disputes and litigation. Also the confidence of the tax payer in the administration would be restored. It is the expectation that the individual recommendations would, when implemented, combine to change the face of the indirect tax administration in the country.

3. CUSTOMS PROCEDURES AND TRADE FACILITATION : BASIC REFORMS

The role of customs is both of a facilitator and a regulator. Whereas it must facilitate the honest importer and exporter it has also to ensure the laws of the country are applied strictly. Therefore, there has to be a very fine balancing. Taking into account all factors it is the view that the bottom line in regard to customs procedures is that these must be based upon trust, which presupposes absence of selectivity. Modern best practice calls for a systems approach that relies on self-compliance (through the maintenance of business records by tax payers), risk analysis and management (development of profiles of risky transactions), and supported by periodic post audits of records. This approach reduces delays for legitimate transactions while allowing full scrutiny of high-risk transactions. In this background, systemic changes are recommended.

3.1 Trust Based System (TBS) : Universal Green Channel

Customs clearance procedures should be based upon trust and be uniformly applied to all importers and exporters and all goods.

EDI network should be expanded to all ports/airports and should include all processes in the automation programme by 1st January 2004. In this direction, one major port and one airport should be made fully EDI operational by 1st April 2003.

The verification of declaration through pre-clearances examination, where necessary, should be based upon Risk Assessment techniques.

There should be increased use of post clearance audit

A system of self-assessment of Bill of Entry by the importer should be introduced.

Release of imported goods should be allowed on minimum documentation for certain importers of good track record of compliance.

Enhanced Systems Appraisal should be progressively extended and compliance would be ensured through Risk Management techniques.

Release of goods should be allowed in offence cases provided the goods are not liable to absolute confiscation.

Issue of amendments to Bill of Entry should be allowed settled at the service centre itself.

On-line filing of electronic declarations on internet etc. should be encouraged.

The custodians (IAAI/Port Trust Authorities etc.) should encourage establishment of warehouses by shipping airlines/airlines/couriers/ freight forwarders and consolidators within the port/airport for reducing dwell time.

It should be provided that a complete Import General Manifest (IGM) with house level details is filed with the Customs before the arrival of the vessel/ aircraft; the carrier/ steamer agents should file the IGM at Master level and the consol/ forwarding/ break-bulk agents should file the House level details; and the carrier/ steamer agents shall alone be responsible for correct and proper filing of complete IGM (including House level details) with the Customs.

A High level Inter-Ministerial Committee may be set up under the Chairmanship of Chairman, CBEC to resolve inter-agency issues to ensure a steady progress of clearance of import and export goods with reference to international norms.

A Permanent Trade Facilitation Committee should be constituted at each Port/airport/ICD/CFS comprising senior representatives of all agencies

including Custom House Agents (CHAs) under the chairmanship of the Commissioner of Customs.

Customs should lay down a time limit within which an import or an export document shall be processed.

Customs should rely increasingly upon Pre-shipment inspections.

[Chapter 3 : Paragraph 2]

3.2 Other measures for improved Customs administration

The Intelligence, Investigation and Audit Sections of the Custom House may be strengthened.

It is recommended that the instructions on the functioning of the Special Valuation Branch should be reviewed to provide for time bound finalization of cases in practice. Further, pre-deposit of duty should be dispensed with.

There should be sharing of Merchant overtime fees for activities done in Customs area.

Export valuation rules should be framed for export promotion schemes.

Customs should allow abandonment of warehoused goods.

Customs duty payment may be through cheques.

The scope of confiscation provisions in respect of export goods should be expanded to include non-dutiable goods as well as goods not covered under Drawback scheme.

It should be provided that Export Obligation Discharge Certificate issued by DGFT is accepted by customs without delay.

Customs officers may be empowered to enforce IPR by a suitable amendment to the Trade and Merchandise Marks Act and the Copyrights Act.

[Chapter 3 : Paragraph 3]

3.3 Custom House Agents (CHAs)

CHAs should be licensed through an All India entrance examination to be conducted by Directorate General of Inspection, C.B.E.C. once a year at Delhi and at its Zonal Units for licensing of CHAs.

CHAs once licensed should be allowed to operate at any Custom House/Port/Inland Container Depot anywhere in the country subject to simple registration of the business premises with the jurisdictional Commissioner of Customs.

Once a CHA licence is issued it should be valid for all time unless the CHA comes to adverse notice of Customs on account of misconduct, delay, etc. for which penal provisions, including suspension/revocation of Licence may be applicable.

Rates for CHA work should be determined by market forces, which will induce a healthy competition amongst CHAs resulting in competitive rates and better service and accountability towards the clients.

There should be a review of the technical qualifications of the CHAs to include knowledge of computer, Prevention of Corruption Act, etc.

[Chapter 3 : Paragraph 4.1]

4. CENTRAL EXCISE PROCEDURAL SIMPLIFICATION

Being the single largest contributor to the tax revenues of the Government, central excise revenues and administration have a critical role in the Indian economy. Naturally, any set back or slow down in central excise revenue

mobilization adversely impacts economic planning. Therefore, it is important to devise a suitable tax administration which facilitates voluntary compliance by the tax payer and leads to the collection of revenue at minimum cost. The steps taken so far have not materially altered the general perception that the central excise administration is not tax payer friendly and the systems and procedures are even now far too complex. Therefore, much more need to be done. Importantly, to make a visible impact it is necessary to make fundamental changes without further loss of time. Accordingly, the recommendations are aimed at comprehensively changing the essence of central excise administration with the twin objective of tax payer facilitation and encouraging compliance for increased revenue.

4.1 Manufacture

It is recommended that through suitable legislative changes, the levy of central excise should be progressively based upon value addition to be applied only to the processing stage (of manufactured goods) while ensuring that the other areas of value addition not relating to the processing activity (such as Sales Tax) is not entered into and possibility of double taxation is avoided.

[Chapter 4 : Paragraph 2.1.5]

It is recommended that the said provision should not be used routinely. Moreover, a suitable amendment is necessary so that it is applied prospectively.

[Chapter 4 : Paragraph 2.2.3]

In order to prevent any misuse of the MRP provisions, it is recommended that the wherever MRP based levy is applied on an item, the act of repacking, re-labelling and putting the item into unit container for retail sale may be deemed to be amounting to manufacture.

[Chapter 4 : Paragraph 2.3.2]

4.2 Assessment

It is recommended that the officers should be make responsible for assessments of ER 1 returns, and for this purpose clear cut instructions should be issued. Some monetary limit may be fixed for confirmation of assessment by each level of Central Excise officer upto Additional Commissioner.

[Chapter 4 : Paragraph 3.1.4]

4.3 Valuation

Guidelines on determination of cost of production should be issued at the earliest, and till such time all disputes be kept pending.

[Chapter 4 : Paragraph 3.3.3]

The present stipulation of valuing at 115% of cost of production when the goods are removed to sister units should be brought down to 105%. Moreover, there should be a moratorium on this figure, so that there is certainty in taxation.

[Chapter 4 : Paragraph 3.4.2]

The recommendations as regards the MRP based levy are that the system of MRP based valuation may be expanded; Explanation 1 to Section 4A should be amended to delete reference to the term "sole consideration" and it should only be provided that there is no additional flow back to the manufacturer over and above his selling price; and for transparency in mechanism of fixing abatement C.B.E.C. is advised to consider setting up an advisory Committee (including representatives of Chambers of Trade and Industry Associations) on the subject.

[Chapter 4 : Paragraph 3.5.4]

4.4 Cenvat

The Cenvat Credit Rules, 2002 should be amended to abolish the distinction between capital goods and inputs and allow credit on all inputs

brought into the factory except for those figuring in a small negative list, such as office furniture, motor vehicles, MS, HSD, etc.

[Chapter 4 : Paragraph 4.1.4]

It is recommended that the Cenvat Credit Rules, 2002 should be amended to allow with effect from 1.4.2004 full credit of the duty paid on the capital goods immediately on receipt, as in the case of inputs. As an interim measure, 75% of the credit may be so allowed from 1.4.2003.

[Chapter 4 : Paragraph 4.2.3]

Suitable provision should allow Deputy/Assistant Commissioner to condone technical lapses/ infirmities while allowing Cenvat credit.

[Chapter 4 : Paragraph 4.3.2]

An explanation may be inserted in rule 16 to the effect that the amount paid on removal of returned goods can be taken as Cenvat credit in the hands of the recipients.

[Chapter 4 : Paragraph 4.4.2]

A specific provision may be introduced to charge duty on the dismantled capital goods when removed from the factory.

[Chapter 4 : Paragraph 4.5.2]

Cenvat credit should not be allowed on deemed credit basis.

[Chapter 4 : Paragraph 4.6.3]

Rule 12 of the Cenvat Credit Rules, 2002 should be amended to provide for recovery of Cenvat credit erroneously refunded.

[Chapter 4 : Paragraph 4.7.3]

Cenvat inputs maybe allowed to be stored outside the factory in an identified place of storage subject to procedural safeguards for due accountal of the inputs.

[Chapter 4 : Paragraph 4.8.2]

4.5 Exports

It is recommended that sealing of export consignments by Central Excise officers should be replaced by self-sealing by the exporter. This should be granted as a matter of right and not on case to case basis.

[Chapter 4 : Paragraph 5.1.3]

The following recommendations are made to improve the system of grant of rebate :

(i) The work of grant of rebate should be centralized at the Custom House itself. In the alternative, an EDI link can be provided between the Customs House and the Maritime Commissioner. This measure is in addition to the grant of rebate by the Deputy/Assistant Commissioner of Central Excise having jurisdiction over the factory of the manufacturer or warehouse, as at present.

(ii) Notification No. 40/2001 CE (N.T.), dated 26.06.2001 should be amended to provide grant of full rebate in respect of mineral oil products falling under chapter 27 of the schedule to the Central Excise Act, 1985, which are exported as stores for consumption on board an aircraft on foreign run.

[Chapter 4 : Paragraph 5.2.5]

In order to reduce contact points and speed up the disbursal of the rebate/refund the same should be directly credited to the tax payer's own bank account.

[Chapter 4 : Paragraph 5.3.2]

4.6 Manner of payment of duty

Fortnightly payment of duty may be replaced by monthly payment.

[Chapter 4 : Paragraph 6.1.2]

The date of payment of central excise duty may be prescribed as the date of presentation of the cheque to the Bank subject to its realization.

[Chapter 4 : Paragraph 6.2.2]

It is recommended that in case of default in payment of duty :

(i) The provision of withdrawing the facility of payment of duty in installments in case of default should be revoked.

(ii) There should be automatic charge of interest and penalty in the event duty is not paid on time.

(iii) In the event it is decided to retain the provision of withdrawing the facility the assessee should be allowed to pay duty during this period through Cenvat credit.

[Chapter 4 : Paragraph 6.3.5]

4.7 Budget Day restrictions

The Budget Day restrictions are out of tune in present day world and should be removed.

[Chapter 4 : Paragraph 7.3]

4.8 Removal of goods for job-work

There should be a provision for allowing the movement of dutiable goods without payment of duty to job worker even in situations when the principal manufacturer is not working under Cenvat Scheme.

[Chapter 4 : Paragraph 8.2]

4.9 Collection of information from tax payer

Fortnightly statement of revenue paid, which is presently being collected from tax payers, may be discontinued. Further, as a policy, no information should normally be asked for (from departmental officers or industry) unless it is being obtained in the prescribed returns from the tax payer.

[Chapter 4 : Paragraph 9.2]

4.10 Dispute resolution

It is recommended that :

(i) Scope of Section 11A(2)(B), i.e. non-issue of SCN to be expanded to include cases of non-payment detected by Audit/ Department.

(ii) Section 11A should be amended to provide for the issue of a Show Cause Notice which automatically collapses if the tax payer voluntarily pays the duty and interest and 25% penalty within a period of 30 days of the issue of the notice. This would apply to cases involving fraud, suppression etc. In such cases the Notice should also mention in its preamble that there would also be no prosecution proceedings. The provision regarding collapse of the Show Cause Notice should apply to 'other' cases but without the requirement of payment of 25% penalty.

[Chapter 4 : Paragraph 10.3]

4.11 Filing of Returns

Date of filing return may be shifted to the 15th of the close of the month/quarter, as the case may be, for all tax payers i.e. including those in the SSI sector. However, the large units would furnish on-line or otherwise, by the 6th of each month, the information of total duty paid.

As a first step towards on-line filing of returns, the monthly/quarterly submission of TR6 challans may be discontinued and steps should be taken to eventually allow on-line filing of returns. The details of TR 6 Challans will be mentioned in the returns.

[Chapter 4 : Paragraph 11.3]

4.12 Voluntary filing of documents by tax payers

It is recommended that it must be made binding on the field officials to accept documents and give an acknowledgement in writing, if needed, in order to safeguard tax payers interest.

[Chapter 4 : Paragraph 12.2]

4.14 Arrest

The arrest in central excise cases, if warranted, should be made with the sanction of a Magistrate. This would require suitable amendment to the Central Excise Act, 1944.

[Chapter 4 : Paragraph 13.3]

4.15 Tax Clinics for Small Scale Sector Manufacturers

It is recommended that by 1st April 2003 each Central Excise Commissionerate should establish one Tax Clinic for the Small Scale Sector, under the charge of Deputy/Assistant Commissioner to guide small scale manufacturers. This Cell should closely coordinate with the Small Scale Manufacturers Associations.

[Chapter 4 : Paragraph 14.2]

5. EXPORT PROMOTION

Sustained export growth is crucial for maintaining and accelerating the GDP growth momentum, increasing employment and alleviating poverty. Since full liberalization of imports and sharp reduction in transaction costs were

expected to take time to implement, several export promotional schemes were introduced in the last two decades. It is the view that a viable export strategy must rest upon two basic premises. Firstly, to be competitive in the international market, the export product must match, if not better, the competition in terms of pricing and quality. Secondly, the exporter must have an incentive to enter the highly uncertain export market. Both these objectives are achieved through wide-ranging facilities, infrastructure, financing, income tax relief, trade facilitation, etc. and indirect taxes play a critical role. Taking up indirect taxes, it is evident that the strategy so far has been to grant customs and central excise duty exemptions on the raw materials, inputs etc. used in the export product. Particularly on the customs side this leads to making available the international high quality raw materials, inputs etc. at the international price and our exporters are thus not disadvantaged viz. a viz. their competitors abroad. Moreover it ensures that the price of the export product is not loaded with any tax element.

5.1 Viable export strategy

Multiple schemes cause difficulties in administration and are liable for some misuse. It is recommended that the export strategy should focus upon the following schemes :

(i) SEZ and EOU schemes – This is for the grant of duty exemption on all goods (capital goods, raw materials etc.) required by the units for their export production.

(ii) Advance Licensing (actual user) scheme - This would grant duty exemption to actual users on capital goods, raw materials etc. used for export production subject to post-clearance intelligence and audit-based verification.

(iii) Drawback scheme – Here, the relief from duties on the inputs, raw materials, capital good etc. would be provided through a mechanism of refund of the duties paid.

[Chapter 5 : Paragraph 2.2]

5.2 SEZ and EOU schemes

It is recommended that the C.B.E.C. must immediately work upon consolidating the numerous notifications, circulars and instructions, on both customs and central excise side in respect of the SEZ and EOU/EPZ schemes. This may be done by 1st April 2003. Ideally, all the notifications should be combined into one, and the circulars and instructions issued as a compendium, subject wise.

[Chapter 5 : Paragraph 3.2.2]

The following recommendation is made as regards the facility of DTA access to the EOU/EPZ units subject to the unit meeting the requirement of the EXIM Policy as regards the eligibility of access to DTA :

(i) EOU/EPZ units using wholly indigenous raw materials - status quo to be maintained i.e. DTA access of 50% on payment of duty equal to the central excise duty unless the central excise duty is nil in which case duty paid will be equal to 30% of the customs duty on like goods, as if imported.

(ii) Other EOU/EPZ units - 100% DTA access subject to payment of full customs duty on like goods, as if imported.

[Chapter 5 : Paragraph 3.3.2]

5.3 Drawback Scheme

It is recommended that C.B.E.C. may work out a mechanism to formally associate a representative of the Department of Commerce in the process of fixing the All Industry rates of Drawback.

[Chapter 5 : Paragraph 4.3.2]

It is recommended that through suitable legislative changes the scope of the Drawback scheme should be expanded to provide for rebate of all duties – central, state and local – and on all goods which go into export

product including capital goods. Similar action should be taken to include capital goods in the Advance Licencing (actual user) Scheme.

[Chapter 5 : Paragraph 4.4.3]

It is recommended that Customs should accept self- declaration from the Merchant Exporters that their supporting manufacturers are not registered with Central Excise and they do not avail Cenvat benefit. Similar self-declaration should be accepted from manufacturer-exporters. Such claims may be subjected to post disbursal verification on basis of intelligence and risk assessment techniques.

[Chapter 5 : Paragraph 4.5.2]

It is recommended that that Drawback should be sanctioned on the basis of Let Export Order without waiting for the EGM.

[Chapter 5 : Paragraph 4.6.3]

The following recommendations are made in respect of improving the mechanism of sanction of Brand rate of Drawback :

(i) In cases where the exporter has applied for fixing the Brand Rate of Drawback, the amount at the All Industry Rate of Drawback may be immediately released once the Let Export order is given. The balance amount may be released upon the determination of the Brand Rate of Drawback.

(ii) Drawback Rules should be modified to provide for an appeal to CEGAT in case an exporter is dissatisfied with the Brand Rate or Special Brand Rate of Drawback fixed for him.

[Chapter 5 : Paragraph 4.7.4]

It is recommended that the Deputy Commissioner (Export) may be made fully responsible for "Let Export" and also sanction of Drawback amount.

[Chapter 5 : Paragraph 4.8.2]

It is recommended that there should be an immediate software modification such that amount of Drawback blocked should not at any one point of time exceed the amount under dispute.

[Chapter 5 : Paragraph 4.9.2]

For expeditious recovery of inadmissible export benefits, it is recommended that the Export Outstanding Statement (XOS) must include a reference to the Code Number of the Custom House/port/airport/ICD/CFS of export. There should also be electronic exchange of information between the RBI and the nodal Custom House.

[Chapter 5 : Paragraph 4.10.4]

It is recommended that to avoid un-necessary issue of demand notices, the Customs may accept from the exporters themselves Bank Realisation Certificates as a proof of realisation.

[Chapter 5 : Paragraph 4.11.2]

It is recommended that as a general policy the weight declared by the exporters should be accepted. Verification should be done only in case of doubt or there is intelligence to the contrary.

[Chapter 5 : Paragraph 4.12.2]

It is recommended that after issuance of Brand Rate (including Special Brand Rate) letter, a copy should be forwarded to Customs EDI system for data feeding. The amount of Drawback should then be credited automatically in the exporter's bank account as in case of claim of All Industry rate of Drawback.

[Chapter 5 : Paragraph 4.13.2]

It is recommended that at the option of the exporter C.B.E.C. should work out an arrangement with its designated Bank which, when authorized, should send a mail transfer of the Drawback amount direct to the tax payer's bank account, wherever located.

[Chapter 5 : Paragraph 4.14.3]

It is recommended that in case, the sanction of Drawback is delayed beyond a period of one week of the receipt of listed documents, the Department should be liable to pay interest on the amount of Drawback. On its part the C.B.E.C. should list out the documents required for sanction of Drawback, which should be made known to the exporters.

[Chapter 5 : Paragraph 4.15.2]

5.4 Duty Entitlement Pass Book (DEPB) scheme

It is recommended that DEPB should be merged with the Drawback scheme from 1st April 2005.

[Chapter 5 : Paragraph 5.2]

5.5 Coordination between DGFT and Customs

It is recommended that towards improved coordination between the DGFT and customs the following steps may be taken :

(i) Duty exemptions, which are in general a critical component of the export promotion schemes, should be notified along with the EXIM Policy announcement. For this purpose the EXIM Policy should be made available to the Department of Revenue by 15th of March each year.

(ii) Both Customs and DGFT should make use of EDI technology for exchange of information, which would cut the delays.

(iii) There should be an institutional arrangement to resolve the co-ordination problems between the DGFT and Customs. The recommended structure is as follows :

(a) 'Export and Import Co-ordination Committee' co-chaired by Member (Customs), C.B.E.C. and DGFT and having as its members J.S. (Customs), C.B.E.C., J.S.

(Drawback), C.B.E.C, Additional DGFT, Director (Customs), C.B.E.C. and Joint DGFT and members of Exporters', Importers' and CHA Associations. The Committee would meet once in a quarter to examine and resolve all co-ordination issues. It would also oversee the work of the Regional Export and Import Co-ordination Committees.

(b) 'Regional Export and Import Co-ordination Committee' at each of the ports/airports/ICDs/CFS. This Committee would be chaired by Chief Commissioner of Customs. Senior most member of the DGFT at the port/airport/ICD/CFS would be a member. The Committee would also include all concerned departments and agencies such as custodians, banks, etc. and members of Exporters, Importers and CHA Associations. The Committee would meet once in a quarter to resolve all co-ordination problems. It is expected that since the customs is the chief implementation agency of the DGFT policies this Committee under the Chief Commissioner would ensure early resolution of the problems.

[Chapter 5 : Paragraph 6.4]

These Export and Import Coordination Committees should be notified in the EXIM Policy and the C.B.E.C. Circular.

[Chapter 5 : Paragraph 7.5]

6. AUTOMATION OF INDIRECT TAX ADMINISTRATION

It is clear that the success of an efficient tax administration rests upon making full use of the potential of automation and related technologies. The bottom line is that change shall, and indeed must, be automation driven. The major benefit of an automation programme is experienced in the area of trade

facilitation. Automation leads to quicker clearances, standardization of procedures, reduced discretion, less interface and faster decision making, all of which greatly benefit the trade and industry. At the same time, compliance issues are not neglected and, in fact, there is far greater control, though unobtrusive, which is desirable. However, a successful automation programme rests upon committed administrative support backed by significant financial investment.

6.1 Automation driven tax administration

The following recommendations are made for an automation driven tax administration.

(i) **All Customs and Central Excise Commissionerates should fully automate their processes by 1st January 2004. This requires a Commissionerate-wise work programme to identify the requirement of each station in terms of resources required.**

(ii) **EDI must be expanded to cover each Customs and Central Excise Commissionerate by January 2004 for on-line processing of returns and applications (for e.g. refund), risk analysis, profiling and management, message exchange with related agencies, etc. In this direction, one major port and one airport should be made fully EDI operational by 1st April 2003.**

(iii) **C.B.E.C. and its Directorates should be included in the automation programme. All processes should be automated by January 2004.**

(iv) **Facility of video conferencing between the C.B.E.C. and the Chief Commissioners should be created.**

(v) **Research capabilities in TRU should be enhanced by intensive automation and development of new software tools, particularly in the context of emerging challenges once VAT is introduced and integration of Service Tax and Central Excise take place.**

(vi) **On-line filing of returns and documents should be encouraged. For this, Service Centers may be established with a computer link to the Customs and Central Excise Commissionerates for providing the facility. For instance, Excise-Return data is at present entered by the data-entry-operators of the Department. In order to improve the data accuracy and timely capture of data, entry of the particulars by the assessees through a web-based application at their own premise or at Service Center should be allowed.**

(vii) **Telephone help-line system should be made available in all Custom Houses and Central Excise Commissionerates for providing information support to trade in respect of status of pending documents/claims and other information on procedures etc. In the long run this should become a centrally operated facility.**

(viii) **Implementation of the automation programme in a time bound manner requires four dedicated teams to oversee the timely implementation of this work, one for Customs, other for Central Excise, the third for Service Tax, and the last for automation of C.B.E.C. and its Directorates. These should be created in the Systems Directorate, from the staff available consequent to cadre restructuring. The teams would work under the Commissioner, Systems and lay down the road map for automation including resource requirement.**

(ix) **Sufficient resources must be made available at one go to the C.B.E.C. for the automation project. This step will obviate the necessity of taking sanctions and seeking release of funds each time. Importantly, the resources should include an element for an 'Upgradation Fund' for the timely upgradation of the hardware and software on regular basis.**

(x) **To the extent possible, the automation work should be out sourced as it is not within the core competence of the department. On the other hand India is a leader in software and full use must be made of the local available expertise.**

(xi) **Senior officers of the Department must take an active interest in computerization by using computers and relying upon the information generated. They should also ensure its use by others. In short, there has to be better ownership at senior levels.**

(xii) **Systems wing of C.B.E.C. should be strengthened (in terms of both manpower and resources) to ensure immediate dissemination of information through an updated website.**

(xiii) **Simplification, standardization and stability of law and procedures are essential prerequisites of a successful automation programme.**

(xiv) **Providing lead-time for software changes when laws are changed is essential for successful automation. For example, a notification must not come into force immediately from the date of its issue but from the next day. Similarly, new procedures should be implemented after a time gap of at least 30 days.**

(xv) **All procedures must be devised in consultations with the systems personnel who can advise on their adaptability to computerization.**

(xvi) **Multiple levies create complexities in development of software and retrieval of data. Accordingly, there must be an attempt to reduce the number of levies. Similar is the case in respect of multiple rates of duties. By and large an item should be subject to one duty rate.**

(xvii) **Levies and exemptions must be aligned to tariff headings. At present levies and exemptions are, at times, announced with**

reference to the description of the goods. Since the descriptions are not standardized, it creates difficulty in automation.

(xviii) **Automated processes should provide for bifurcation of total duty paid into individual heads. In other words, for each Tariff Heading read with the exemption notification, there should be one duty amount to be deposited by the importer. Once deposited, the system should do the further allocation of this amount under the respective duty heads. Presently this work is done by the tax payer. For this purpose to facilitate the tax payer, C.B.E.C. should come out with a Working Schedule indicating the break up of the duties.**

[Chapter 6 : Paragraph 2.2]

7. IMPROVING INDIRECT TAX ADMINISTRATION

7.1 Directorate of Anti-dumping and Safeguards duties

It is recommended that an independent body such as the Tariff Commission should be suitably strengthened to conduct the work of investigations such as injury determination, dumping margin, etc. relating to Safeguard duties and Anti-dumping.

[Chapter 7 : Paragraph 1.4]

7.2 Advance Ruling

It is recommended that suitable legislative changes may be made to include within the ambit of the Authority on Advance Ruling:

(i) **A wholly owned subsidiary Indian company, of which the holding company is a foreign company, proposing to undertake an activity in India, and**

(ii) **Notifications issued under the Finance Acts in respect of duties collected as excise or customs duties, and notifications issued under the Customs Tariff Act.**

(iii) **Admissibility of Cenvat credit.**

[Chapter 7 : Paragraph 2.4]

7.3 Prosecution of individuals

It is recommended that the prosecution provisions under the Central Excise and Customs laws be suitably amended to restrict their applicability to the persons actually responsible for the offence.

[Chapter 7 : Paragraph 3.3]

7.4 Adjudication and Appeal

It is recommended that in order to restore the confidence of the tax payers, Section 11A of the Central Excise Act, 1944 and Section 28 of the Customs Act, 1962 should be amended to restore the earlier position of issue of Show Cause Notice for demand of duty by an officer of the level competent to adjudicate the case.

[Chapter 7 : Paragraph 4.1.3]

It is recommended that pre-deposit of duty should not be taken at the first stage of appeal, i.e. at the level of Commissioner (Appeals). This would require suitable amendment to the said Section 35 F.

[Chapter 7 : Paragraph 4.2.3]

It is recommended that the relevant provisions should be modified to provide for the finalisation of the case (wherein stay is granted) within a period of six months so far as it is possible to do so. This would act as a signal to the CEGAT to decide the cases in a time bound manner. The provision that the stay is automatically vacated when the case is not finalized in six months should be revoked.

[Chapter 7 : Paragraph 4.3.2]

It is recommended that suitable measures may be taken to authorize Commissioners of Customs and Central Excise to appoint Special Fee

Counsels upto a certain monetary limit. The Chief Commissioners may also be suitably authorized for appointment of Counsels beyond the monetary limit prescribed for Commissioners.

[Chapter 7 : Paragraph 4.4.2]

It is recommended that in like manner of CEGAT, Departmental representatives should be appointed at the benches of the Settlement Commission. Subsequently, this practice can be replicated in case of Authority for Advance Rulings.

[Chapter 7 : Paragraph 4.5.2]

7.5 Strengthening Internal Audit

It is recommended that the following steps may be explored to strengthen the system of audit for the benefit of both revenue and the tax payer:

(i) Instruction may be issued that Audit should be participative and a fact finding mission with the objective of guiding the tax payer; the attempt should be to evolve a consensus on the issues and Audit teams should not be empowered to issue show cause notices for duty demand.

(ii) C.B.E.C. and CAG should identify posts within their organizations to be occupied by the officers of the other department on deputation.

(iii) Rule 22(3) of the Central Excise Rules, 2002 may be amended to exclude reference to audit party deputed by the CAG so that they need not visit the tax payers premises.

[Chapter 7 : Paragraph 5.1.5]

7.6 Trade facilitation

Keeping in mind that the objective of tax administration should be to provide certainty and transparency, the following recommendations are made in so far as introduction of new procedures are concerned:

(i) An institutional mechanism, namely Standing Committee on Procedures chaired by Chairman CBEC and including trade and industry representatives, should be established to identify and resolve the problem areas in present procedures and evolve new procedures on a need basis. This Committee should meet once a quarter.

(ii) A new procedure should come into force after minimum 30 days of its announcement.

[Chapter 7 : Paragraph 6.1.3]

The following is recommended in respect of fixing revenue targets :

(i) Revenue targets must be fixed realistically. The target must be broken into POL and Non-POL which would enable the Commissionerates to make realistic attempts to reach the target through legal measures and trade facilitation.

(ii) On the customs side, as an export facilitation measure, the revenue target should be fixed by including Drawback disbursed and refund sanctioned. This will ensure against blockage of Drawback and refunds. It would also encourage the Commissionerates to release Drawback in order to meet the target.

(iii) On the central excise side the revenue target should take into account duty paid through both Personal Ledger Account (PLA) and Cenvat credit. Refunds sanctioned should also be taken into account. This will ensure against stoppage of payment through Cenvat during revenue drive and withholding of refunds.

[Chapter 7 : Paragraph 6.2.4]

It is recommended that the 8-digit Common Commodity Classification Code should be implemented at the earliest and latest by 1st April 2003. This should be used by all other agencies (DGFT, DG, CIS, custodian, etc.) also.

[Chapter 7 : Paragraph 6.3.4]

It is recommended that a time bound programme should be initiated for the ISO Certification of all Custom Houses and Central Excise Commissionerates – to be started in 2003 and completed by 1st January 2005. This presupposes standardization of procedures.

[Chapter 7 : Paragraph 6.4.2]

The following recommendations are made as regards role of the Banks in indirect tax collection :

(i) Multi-banking should be encouraged by recognizing new banks including private sector banks to handle receipt of Government revenue.

(ii) A pre-condition to the appointment of the banks should be establishment of an EDI link with the Custom House/Central Excise Commissionerate to facilitate reconciliation of revenue.

(iii) Banks should have the responsibility of issue/transfer of refund checks/amount direct to the tax payers bank account on the basis of a release advise form the Commissionerate.

(iv) Option of payment of duty through debit card and the like should be explored for implementation.

(v) Appointed banks should give the tax payer the option of internet banking for deposit of duty and transfer of funds.

[Chapter 7 : Paragraph 6.5.1]

On matter of interest rates it is recommended that :

(i) The interest payable by the tax payer and the department may be made uniform.

(ii) The interest so determined must be uniformly applied in each and every situation where it is decided to charge interest.

(iii) The law should itself clarify that the interest is simple and not compounded.

(iv) The rate of interest should be reviewed each year at the time of the Budget and brought in line with the prevailing market rate. Rate determined should not be changed during the year.

[Chapter 7 : Paragraph 6.6.2]

It is recommended that the provision in respect of Unjust Enrichment may be amended to the effect that it would not apply when the refund arises in respect of provisional assessment, goods captively consumed and pre-deposit of duty.

[Chapter 7 : Paragraph 6.7.2]

It is recommended that the system of receipt and acknowledgement of dak and correspondence should be reviewed and it should be ensured that a receipt counter manned at all hours during office hours is positioned at an easily accessible place. In the case of small offices where there is a paucity of staff, a Mail box should be provided and acknowledgements issued next day. Every correspondence should be acknowledged and timely replies sent.

[Chapter 7 : Paragraph 6.8.2]

It is recommended that C.B.E.C should codify all circulars/ instructions in one cover, subject-wise by 1st April 2003.

[Chapter 7 : Paragraph 6.9.2]

It is recommended that C.B.E.C should ensure by 1st April 2003 that all its tax payers are entered into its computer record on the basis of PAN.

[Chapter 7 : Paragraph 6.10.2]

The recommendations in respect of search and seizures are as follows:

(i) **Central Excise officers should not be required to wear uniform. This would change the mind set on both side (Department and taxpayer) and contribute to freer communication.**

(ii) **Videography should be done whenever statements are recorded and searches made.**

(iii) **Seizure of documents and records adversely affect the conduct of business. Accordingly, these should be mandatorily released upon the completion of adjudication.**

[Chapter 7 : Paragraph 6.11.1]

7.7 C.B.E.C. Administration

As long term measures to give stability and direction to the indirect tax administration, which is so critical for the economic well being of the country it is recommended that Chairman, C.B.E.C. should be selected on criterion of merit cum seniority and once appointed (at whatever age before 60 years) should have a minimum tenure of 2 years.

[Chapter 7 : Paragraph 7.1.3]

It is recommended that a mechanism may be found to give C.B.E.C. financial autonomy. The Chief Commissioner and the Commissioners may also be given enhanced financial powers.

[Chapter 7 : Paragraph 7.2.2]

It is recommended that the C.B.E.C. should evolve a time bound strategy to improve the office accommodation as follows:

(i) **A Task Force should be set up to standardize the requirement of a modern customer friendly office (model office) which should**

(ii) **Furnish its report by 31st January 2002. The report should include financial estimates.**

(iii) **Based on the report of the Task Force, the C.B.E.C should ask the Chief Commissioners to identify the shortcomings in each of their offices in their jurisdiction by 1st April 2003 and send a consolidated proposal to C.B.E.C.**

(iv) **By 1st August 2003, a model Commissionerate (Customs and Central Excise), Central Excise Division and Central Excise Range office should be set up in each of the Chief Commissioner zones.**

(v) **C.B.E.C. should seek financial sanctions and replicate the model offices by upgrading the existing offices and purchasing land, building, etc., where necessary. The entire exercise should be time bound, so that by 2005, modern offices are in place in each Commissionerate.**

(vi) **Modernisation of C.B.E.C and its Directorates should be done by setting up a Task Force to identify the areas of improvement and thereafter taking time bound action.**

(vii) **Facility of video conferencing between the C.B.E.C. and the Chief Commissioners should be created.**

(viii) **Research capabilities in TRU should be enhanced, particularly in the context of emerging challenges once VAT is introduced and there is integration of Service Tax and Central Excise.**

[Chapter 7 : Paragraph 7.3.2]

7.8 Human Resource Development and training

In the area of training and human resource development it is recommended that :

(i) **The infrastructure available for training at regional level should be upgraded. Training should be accorded priority and sufficient infrastructure needs to be created to impart training especially in areas of use of information technology, managerial skills and attitude changes at the cutting edge level. Each Chief Commissioner of a Zone should have an in-house training center equipped with latest training aids and adequate infrastructure to take care of the training requirements in addition to the proposed regional training centers in the Cadre Restructuring proposal.**

(ii) **The C.B.E.C. should make full use of the technical assistance of multilateral agencies such as World Bank, Asian Development Bank and World Customs Organization, especially their reform and modernization projects and programmes, that support customs reform through training in diagnostic study and in customs needs analysis. These help domestic customs authorities implement the required changes that have been identified and evaluate their impact on trade facilitation and customs compliance.**

(iii) **A relevant UN body to be contacted for assistance is the Center for Facilitation of Procedures and Practices for Administration, Commerce, and Transportation (CEFACT- UN/ECE).**

(iv) **Group 'B' and 'C' officers who are at the cutting edge should be given training to change the mind-set for bringing about pro-client/customer orientation.**

(v) **Entry level training to officers who are promoted from Group 'B' to Group 'A' should be mandatorily provided at NACEN, for a minimum**

period of 3 months covering both Customs & Central Excise. This is essential as officers promoted from Customs are often posted to Excise Commissionerates and vice versa.

(vi) **Cadre training should be compulsory in respect of all Group 'A' officers and periodical refresher courses should be organized to impart training of managerial skills.**

(vii) **Senior Group 'A' officers of the rank of Commissioners and above should be deputed to attend Executive Development Programmes in premier management institutes in the country such as, IIM, IIFT, ASCI etc.**

(viii) **Group 'A' officers should be exposed to the tax administrations abroad and international best practices in training followed to enhance their skills.**

[Chapter 7 : Paragraph 8.2]

9. REVENUE AUGMENTATION, TAX LEVIES AND RATES

It is but evident that there is an urgent need to arrest the trend of falling indirect tax to GDP ratio if an impact is to be made on the fiscal deficit. Broadly, this calls for action in two areas of tax policy. First is the tax structure and second is tax implementation. Widening the tax base by reviewing and removing to the extent possible the duty exemptions; reducing the types of tax levies and the number of duty rates; expanding coverage of Service Tax and integration of Central Excise (goods) and Service Tax legislation; and implementing VAT are some of the measures.

9.1 Customs Tariff and Exemptions

As a policy, multiplicity of levies must be reduced. Accordingly, it is recommended that there should be only three types of duties, viz. Basic Customs Duty, Additional Duty of Customs (or Countervailing duty) and

Anti-dumping/Safeguard duties. All other duties should be removed. However, removal of SAD should be linked to implementation of State level VAT, where SAD would get replaced by the State VAT to be levied on imports.

[Chapter 8 : Paragraph 2.1.2]

The following road map for the future is recommended in respect of customs duties so that there is no uncertainty in the minds of the investors and industry.

(i) O% - for items like life-saving drugs and equipments, sovereign imports (defence and security related goods etc.) and imports by RBI.

(ii) For other goods -

By 2004-05 :-

10% for raw materials, inputs and intermediate goods.

- 20% for consumer durables.

By 2006-07 :-

5% for basic raw materials like coal, ores and concentrates, xylenes, etc.

- 8% for intermediate goods which will be used for future manufacture (capital goods, basic chemicals, metals etc.).

- 10% for finished goods other than consumer durables

- 20% for consumer durables.

[The duty reduction to the level of 5%-8%-10% should start only after introduction of State VAT so that imported goods are also made subject to the same State VAT (in lieu of SAD) by way of Additional Duty of Customs.]

(iii) Motor vehicles - nominal reduction in the duty from 60% to 50%. The import duty on second hand cars may continue at the existing rates. Higher import duty on defective steel items may continue.

(iv) Cellular phones - the exemption from CVD may be withdrawn but the basic import duty may be reduced to zero in 2003-04. The SAD on this item should also be abolished, so that the total incidence of duty goes up only marginally.

(v) 2003-04 : - 8% on crude oil.

- 15% on the petroleum products.

2004-05 : - 5% on crude oil.

- 10% on the petroleum products.

(vi) Higher duty rate upto 150% for specified agriculture produce and demerit goods.

[Chapter 8 : Paragraph 2.2.11]

Hence, it is recommended that as a general policy, the downward revision of duty rates should be in stages of (–) 5% each year. However, having regard to our commitment to reform, it is recommended that to the extent possible, for no item should the present duty rate be increased, unless the item is charged to nil duty, in which case a minimum duty of 5% can be imposed. Some increases may be resorted to only on administrative consideration to avoid multiple rates depending upon end use.

[Chapter 8 : Paragraph 2.2.12]

It is recommended that the grant or continuance of exemptions must be judged against the following criterion and if this done it would widen the tax base, improve the tax to GDP ratio and improve the tax administration :

(i) As a policy, all exemptions must be removed except in case of :

- **(a) Life-saving goods.**
- **(b) Goods of security and strategic interest.**
- **(c) Goods for relief and charitable purposes.**
- **(d) International obligations including contracts.**

(ii) As a general policy, when exemptions are removed but the relief is justified, the targeted beneficiary may be assisted by upfront transparent budgetary support based on a prior stated objective criteria. By such method, the expenditure would be subject to Parliamentary scrutiny and there would be public debate besides CAG audit.

(iii) In case an exemption is justified, it should not be end-use based conditional exemption. However, in the event the end-use condition cannot be avoided, the confirmation of end-use should be done on the basis of selective post clearance checks by using Risk Assessment techniques. It should not be based upon the Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996, as the implication in terms of registration with central excise, execution of bond etc. increases contact points and the cost of compliance.

(iv) As a general policy, there should be no exemption from Countervailing duty (CVD), which is at par with the duty paid by the domestic manufacturers of similar goods, including in cases where the exemption from basic customs duty is merited. An exemption from CVD places domestic industry (including potential industry) at

disadvantage and discourages domestic investment in these areas, which is not desirable.

(v) Best international practices should be one criteria for determining the requirement of otherwise of an exemption.

[Chapter 8 : Paragraph 2.4.7]

As a policy there should be a move away from specific rates towards ad-valorem rates.

[Chapter 8 : Paragraph 2.5.1]

The suggested customs duty structure on imports is given in Annexure 'A'. Since agricultural products stand on a different footing, the Task Force has refrained from suggesting the proposed rates and recommends an Expert Group should be set up for the same.

[Chapter 8 : Paragraph 2.6]

9.2 Central Excise Tariff and Exemptions

It is recommended that as a policy, we should review all levies and have only one levy, i.e. the Cenvat.

[Chapter 8 : Paragraph 3.1.3]

It is recommended that till such time as there are multiple levies, there should be a working schedule indicating the total tax payable on a particular product and the system should internally segregate the same into the respective levies.

[Chapter 8 : Paragraph 3.1.5]

The following recommendations are made for the central excise duty structure:

(i) 0% - for life-saving drugs and equipments, security items, food items, necessities and the like, agricultural products.

(ii) **6% - for processed food products and matches.**

(iii) **14% - standard rate for all items not mentioned against other rates.**

(iv) **20% - for motor vehicles, airconditioners and aerated water.**

(v) **Separate rates for tobacco products and their substitutes (like Pan Masala).**

(vi) **The specific rate of excise duty of Re.1 per kilo on bulk tea today translates to about 1% in ad-valorem terms. Raising it to 6% may not be desirable, more so when coffee is already exempt from excise duty. Thus, bulk tea may also be exempted from duty. This is anyway a plantation product.**

(vii) **Specific duty on cement may continue as most of the clearances are to the depots where the prices vary from day to day and ad valorem levy would necessitate provisional assessments, and may result in uncertainty.**

[Chapter 8 : Paragraph 3.2.6]

It is recommended that the road map of duty rates should lead towards the identified duty rate (for the product) through a mechanism of (+) 2% or (+) 6% or (+) 8%, as the case may be or (-) 4% each year, depending upon its current rate of duty.

[Chapter 8 : Paragraph 3.2.7]

It is recommended that Government may move down to the long term rates even quicker, in case there is adequate revenue buoyancy from other tax proposals such as taxes on services sector.

[Chapter 8 : Paragraph 3.2.8]

9.3 Central Excise duty structure for Petroleum sector

The following recommendation is made in respect of the duty structure of the Petroleum sector :

(i) Central excise duty on petroleum products, particularly HSD and motor spirit, may be fixed at specific rates. But keeping in view the importance of the petroleum sector to the revenue, there should be a quarterly review of the specific duties by joint discussions between the Department of Revenue and Ministry of Petroleum so that the duty rates can be adjusted to take account of fluctuation of prices in the prevailing quarter.

(ii) Central excise duty on kerosene may be raised by Rs.1/litre. An additional duty of Rs.1/litre may be imposed on LDO to make the duty at par with diesel.

(iii) Warehousing facility for petroleum products should be withdrawn.

[Chapter 8 : Paragraph 4.4]

9.3 Central Excise duty structure for Textile sector

The following recommendations are made as regards the central excise levy on Textile sector :

(i) A uniform duty of 16% (to be reduced to 14% in 2004-2005) on all fibres and yarns by raising duty on cotton yarn from 8% to 14% and bringing down the duty rates on polyester filament yarn. The duty on polyester filament yarn to be brought down to 14% in four installments.

(ii) A uniform duty of 12% on all fabrics,(knitted or woven) which are not processed, till 2004-2005.

(iii) All exemptions should be removed except for the following :

(a) Fabrics woven on handlooms(unprocessed);

(b) Fabrics processed without the aid of power or steam. Articles of yearn, strip, twine, cordage, rope, cables (56.07/09) manufactured without the aid of power;

(c) Handloom fabrics (whether cotton, woollen, etc.) certified, as khadi as well as Polyvastra;

(d) Silk yarn spun from silk waste and manufactured without the aid of power;

(e) Woolen yarn spun without the aid of power;

(f) Fabrics processed without the aid of power or steam (but using power for certain specified processes) may be brought under the SSI exemption, when the present exemption is removed;

(g) Dyeing/printing/bleaching/mercerizing of filament & spun yarns without aid of power or steam in a factory which does not have the facilities for producing single yarn;

(h) Yarns manufactured without aid of power;

(i) Jute and jute products (being natural fibres and used mainly for industrial purposes. These are extremely eco-friendly), and also impregnated, coated, covered or laminated with plastics;

(j) Strips of jute (5806.39);

(k) Rot proofed jute products, laminated jute products and fire resistant jute products; and

(l) Blankets of wool/shoddy yarn of value not exceeding Rs. 150 per square metre.

(iv) Processing of woolen fabrics (woven on powerlooms), not containing worsted yarn or made of shoddy yarn or melton cloth (made of shoddy yarn), where the fabric value does not exceed Rs. 150 per square metre.

(v) Synthetic fabrics, manufactured from shoddy yarn and consumed in the factory of production for manufacture of shoddy blankets of value not exceeding Rs. 150 per square metre.

(vi) Captive consumption of Printing frames for use in printing of fabrics(Administrative convenience)

(vii) Following full exemptions may be withdrawn, and the items brought under the general SSI duty exemption scheme, if not already covered:

(a) Sisal and manila twist yarn, thread, ropes and twine (Ch. 53/56), if consumed within the factory where it is produced for manufacture of sisal and manila products falling under Ch. 53, 56, 57 or 63;

(b) Hair belting of wool (5806.39); and

(c) Raincoats, undergarments & clothing accessories.

(viii) Exemption to all other handloom fabrics processed by any agency may be withdrawn and replaced by an outright transparent subsidy similar to the hank yarn subsidy scheme.

(ix) **Excise duty on coated and bonded fabrics (Chapter 59) should be rationalized to 16% (and subsequently to 14%) instead of 21% (16% + 5%) as at present.**

(x) **The deemed credit schemes should be immediately withdrawn, and credit given only on production of duty paying documents. The Task Force recognizes that Textile industry is to a large extent controlled by traders. With the withdrawal of the deemed credit scheme, if the users are to avail of the credit of duty paid on inputs, all down stream manufacturers would have to come under the excise net. This might create some problems for the power looms which can, however, be obviated if the supplier of yarn to the power looms is deemed to be the manufacturer, so that all excise formalities including taking of credit undertaken by the traders. Similar dispensation can be made in the case of processed fabric in cases where the traders send grey fabrics to the processors for further processing. Such scheme already exists in the garment sector. Needless to say, the procedure for payment of duty by the traders will have to be simplified so as to encourage the acceptance of the scheme. However, optional levy on unprocessed fabrics may continue.**

(xi) **There may be a problem when the general SSI duty exemption for ready-made garments is removed, as in that case, even tailors may have to be brought under the excise net. To overcome this, it can be provided that when ready-made garments are made on job-work basis for use and not intended for sale, no excise duty should be charged.**

(xii) **As regards rate structure, the existing 12% rate may continue till 2005, as a commitment has already been made in this year's Budget to that effect.**

(xiii) **The Additional Duty of Excise (Goods of Special Importance) Act, 1957, should be amended from 2005 in respect of textile fabrics so that like any other goods, the States can levy sales tax on such goods also.**

[Chapter 8 : Paragraph 5.7]

9.4 Central Excise duty exemptions

It is recommended that the following factors must be taken into account while considering the grant of a duty exemption :

(i) **Income elasticity of the product; cost of compliance; international best practices; and canon of transparency;**

(ii) **Instead of duty exemption whether it is possible to extend the same benefit through a budgetary mechanism; and**

(iii) **If an exemption is issued it should indicate the period of its validity with a proviso that changed circumstance may warrant a mid-term review.**

[Chapter 8 : Paragraph 6.7]

9.5 Small Scale Sector duty exemption

The following recommendations are made as regards the central excise duty exemption for the small scale sector:

(i) **The duty exemption should be extended to only small units with a turnover of Rs. 50 lakhs**

(ii) **The duty exemption limit for the larger SSI units should be gradually brought down to Rs. 50 lakhs. The time frame is suggested, as follows :**

(a) **Year 0 (2004-05) – From Rs.100 lakhs to Rs. 75 lakhs.**

(b) Year 0 (2005-06) – From Rs.75 lakhs to Rs. 50 lakhs.

However, on reduction of the exemption limit, the unit would have the option of payment of duty at 4% (without Cenvat) on the value of clearance upto Rs. 100 Lakhs. The other option available at present of paying duty at a certain percentage of the normal rate would continue to be available.

It is important to note that the downward revision in exemption is proposed to be complemented by a transparent and hassle free tax collection mechanism, which must be in place from April 2004.

(iii) The duty exemption should provide for determining the turnover based on value of total clearances including exempted goods. However, in view of the special contribution of the sector towards the overall exports and to encourage exports, it is proposed that the clearances for exports may continue to be excluded for this purpose, as at present.

(iv) On principle duty exemption for SSI sector should not subsidise consumption of luxury items by the affluent

(v) It is proposed that with effect from 1st April 2003 a Declaration should be filed by the unit when value of its clearances touches Rs.50 lakhs.

[Chapter 8 : Paragraph 7.5]

It is recommended that the present list of items to which the small scale sector duty exemption has not been extended should be subjected to a comprehensive review and to the extent possible the exemption should be extended. A relevant factor would also be the nature of the item and it should not be the case that grant of exemption subsidizes consumers of luxury items.

[Chapter 8 : Paragraph 7.6]

9.6 Small Scale Sector duty exemption to Matches

It is recommended that :

(i) The small scale sector duty exemption should be extended to Matches - the vast majority of the manufacturers would then be outside the scheme of excise procedure i.e. – no registration, no records, no returns and no payment of duty. This would be source of great relief to the small and cottage sector units.

(ii) The duty structure may be made ad-valorem. Since, the duty would be paid only by the large units (semi-mechanized and mechanized) only, the Cenvat credit scheme can be extended. Such step would also clean up the Central Excise Rules as the rules 13 and 14 may be deleted. The present duties incidence various from less than 1% to about 8%. Since it is an item of necessity, a duty of 6% is recommended.

[Chapter 8 : Paragraph 7.7.4]

In the light of all the above recommendations, the suggested central excise duty structure is given in Annexure 'B'.

[Chapter 8 : Paragraph 8]

9.7 Location based exemptions

It is recommended that there is a need to review the policy of granting exemption based upon location and no further exemption should be granted.

[Chapter 8 : Paragraph 9.2]

10. Relevant date of Notification

It is recommended that a notification should come into force from the day after the day of its issue.

[Chapter 8 : Paragraph 10.3]

9.8 Zero rating of exports

It is recommended that from 1st April 2003 exports should be zero rated.

[Chapter 8 : Paragraph 11.4]

10. VALUE ADDED TAX

Value Added Tax (VAT) is unanimously acknowledged to be a major reform in the indirect taxation system. By adopting VAT the country would soon be joining the majority of the countries and hopes to derive the advantages thereof in like measure. The Task Force has had the benefit of meeting with the Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nationwide State-level VAT. Most all vital areas have been covered by the Empowered Committee and it would not be appropriate, nor is it considered necessary for this Task Force to reexamine these issues. The Task Force would like only to highlight few issues to ensure successful implementation of VAT, and its continuity and stability in a dynamic sense. These matters assume importance in view of the limited time now left for the proposed implementation of State VAT, from 1st April 2003.

10.1 Preparedness for State VAT

It is recommended that a publicity awareness programme should be started jointly by the Central Government and the State Governments and the former should extend financial support for this, if required. Since the State VAT is expected to be implemented from 1.4.2003 it is also necessary that the publicity awareness programme should be implemented at the earliest.

[Chapter 9 : Paragraph 2.2]

10.2 Uniformity of definitions

It is recommended that an attempt should be made towards uniformity of all State legislations, procedures and documentation relating to VAT.

[Chapter 9 : Paragraph 3.2]

10.3 Compensation to States

It is recommended that issue of compensation, if it arises, must be tackled through mutually acceptable mechanism of additional resource mobilization through Service Tax and not through Budgetary support.

[Chapter 9 : Paragraph 4.2]

10.4 VAT to unify all local taxes

It is recommended that with the introduction of VAT, all other local taxes be discontinued, and the same should be taken into account in determining the RNR.

[Chapter 9 : Paragraph 5.3]

10.5 VAT and AED

It is recommended that that whereas AED may continue for textiles upto 2005, it may continue even thereafter for cigarettes which should not be subjected to VAT.

[Chapter 9 : Paragraph 6.4]

10.6 Credit on Inter-state transactions

It is recommended that the VAT scheme should provide for grant of credit of duty by the importing State for the duty paid in the exporting State, in the course of inter-State movement of goods.

[Chapter 9 : Paragraph 7.3]

10.7 Stability and continuity of the VAT regime

It is recommended that for the stability and continuity of VAT, a VAT Council or a permanent suitable alternative vested with adequate powers to take steps against discriminatory taxes and practices and eliminate barriers to free flow of trade and commerce across the country should be explored.

[Chapter 9 : Paragraph 8.3]

11 SERVICE TAX

The service sector contributes roughly 48.45% of the GDP (2000-01) and, as has been the experience worldwide, its contribution to GDP is expected to grow over the time. The scope has been considerably enhanced it is expected the importance of Service Tax, as a source of revenue to the exchequer shall further increase. Whereas the expansion of Service Tax in the coming days is not debatable certain critical issues need to be addressed at this juncture to ensure smooth administration of this tax. The matter assumes importance considering that the country is progressing towards implementation of VAT and the compensation of revenue to the States (in the case there is revenue loss in the transition period) through revenue from Service Tax is under consideration. At the same time, it is learnt that the Government has already taken a view in the matter of levy of Service Tax in the future. Accordingly, it would not be appropriate at this stage to re-open the issues on which a consensus appears to have been arrived at after much deliberation. In this background, the Task Force has examined the critical issues which, in its opinion, would facilitate the early implementation of a modern Service Tax administration and its integration with central excise and VAT.

11.1 Comprehensive Service Tax

It is recommended that to the extent possible Service Tax should be levied in a comprehensive manner leaving out only few services by including them in a negative list.

[Chapter 10 : Paragraph 2.2]

11.2 Extension of duty-credit scheme to service sector

It is recommended that the following measures should be taken to allow the credit of duty paid by a service provider on the goods and services procured:

(i) There should be complete integration of the Cenvat credit and Service Tax credit schemes with effect from 1.4.2003.

(ii) Credit of Central duties (on goods and services) should be utilized for payment of Service Tax collected and appropriated by the Central Government.

[Chapter 10 : Paragraph 3.3]

11.3 Rate of Service Tax

It is recommended that along with integration of the goods and services credit schemes from 1.4.2003, the rate of Service Tax should be suitably enhanced so as to achieve parity with the Cenvat rate by 2006-2007. However, there should be two rates, one for service providers who avail credit and a lower rate for those who do not.

[Chapter 10 : Paragraph 4.3]

11.4 Threshold limit of exemption

It is recommended that the service providers who provide services upto a value of Rs. 10 lakhs in a financial year should be subjected to a total tax of 1% on the value of the services on an annual basis on the basis of simple declaration. Such service providers would be exempt from the normal procedures of returns and documentation. This scheme does not envisage availment of the credit of the duty paid on the input goods and services.

[Chapter 10 : Paragraph 5.3]

11.5 Separate enactment for Service Tax

It is recommended that there should be a separate legislation for levy of Service Tax, which should eventually be integrated with the central excise law.

[Chapter 10 : Paragraph 6.2]

11.6 Classification of services

It is recommended that the services should be classified on the basis WTO classification, which should be made a part of the Service Tax legislation.

[Chapter 10 : Paragraph 7.2]

11.7 Dispute resolution

It is recommended that as a measure of early settlement of disputes :

(i) Suitable legal provision should be provided to allow voluntary payment of Service Tax not paid when detected either suo-motto or by Department.

(ii) Suitable legal provision should provide for the automatically collapse of a Show Cause Notice if the duty is voluntarily paid along with interest and 25% penalty within a period of 30 days of the issue of the notice in cases involving fraud, suppression of fact etc. In such cases the Notice should also mention in its preamble that there would also be no prosecution proceedings. The provision regarding collapse of the Show Cause Notice should apply to 'other' cases but without the requirement of payment of 25% penalty.

[Chapter 10 : Paragraph 8.2]

11.8 Non-recovery of Service Tax in certain situations

It is recommended that a provision similar to that contained in Section 11C of the Central Excise Act, 1944 should be provide in respect of levy of Service Tax.

[Chapter 10 : Paragraph 9.2]

11.9 Service Tax as the first E-tax

It is recommended that there should be a time bound review of the automation needs of the service tax administration and in like manner as

proposed for other indirect taxes steps should be taken to automate the processes and allow online filing of returns and payment of Service Tax.

[Chapter 10 : Paragraph 10.2]

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CHAPTER 1

REACTIONS TO CONSULTATION PAPER : OUR RESPONSE

The consultation process for formulating the recommendations of the Task Force is now over. What has been witnessed in the past almost 2 months, after the Consultation Paper was made available on 29th October 2002 on the website of the Ministry of Finance & Company Affairs (http://finmin.nic.in), in terms of intense public debate, is in many respects unprecedented in the history of fiscal policy making in the country. The debates and discussions that took place and the response received through memoranda, e-mails, op-eds and other articles in national dailies and regional newspapers were naturally thought provoking and very useful for firming the recommendations. However, the success of the process is reflected not so much in terms of the number of new ideas now included in this Report but that it enthused so many across the country to convey their thoughts with the common objective of improving our fiscal condition.

2. By and large the proposals contained in the Consultation Paper were appreciated. However, there was also constructive criticism in respect of some proposals, particularly relating to tax rates of individual items. Suggestions for improvement of some other proposals were also received. This Report takes into account all responses received. An endeavour has been made to now make recommendations based on consensus, which reflect the concerns and aspirations of all concerned, while adhering to the principles considered critical for our indirect tax system and administration at par with the dynamic economies of the world.

3. Interestingly, though not entirely unexpected, the maximum reaction and debate was generated with regard to the proposed customs and central excise duty structure and its road map, and not the measures to improve tax administration. It transpires that the tax administration is largely viewed as being internal to the Government and the public is not so far attuned to being asked to comment upon it. Notwithstanding this general observation, suggestions were received and the proposed measures to expedite decision making, increase transparency and intensify automation were taken on board.

4. In the context of the recommendations for improving customs administration by making available the officers round the clock for clearance of jewellery for export and doing away with merchant overtime fees for work in customs area, attention of the Task Force was drawn to the provisions of Kyoto Convention and the practical constraint of not having the adequate number of officers to provide the facilities. At the same time, it was informed that whenever an individual exporter or importer requires the services of customs officers the same is being provided and clearances are not held up. The Task Force found substance in this assertion.

5. In the area of tax administration, the proposal to improve the credibility of adjudication by appointing a two member bench to adjudicate matters was by and large not welcomed. The majority view felt that this would delay the proceedings. Apprehension was also voiced that this would not guarantee a judicious approach as the view of the senior member of the bench is likely to prevail. Hence, while recognizing the issue of bringing credibility to adjudication proceedings and restoring the confidence of the tax payer needs resolution, the Task Force has refrained from reiterating its earlier proposal. However, it is urged that C.B.E.C. should initiate administrative measures to ensure a judicious approach is adopted by the adjudicating officers and a pronounced pro-revenue bias, as at present is avoided. No doubt the recommendation to do away with the pre-deposit of duty at the first appeal stage, which is being reiterated, would benefit the tax payers who are aggrieved of the adjudication order.

6. Another matter which attracted enormous attention was export promotion. While almost all concerned concurred with the proposal to reduce the multiplicity of export promotion schemes, a case was made out that DEPB should be allowed to continue for some more time. It was also opined that Drawback would be the preferred scheme in the long run subject to steps being taken to reduce the delays in its sanction. An important suggestion was that Drawback scheme should be made comprehensive to include in its ambit not only capital goods but also state level taxes imposed on the export products. Accordingly, the Task Force has suitably modified its earlier proposals while reiterating the principle that the multiplicity of schemes should be reduced. The objective is that the exporting community should continue to be facilitated by neutralizing the domestic taxes through transparent schemes and the future scenario should rest upon the schemes for EOU/SEZs, Advance Licensing (actual user) and Drawback.

7. In respect of Export Oriented Units, the proposal that the DTA access should be reduced in respect of the units to bring back their focus on exports was endorsed by many. However, many others contended that so long as the export obligation is met there should be no restriction on DTA access subject to payment of full Customs duty. This view took support from the provisions of the SEZ scheme, which is being projected as a scheme in line with the best international practices. It was also mentioned that that the underlying philosophy that the units are 'as if abroad' needs to be reinforced. Hence, taking into account the pros and con of the proposal, the Task Force decided to adopt the SEZ scheme as the role model and recommend suitably the dispensation for the access of the Export Oriented Units to the DTA.

8. In so far as the tax structure is concerned, there was near unanimous view that indeed the time has come to remove the multiplicity of levies and rates. In fact, on the customs side there was a suggestion that there should be only one rate of duty instead of the two tier structure (10% and 20%) proposed by the Task Force. However, this was not found feasible due to presence of the local taxes and indeed the international practice amongst of the open economies is to have more than one rate of duty, though few in number and at low rates. The Task Force had also taken into account the fact that categorization of goods as intermediate or final for the purpose of fixing the rate of duty may be considered a subjective exercise. Hence, the idea had been to evolve a consensus on the categorization and then apply the yardstick to specific items. Expectedly, many views and counter views were received on this, which are now attempted to be reconciled and the broad categorization of the items has been achieved.

9. In relation to the rates of customs duties, references were also received from many quarters on the need to remove distortions such as inverted duty structure, where existing. While many viewed high customs duty as a protection that should continue, others commented adversely upon the conservative approach of the Task Force in reducing the duty rates! By and large the majority view was that the downward movement should be faster. It was also mentioned that if the avowed objective is to be at par with the international practices, particularly the dynamic ASEAN States, then we can ill afford high duty rate of 20%, as proposed. Accordingly, the customs duty rates have been comprehensively reviewed and the road map extended taking into account the suggestions received. The proposal now is that we shall aim at the lower rates with

a peak of 10%, though specified final consumer goods would continue at higher rate, and this may be achieved during the Tenth Plan period.

10. As regards the central excise rates of duties, the sanctity of adhering to the 16% rate was questioned by many. Considering that central excise duty rates tend to impact demand and there is a pressing need to revive both demand and investment, the Task Force found force in the argument for a lower rate of duty. Concern was also expressed in some quarters regarding the removal of few duty exemptions and the criterion for categorization of the goods for the lower rate of duty (8%). An attempt was made to justify that other items (and not only food products) also warrant a low rate of duty. Likewise a case has been made out for placing certain other items which have a high income elasticity in a distinct category and at a higher rate. The Task Force saw considerable merit in the arguments. Accordingly, the Task Force has re-examined the entire duty structure and exemptions and this Report recognizes the need for a three-tier structure (other than nil) viz. a low rate of 6% only for the processed food items, a rate of 16% (moving towards 14%) for all the other items, and a higher (though lower than at present) rate of 28% (moving towards 20%) for few items, namely motor vehicles, airconditioners and aerated waters. The Task Force have proposed that the target of 6% - 14% - 20% rate structure be achieved by 2004-2005.

11. Petroleum and textiles sectors occupy a special place in the economy and the proposals thereon attracted considerable reaction. In respect of the petroleum sector there was a demand for continued high protection by keeping a suitable differential between the custom duties on crude and petroleum products. Problems of valuation of the indigenous petroleum products was also pointed out on account of matters such as transit losses during pipe line movement. In so far as textiles are concerned, a case was made out for continuing with certain duty exemptions and having lower rate of duty, at least upto 2005 in line with MFA. Accordingly, the Task Force comprehensively reviewed the duty structure, both customs and central excise, in respect of these sectors and has come up with revised recommendations which, in its view take care of the reported problems and is also in line with the best international practices.

12. On the small scale sector duty exemption, there was a view that the exemption limit had been extended upto Rs. 100 Lakhs only two years back and should continue for

some more time. The other view was that the duty exemption should benefit the genuinely small scale units and the high exemption limit has encouraged horizontal proliferation and is anti-growth, adversely impacting economies of scale and efficiency. Further the road map for reduction in duty exemption was supported as a transparent move that would give this sector time to adapt. It was also contended that in so far as the duty exemption allows the small scale sector units to pay concessional duty (upto Rs.100 Lakhs value of clearances), in actual fact the concession gets extended beyond this limit on account of the accumulation of the Cenvat credit. By and large the view was that it is necessary to quickly integrate the small scale sector units into the mainstream of central excise administration by reviewing the duty exemption limit such that it benefits the genuinely small units. The Task Force endorsed this view with the caveat that confidence building measures are also undertaken by the central excise administration.

13. In so far as VAT is concerned, the Task Force interacted with the Empowered Committee of State Finance Ministers. This was educative and the Task Force learnt of the many initiatives taken over the time and achievements of this unique experiment in federal fiscal administration, namely the Empowered Committee. There was a lot of common ground and the Task Force was sensitized to the enormity of the task relating to the implementation of the State VAT. It recognized that the hands of the Empowered Committee need to be strengthened through support of the Government of India in all matters of concern including publicity, computerization and compensation. Accordingly, an endeavour is now being made to place in perspective the critical contribution of the Empowered Committee and the important areas requiring immediate attention for the smooth transition to and implementation of VAT.

14. On the subject of VAT, a case was made out for keeping tobacco products particularly cigarettes outside its scope. The rationale is that this item i.e. cigarettes is a high tax item and subjecting it to State level taxes would adversely impact the industry through encouraging illicit cross border movements. The impact on revenue would be significant. Similar rationale was applied to textiles, particularly in the background of expected move towards post MFA period. The Task Force found considerable force in the arguments and has accordingly modified its earlier proposals suitably.

15. In the Consultation Paper, the Task Force had mentioned that it would discuss issues relating to the Service Tax in its Report. In this regard, it was found that the Government has since taken a view on Service Tax. Therefore, it was felt that not much point will be served in examining the entire gamut of issues relating to Service Tax afresh. At the same time it has been considered necessary to re-emphasize that Service Tax shall be a major revenue source in the coming years, as is also the experience worldwide. Accordingly, certain fundamental propositions such as extension of the credit scheme to services sector are being presented for efficient administration of Service Tax and its eventual merger with central excise and State level VAT.

16. The Task Force is mindful that one of the tests of a good tax system, other than encouraging compliance, reducing transaction costs, facilitating investment decisions etc. is its capacity to facilitate revenue generation for the exchequer. This criterion assumes far greater importance in a developing country such as ours. Hence, an exercise has been done to assess the impact of the recommendations contained in this Report on the revenue. The finding is that revenue buoyancy is a function of the administration on the one hand and the tax rates on the other. Thus, recommendations such as relating to reduced complexities in levies, better administration, training, increased use of automation, bolstering tax payer confidence in the administration, better enforcement, etc. would certainly improve revenue collections through improved compliance and lower leakages. The other positive fall out is in terms of increased economic activities such as enhanced exports, which does not directly translate into revenue for the Government but boosts the economy through employment generation and other benefits. It is, however, difficult to quantify and put a figure on the net gains on these accounts.

17. The rationalized and lower tax rates and removal of exemptions also positively impact the compliance and, in turn, the revenue. Expectedly, both the accountal of transactions as well as the transaction volumes themselves improve when the tax rates are low. However, it is also a fact that the revenue impact on this count may not be felt in the immediate short run as there is invariably a lead time for investment decision to fructify. It also merits appreciation that the manufacturing sector contributes roughly 16.8% of the GDP and India's share in world trade is also nominal at present. Thus, on expected lines the net impact on revenue, both central excise and customs, on account

of the general reduction in the duty rates may initially be marginally negative despite the removal of exemptions. However, even in the short run the total package (on indirect taxes) would be revenue neutral once we take into account the greater buoyancy which will be possible from service tax revenue, this sector presently contributes roughly 48.45% of the GDP. Undoubtedly in the near future the proposed lower rates of duties would encourage greater transaction volumes and revenue even from central excise and customs. Thus, the outcome of the implementation of the recommendations of the Task Force would be revenue neutral in the immediate short run and lead to positive revenue growth in the near future.

18. As aforestated, the proposals contained in the Consultation Paper have been broadly endorsed by all concerned. Accordingly, these are now being reiterated with modifications, where warranted. A few proposals have had to be dropped in the light of the response received. Some others have been dispensed with as these have already been implemented, such as the decision not to issue protective duty demands on the basis of an audit objection which is in contrast to the instruction or circular of the C.B.E.C. At the same time, few new proposals have also been included as these were found to be in conformity to the principles enunciated by the Task Force and serve to give further boost to the economy. What follows in this Report are recommendations which, in the view of the Task Force, combine together to simplify and rationalise the tax system, effectively reduce transaction costs, encourage voluntary compliance and, in short, bring our indirect tax system and administration at par, if not better, than the best international practices.

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CHAPTER 2

MACRO-PERSPECTIVE AND APPROACH TO REFORMS

1. Macro-perspective

1.1 Our economy is at a critical juncture in its efforts to accelerate growth and employment in order to rapidly reduce poverty. Towards this, one of the key components of the strategy will have to be to exploit the opportunities afforded by more rapid globalisation. While our economy has succeeded in maintaining one of the highest GDP growth rates in the world in the last decade with very low inflation, there are several areas where immediate improvements are required to sustain the growth momentum. The principal concerns are the deteriorating public finances, with the consolidated public sector deficit estimated to be over 11 percent of GDP, decline in investment dynamism and relatively weak performance of exports and FDI, the two pillars of trade and financial sector integration. On the fiscal side, while the Government needs to focus on expenditure rationalization, a more critical area which needs immediate attention is to raise the declining tax to GDP ratio. This will also facilitate greater emphasis on public investment in infrastructure : a key for overall investment dynamism. On the external front, India's success in integrating into the world economy critically hinges upon raising the share of its exports in world trade closer to it's pre-independence level of over 2 percent from the current level of 0.6 percent, and increasing the inflow of FDI to at least $ 10 billion annually in the current plan period (China receives close to $ 46 billion) from the current dismal level of $ 2 billion.

1.2 The stated objective of the Ministry of Finance and Company Affairs in setting up the Task Force on Indirect Taxes is "to take advantage of information technology and bring the indirect tax systems and procedures at par with the best international practices and thus, encourage compliance and reduce transaction costs". This mandated the review of the extant indirect tax laws and procedures - Customs, Central Excise and Service Tax - with an eye toward removing complexities and facilitating voluntary compliance. The bottom line is to set in place a user friendly and transparent tax administration in tune with the best international practices. The understanding is that such measures would improve voluntary tax compliance and reduce the transaction costs and, thus arrest the trend of falling tax to GDP ratio.

1.3 The most direct way to raise tax to GDP ratio is to remove most of the plethora of exemptions granted on import and excise taxes for a variety of reasons, mostly for non economic considerations; widen the net by expanding the service tax base; and to improve taxpayers compliance. Recent research in tax policy suggests that, in general, indirect tax incentives are very prone to abuse, as qualified purchases can easily be diverted to buyers not intended to receive incentives. Thus they are difficult to justify on policy grounds. Their use should, therefore, be limited to removing import duties on inputs used in the direct production of exports. Granting indirect tax incentives to export-oriented industries is a prevalent practice worldwide. Conceptually, relieving inputs used in the direct production of exports from the burden of indirect taxes is clearly justifiable on the principle of destination-based taxation, and should, in general, be supported. Such measures will also revive growth and stimulate investment, the tax system in general is in conformity with international norm, supported by suitable macroeconomic, structural, legal, and regulatory environments.

1.4 To boost exports and FDI, the government must sharply reduce the transaction costs associated with trade and doing business with India. Apart from maintaining a realistic market-driven exchange rate, and liberalization of imports, this will involve changes in policies and procedures involving improvements in trade logistics to allow exporters to compete in today's time-dependent markets. This will require a change in mindset away from controls rigidly administered, towards a more liberal policy environment in line with international standards. Trade facilitation revolves around the reduction of all the transaction costs associated with the enforcement of legislation, regulation, and administration of trade policies. It involves several agencies such as customs, airport authority, port authority, central bank, trade ministry etc. The main objective is to reduce the cost of doing business for all parties by eliminating unnecessary administrative burdens associated with bringing goods and services across borders. The means to achieve this objective are the modernization and automation of clearance procedures to established international standards. There is a dire need to streamline trade administration so that exports and imports are cleared in line with international norms. It takes days in major ports/airports to clear goods as against hours in most successful globalized countries. This is a key step to stimulate a rapid export drive and to attract a sizeable FDI. In this context, the Task Force would like to recommend the Government to take a more proactive stance towards trade facilitation in

the coming WTO round. The Government is in dire need to streamline trade administration so that exports and imports are cleared in line with international norms. This is a key step to stimulate increased investments, attract a sizeable FDI and promote exports and employment. A positive stance by India in WTO on trade facilitation would serve two purposes. We could use it to get some concessions from the developed countries who are championing this idea. Secondly, this would improve our international image as a committed reformer.

1.5 It is important to note that once Universal Green Channel and EDI in all major ports/airports are in place, transaction costs will be substantially reduced. This will sharply bring down the anti-export bias in the economy. According to a recent EXIM Bank study (October 2002) - "Transaction cost of Indian exports : an update", transaction cost which has come down in the last four years, continues to be high. For example, for dynamic sectors of textile and garments and pharmaceuticals such costs are 10% and 8%, respectively. With the proposed reforms, it is estimated that the reduction in the transaction costs could be as much as 50%, the potential gains to the economy would be Rs.4000-5000 crores per annum i.e. this large benefit would accrue to the economy every year. In a dynamic sense, in terms of exports foregone on account of high transaction costs, the reduction in costs will be several times higher. Reducing transaction costs and costs of doing business is important not only for boosting exports and FDI but even for creating an appropriate framework for vibrant domestic business.

1.6 What ails the indirect tax administration beleaguered by low collections, revenue leakages and high cost of compliance has been the subject matter of intense debate over the years. Whereas recent initiatives are directed at a more transparent and rule bound system, there is an increasing realisation that whatever has been done has neither been sufficient nor effective. As a result, it becomes evident that the present system does not lead to confidence building in the tax payer, which has grave implications such as the falling tax to GDP ratio. Accordingly, it is imperative to go to the root of the problems and arrive at long terms solutions.

2. Approach to reforms

2.1 In this background, as a part of its work programme, the Task Force undertook studies and analysed the different aspects of indirect tax laws and administration. It initiated dialogue with a large number of stakeholders from the trade, industry and department and also examined the best international practices in the critical areas of indirect tax administration. A close look was also had at important reports of Expert Committees and Groups which had examined the indirect tax system in the recent past - The Advisory Group on Tax Policy and Tax Administration for the Tenth plan (Chaired by Shri Parthasarathi Shome), Committee on Review of Central Excise Collection System (Chaired by Shri S. V. Iyer), Expert Group on Taxation of Services (Chaired by Dr. M. Govinda Rao) and Inter-Ministerial Working Group on Customs Tariff (Chaired by Shri Arvind Virmani). All these reports have contributed significantly in shaping the final views of the Task Force.

2.2 The finding was that in the recent past Government has initiated a number of steps to improve the indirect tax administration. To list a few such measures, transaction value concept has been introduced for excise duty assessment; MRP based levy introduced on 92 categories of consumer goods; central excise procedures have been substantially simplified such as dispensation of most pre-clearance requirements, fortnightly payment of duty introduced, alongwith dispensation of statutory records etc. Similar positive steps have been taken on the customs side, particularly relating to EDI based assessment and clearance of import and export cargo. However, it is the perception that much more needs to be done. All in all the common refrain which emerged out of the aforestated exercise was that despite all what has been done, the indirect tax system in the country suffers from the following drawbacks :

(ii) Lack of confidence in the tax administration on account of too much discretion, absence of accountability and a pro-revenue bias in all matters, especially quasi-judicial.

(iii) Alienation from tax administration, which manifests into corrupt practices and low compliance.

(iv) Uncertainty about tax policy, administration and absence of time bound decision making all of which affects business decisions.

(v) Complexities of laws and procedures on account of lack of codification which is exploited for private gain by the unscrupulous tax payer and the tax collector.

(vi) Too many laws and procedures which create an environment of confusion and mistrust.

(vii) Too many conditions attached to each exemption and procedure delay decision making and increase transaction costs.

(viii) Absence of transparency in tax planning.

(ix) Customer orientation is missing in the tax collectors who view all tax payers with suspicion.

2.3 Inspite of these problems, the experience of recent measures undertaken by the C.B.E.C. clearly shows that a modern, transparent and efficient tax system encompassing the best international practices is certainly possible to implement in an acceptable time frame. Beginning has already been made towards the simplification of indirect tax laws and procedures. There has been also a discernible move towards reducing departmental interface with the tax payer, increased reliance upon automation, particularly in customs, reducing complexities in tariffs and procedures etc. These changes have largely been beneficial to the trade and industry. However, it is evident that whatever has been done so far has not been sufficient to impact positively the face of the indirect tax administration in a manner which results in a 'big push' towards best international practices. Therefore, the finding is that for the desired tax system to be achieved without further loss of time mere tinkering with the present law and procedures would not suffice. It is the need of the hour to move away from incremental changes, from the policy of taking ad-hoc and half-hearted measures. What is required is a formulation for a macro-jump of the Indian economy so that India is no longer perceived as a nation hesitantly approaching globalization……. a strategy that revolutionizes the way things are looked at and causes fundamental changes in the way things are

done in indirect tax administration. Only such a strategy would result in a quantum improvement in the administration of indirect tax system in the country. India must be seen as an economy offering the best internationally accepted standards of tax administration and tax payer facilitation .....now and for all time to come. This would no doubt positively impact the tax to GDP ratio also. Basically the strategy must provide the following elements in the tax administration :

(i) Administration should be based on trust. This translates into clearances based on self-certification.

(ii) To the extent necessary all checks should be based either upon risk assessment and intelligence or post-facto audit within a specified time frame.

(iii) To reduce transaction costs there should be no insistence upon securities.

(iv) Disputes and litigation should be minimized and if a dispute does arise early resolution should be ensured.

(v) All procedures should be IT-centered in view of the comparative advantage we have in this field. Increased use of automation ensures greater transparency, accountability and efficiency.

(vi) Reduce contact points by moving to on-line acceptance of documents.

(vii) Decisions to be rule bound not discretionary.

(viii) A modern tax administration depends heavily on change in mind set, which is to be achieved through time bound training and human resource development.

(ix) Confidence to be bestowed upon the tax administrators.

2.4 The outcome of this comprehensive exercise has led the Task Force to postulate certain principles, which in its considered opinion must necessarily govern an efficient

and tax payer friendly tax administration. Thereafter, the Task Force has examined each of the critical areas of the present indirect tax laws and administration against the touchstone of these principles. The corollary is that such a tax system based upon these principles would encourage voluntary tax compliance, discourage tax evasion, reduce compliance and transaction costs and improve the tax to GDP ratio.

2.5 The Task Force has also duly recognized that an efficient rule bound system cannot exist in isolation and the human element in terms of tax administrators and other facilitators perform a critical role. In fact, an efficient system would demand matching performance from the implementers and facilitators or else the system would simply not be efficient. Hence, due attention has been paid to the aspects of training, automation, HRD and change in mind-set.

2.6 After giving considerable thought it is the view that the first principle which must govern the tax administration of the country is a system based upon **TRUST**. So long as the laws and procedures are made with an eye to prevent misuse, and not with the objective of facilitating the honest tax payers, there would be complexities, excessive documentation, avoidable transaction costs, inefficiencies and corruption. Interestingly, no concrete evidence was brought out that even the present such laws, which are based upon checks and counter-checks have really impacted tax evasion. In fact, the contrary appears to be true. Thus, it is the view that our law and procedures should be based upon trust. This is not to state that there should be no checks provided against misuse. However, what is required is that instead of suspecting all tax payers the system should provide for trusting all tax payers by using modern and scientific methods of risk assessment and intelligence gathering to detect misuse by the few unscrupulous persons. Further, trust by its very nature cannot be selective as this would lead to discretion and formation of pressure groups. Hence, it is proposed that as a policy the law and procedures should be based upon the trust that the tax payer is willing to voluntary discharge his legal obligations and is required to be facilitated by providing an efficient and transparent tax administration.

2.7 The second principle which has governed the proposals of the Task Force is that in the age of mobile financial, physical and human capital we must adopt the **BEST INTERNATIONAL PRACTICES**. It is the view that having committed ourselves to fully

integrate into the world economy we can no longer remain unconcerned about having procedures which are not at par with the best in the world. For instance, if the standard in the developed countries is to clear imported goods in 6 hours we should be able to evolve procedures which not only match this but do better. It is only by adopting the best international practices that we can hope to compete internationally. Thus, an endeavour has been made in this direction. It is worth mentioning at this stage that on the customs side we have the advantage of international Conventions (Kyoto and others) which have also been adopted by India. To this extent much has already been done and the C.B.E.C. has taken some steps in aligning the procedures to the extent possible, which is a matter of satisfaction. However, we must act in a hurry and quickly do much more.

2.8 The third principle is that of **SIMPLICITY**. Too many levies, too many rates of duties, too many procedures, and too much documentation, all contribute to complexities, which go against the grain of efficiency. The underlying assumption is that a simple tax law is not only easy to administer at less cost but would also encourage compliance and positively impact the tax revenues. There is a crying need for simplicity in the indirect tax laws. To illustrate, there are over 300 circulars on the subject of EOUs with some overriding the others and some modifying the others. It can scarcely be expected that these many circulars are available to all in the trade and the departmental officers are no better placed. The net result is an absence of uniformity in application, which is often taken advantage of for private gain. It appears reasonable that the minimum effort to codify the instructions in one place after weeding out those which are no longer relevant would ensure better administration. Thus, there is a need to have a simple law, which should be applied uniformly.

2.9 An equally important principle is that of **TRANSPARENCY**. Tax administration should be rule bound and transparent. There should be as less discretion as is possible. This would increase the tax payers confidence in the administration. It has also been reported that the industry feels alienated as there is almost no institutionalized mechanism to obtain its response while framing a new policy. The concern of the industry is genuine. A remedy lies in involving the tax payers in the formulation of new policies to the extent possible. This has the inherent advantage that the users would point out the advantages and dis-advantages of the proposals as they know best.

Secondly, for obvious reasons, compliance would be much better in such sort of participative and transparent policy formulation.

2.10 The next principle is that of **STABILITY**. During its many interactions it was oft repeated to the Task Force that sudden and frequent changes in policies adversely impact the business community. The difficulties get compounded when there is sudden change in the practice of assessment which has revenue implications as reportedly, tax payers are burdened by tax demands for the past 5 years. It is also the view that stability of Government policies is an essential input for healthy and prosperous business. Further, any action of the Government which takes the tax payers by surprise is bound to cause compliance problems. It is, therefore, necessary that not only a policy should be framed in consultation with all the stake holders but it should come into force only from a date in the future and not immediately. Giving sufficient notice is necessary for a healthy business environment.

2.11 The last and very important principle is that of customer orientation of the tax collectors towards the tax payers. There is no doubt that the payment of taxes is the statutory and legal obligation of the tax payers. Similarly, it is the legal responsibility of the tax collectors to collect the taxes for the exchequer. However, it is essential to realize that unless the tax payer is also viewed as customer and treated as such there would be an alienation which tax administration can ill afford. Thus, a tax payer friendly administration requires the administrators to adhere to the principle of **SERVICE** while interacting with the tax payer cum customer. This approach rests upon the assumption that tax payer cum customer facilitation is a critical input for greater tax compliance and reducing disputes and compliance costs.

2.12 It is the view of the Task Force that if the indirect tax administration frames its laws and procedures in adherence to the principles enunciated above viz. **Trust, Best International Practices, Simplicity, Transparency, Stability and Service** coupled with the use of the full potential of information technology the net result would be beneficial to the trade, industry and the Government. There would be improved tax to GDP ratio through enhanced voluntary compliance at reduced costs, and less disputes and litigation. Also the confidence of the tax payer in the administration would be restored. All in all a healthy economic environment. However, it is also important to

appreciate that what is essential is not mere lip service to these principles. These have to be implemented immediately and forcefully. The attempt must bring about systemic and fundamental changes in the indirect tax administration so that we have in place an efficient and transparent tax administration, second to none in the world, facilitating the honest tax payers in the conduct of his business in the overall interest of the country. Accordingly, each of the recommendations of the Task Force must be viewed against the backdrop of the aforestated principles. It is the expectation that the individual recommendations would, when implemented, combine to change the face of the indirect tax administration in the country.

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CHAPTER 3

CUSTOMS PROCEDURES AND TRADE FACILITATION : BASIC REFORMS

1. Overview of procedures

1.1 Custom clearance in India has so far been based on physical control where each consignment is examined and assessed to duty, a legacy, no doubt, of the strict import control regime implemented with the purpose of protecting domestic industry. High import tariffs and multiplicity of exemptions and export promotion schemes also contribute in complicating the documentation and procedures resulting in a major gap between the customs import and export procedures at home and the best international practices. The major problems associated with the customs clearance procedures with reference to international best practices are:

(i) Excessive documentation requirements;

(ii) Less use of automation and information technology;

(iii) Lack of transparency; unclear and unspecified import and export requirements;

(iv) Inadequate procedures; especially a lack of audit-based controls and risk-assessment techniques;

(v) Lack of modernization of, and cooperation among other governmental agencies, which thwarts efforts to deal effectively with increased trade flows;

(vi) Procedures are transaction based. Every document has to be checked, double-checked, signed and countersigned and most import and export goods are physically examined, which also breeds corruption;

(vii) Documentary inspection for all export cargo is intensive though less than in the case of imports; and

(viii) In spite of computerization, the administrative philosophy remains that of a paper-based system with many opportunities for face-to-face contacts on routine matters.

1.2 In this context the Vision Document published by the C.B.E.C., in 1998, shows that trade facilitation and creating a climate for voluntary compliance have been given the same thrust as realizing revenue and combating duty evasion. Therefore it is clear that there is a need for change and attempts are also being made in this direction. C.B.E.C. has taken a number of steps to put in place procedures at par with the best international practices, as expounded in the Kyoto Convention and other international Conventions. It is particularly heartening to note that a major push is being given to EDI and 'System based appraisal'. The fact that C.B.E.C. has suo moto taken up the exercise of evolving modern and efficient procedures reflects the changed mind-set, which must necessarily lead to trade facilitation in all its facets. At the same time care should be taken to ensure that simplification is not at the cost of compliance and accountability is ensured.

1.3 On the subject of trade facilitation it is worthwhile to take a look at the Green Channel system currently in place. As seen, this is a selective approach to trade facilitation restricted to specific importers (Government, PSUs, EOU/EPZ units, approved research institutes, top 20 importers, and importers of specified goods like pulses, sulphur etc.**)** at specific ports, Air cargo complexes (at Kandla, Vishakhapatnam, Cochin, Mumbai, Nhava-Sheva, Kolkata, Chennai, Bangalore, Delhi, Sahar) and ICD at Tughlakabad. Further, the system is product specific and does not apply to about 20 items including variety of engineering products, electronic items, plastics, textiles fibres, yarns, fabrics, miscellaneous item like dry fruits, marble, ash/dross of zinc etc. Goods requiring an import licence or execution of a Bond/Bank guarantee are also kept out. To obtain the facility the eligible importer gets registered with the concerned Customs House. Basically, the normal appraisement procedure is followed except that there is no physical examination of goods unless there are specific doubts about correctness of declaration. The scheme envisages post clearance audit within 48 hours of receipt of Bill of Entry, for which traders are not to dispose of the goods within 3 days including transit time.

1.4 Simply put the Green Channel scheme did not take off in view of its restrictive approach to trade facilitation and complexities which rule out majority of importers. Evidently, the focus on selectivity was mis-directed. Therefore, the present Green Channel has failed to effectively address the twin issues of trade facilitation and ensuring compliance. As a result our clearance time at ports/airports is still far from the best international practices. Delays increase not only the cost of compliance, the other adverse effects are corruption, congestion in the ports etc. Complex assessment procedures, insistence upon bonds and securities are some of the other problems associated with the customs. Thus, there is an urgent need to re-examine the present procedures and identify the critical areas, which may be improved so that we have in place a world class customs administration.

1.5 The role of customs is both of a facilitator and a regulator. Whereas it must facilitate the honest importer and exporter it has also to ensure the laws of the country are applied strictly. Therefore, there has to be a very fine balancing. While the procedures must provide for expeditious clearance of the goods so that international trade is not delayed, it must also provide for the necessary in-built alert signals to detect cases of infringements of the laws. At the same time it is no longer practical or desirable to develop systems based upon physical checks on consignment to consignment basis. The sheer volume of import and export would not permit this. Naturally there has to be selectivity in checks. There are basically two ways to be selective. Firstly, identify the risk free transactions either in terms of class of importer or exporter or in terms of the nature of goods concerned or both and such identified transactions would either not be subjected to checks or to low level checks on random basis. This class would have the benefit of special procedures whereas all other transactions would be subjected to consignment check and normal procedures would apply. The second method is not to create a special class of trusted or risk free transactions but to treat all at par. This system provides uniformity of procedures for all transactions based upon trust and works on the assumption that risk is uniformly spread. Therefore, in this system modern and efficient procedures are made available to all. At the same time the system provides for confirmation of declarations through a system of risk assessment and post clearance audit. The risk criteria are internalized in the automated system which would pick up transactions for examination on random or advise on selection for purposes of post clearance audit. The net result is that all importers and exporters are treated alike and it

the luck of the draw (system based) which will determine which particular transaction would get picked up for examination or post clearance checks. Of course, customs has the undeniable right to intervention on the basis of specific intelligence and information.

1.6 After careful examination of the international procedures, as enunciated in the Kyoto and other Conventions and also the Green Channel system in place in the country it is the view that selectivity does not work and is also not desirable. Selectivity leads to creation of classes and formation of pressure groups. Furthermore, so long as general procedures are not improved (in terms of filing of manifest, availability of goods etc.) no special benefit is available to the selected class. Accordingly, taking into account all factors it is the view that the bottom line in regard to customs procedures is that these must be based upon trust, which presupposes absence of selectivity. If this is done there would be no routine examination of goods and examination, when warranted, would be either on basis of intelligence or on basis of Risk Assessment criteria. At the same time compliance issues are addressed by adopting modern tools of risk profiling and risk management based upon EDI for pre-clearance and post clearance checks. Such tools help in evolving transparent customs clearance procedures applied uniformly thereby increasing the level of facilitation and satisfaction while also obtaining an increased level of control. However, such a system would deliver results provided there are efficient backward and forward linkage with the other agencies concerned with the clearance of the goods. Customs can not work in isolation and the entire (multi-agency) machinery has to work in a finely tuned and cohesive manner for the ultimate benefit of the importer and exporter.

1.7 Modern best practice calls for a systems approach that relies on self-compliance (through the maintenance of business records by tax payers), risk analysis and management (development of profiles of risky transactions), and supported by periodic post audits of records. This approach reduces delays for legitimate transactions while allowing full scrutiny of high-risk transactions. In this background, systemic changes are recommended. As earlier stated, it is appreciated that the C. B.E.C. is also working in the same general direction.

2. Trust Based System (TBS) : Universal Green Channel

(i) Customs clearance procedures should be based upon trust and be uniformly applied to all importers and exporters and all goods.

(ii) Expand EDI network to all ports/airports and to include all processes in the automation programme by 1st January 2004 – For this C.B.E.C. may make a station–wise chart and identify the requirement of each station in terms of resources required. A dedicated team should be set up to oversee the timely implementation of this work and where warranted customs should not hesitate to outsource the work. **In this direction, one major port and one airport should be made fully EDI operational by 1st April 2003.**

(iii) The verification of declaration through pre-clearances examination, where necessary, should be based upon Risk Assessment techniques - As a policy there should be no routine examination of the goods. Examination, where necessary, would be done on the basis of an alert by the system based on risk profiling and risk assessment techniques. Some illustrative risk areas for imported goods could be very high import duty (demerit goods), imports from a country other than the country of manufacture, related party transactions and the like. Detailed profiles of all importers/ exporters are also an input. Importantly, it is the system which would decide the selection of goods (for examination).

(iv) Increased use of post clearance audit – This would be increasingly used to confirm the declarations made at the time of clearance of the goods through customs. This mechanism would allow the clearance of a number of transactions under systems appraisal. This audit could be combined with multi-disciplinary audit (say, including central excise audit) at the importers premises.

(v) Introducing a system of self-assessment of Bill of Entry – Just as in central excise the importer may be allowed to assess the Bill of Entry and

pay the duty thereon. The system would confirm the assessment and after examination of the goods, if warranted, give a clearance. In the event an additional duty liability is detected the same would be discharged before clearance.

(vi) **Release on minimum documentation:** For certain importers of good track record of compliance, a release order could be given on the basis of certain specified minimum information (not documents) to be provided before the import. This minimum information would be name of consignee, name of consignor, country of origin, total assessable value, total quantity, description and H.S.Code. The goods would be released with or without examination as the case may be and on payment of duty. The assessment could be done subsequently after receipt of all other documents within a specified time period.

(vii) **Enhanced Systems Appraisal**: System Appraisal i.e. the process of automated verification of import declaration based on systems/ directory information to determine duty liability without human intervention would be progressively extended. Compliance would be ensured through Risk Management techniques.

(viii) **Release of goods in offence cases** - Even where an offence has been detected, the Customs should release the goods before adjudication provided the goods are not liable to absolute confiscation. In this case the importer/ exporter would pay the duties and furnishes security to ensure collection of any additional duty or payment of penalty.

(ix) **Amendments to Bill of Entry –** Amendment of documents, if required, (other than having revenue impact) should be settled at the service centre itself rather than first being sent to the concerned senior officer for 'No Objection'**.** This would speed up processing and expedite the clearances.

(x) **On-line filing of documents** – Filing of electronic declarations on internet etc. for release of import/export goods from any Customs location should be encouraged.

(xi) Storage of import goods - Section 45 of the Customs Act, 1962 lays down that all imported goods unloaded in a Customs area shall remain under the charge of a Custodian approved by the Commissioner of Customs till such time they are cleared for home consumption/ warehoused or transshipped. It is the finding that one of the major reasons for delay clearance of the goods is the multiplicity of handling between the carrier and the custodian. This also results in demurrage and increase in transaction costs. In the event the import cargo is directly transferred from the vessels/ aircrafts to warehouses (owned by carriers) set up in the Port/ Airport the delays would come down. Accordingly, it is recommended that **the custodians (IAAI/Port Trust Authorities etc.) should encourage establishment of warehouses by shipping airlines/airlines/couriers/ freight forwarders and consolidators within the port/airport for reducing dwell time.**

(xii) Filing of Import Manifest - Internationally, the practice appears to be to allow the filing of advance Import General Manifest before the arrival of the vessel/aircraft. Also other forwarders file cargo declarations pertaining to their own containers directly with the Customs. It is considered essential for effecting quicker clearances that the Manifest is made available to customs without delay, and in fact before the vessel arrives/flight lands. Accordingly, **the following recommendations are made :**

(a) A complete Import general manifest (IGM) with house level details must be filed with the Customs before the arrival of the vessel/ aircraft.

(b) **The carrier/ steamer agents should file the IGM at Master level and the consol/ forwarding/ break-bulk agents should file the House level details.**

(c) **The carrier/ steamer agents shall alone be responsible for correct and proper filing of complete IGM (including House level details) with the Customs.**

(xiii) **Permanent Trade Facilitation Committee - Constitution of multi-agency** framework at ports/airports (port trust, shipping companies, custodian, etc.) is a necessary requirement for a long term solution to the day to day problems associated with the clearance of import and export goods. This is since customs clearance procedures are not the sole cause of delay in the import and export of goods - inefficient port and airport logistics play an equally important role. Since delay by any one agency is invariably viewed as a delay in clearance through customs, the multi agency framework should be placed under Commissioner of Customs. Accordingly, **it is recommended that :**

(a) **A High level Inter-Ministerial Committee may be set up under the Chairmanship of Chairman, CBEC to resolve inter-agency issues to ensure a steady progress of clearance of import and export goods with reference to international norms**. The Committee should meet quarterly.

(b) **A Permanent Trade Facilitation Committee should be constituted at each Port/airport/ICD/CFS comprising senior representatives of all agencies including Custom House Agents (CHAs) under the chairmanship of the Commissioner of Customs**. The Committee should meet once a month to resolve all clearance related issues.

(xiv) **Customs should lay down a time limit within which an import or an export document shall be processed**. This could be implemented

through executive instructions which should be made known to public. Such action would bind the department to certain performance standards and enhance confidence of the importers/exporters.

(xv) **Increased reliance on Pre-shipment Inspections –** At times the clearance of goods is held up on account of inspections from point of view of health and safety considerations, such as in case of food stuff. In such cases increased reliance on certification prior to shipment by internationally recognized inspection firms, a common practice internationally would considerably speed up the pace of clearance. Accordingly, an endeavour should be made to identify the situations requiring certification before customs clearance and explore the possibility of granting the clearance on the basis of pre-shipment certification. However, this exercise should be consistent with the requirements of the other laws of the land being enforced by customs.

3. Other measures for improved Customs administration

(i) **The Intelligence, Investigation and Audit Sections of the Custom House may be suitably strengthened –** This is necessitated on account of the recommendation to increase the use of risk assessment techniques in customs clearance procedures.

(ii) Functioning of Special Valuation Branch - One issue which was raised at many forums was the working of the Special Valuation Branches of the Custom houses. The common refrain was that cases are registered on flimsy grounds and the importers are asked to make numerous visits for submission of documents and information. Besides it was contended that even in cases where the matter has been finally settled in favour of the importer the refund of the amount pre-deposit is a time consuming and often unproductive exercise as the Department tries to hold on to the amount. It was also informed that the pre-deposit amount is so nominal (1% of the value) that it does not really safeguard the duty. Yet, it leads to harassment as the Department tries to incorrectly adjust this amount in

the final duty determined or delays in grant of refund. Accordingly, the functioning of the SVB was examined in the context of the instructions of C.B.E.C. As seen, an attempt has been made to ensure against routine registration of cases for investigation by SVB by providing for approval of Commissioner and periodic reviews. However, it is also a fact that cases once registered are not finalized early. Furthermore, the instructions provide that if no decision has given within 4 months of the registration of the case, the obtaining of extra duty deposit should be discontinued. Considering that discontinuance of the duty deposit is provided for a view may be taken that extra duty deposit is not a safeguard for the revenue and is not warranted. It is also a fact that so long as this nominal duty deposit is taken the importers would be anxious to get the case finalized at the earliest. Thus, it appears that the duty deposit is basically being used as an instrument to obtain the cooperation of the importers. It is the view that this is not desirable and there is a case for doing away with the duty deposit. In any case, the department has sufficient legal methods to obtain the required documents and information from the importers. **Accordingly, it is recommended that the instructions on the functioning of the Special Valuation Branch should be reviewed to provide for time bound finalization of cases in practice. Further, pre-deposit of duty should be dispensed with.**

(iii) **Sharing of Merchant Overtime Fee for activities done in Customs area** – On principle once the goods enter the customs area any activity therein should be done during the office hours. However, at times certain activities such as examination of the goods are required to done after office hours. This facility is extended by customs subject to the payment of overtime fees by the importer or exporter, as the case may be. It also happens that at times there are more than one importer or exporter who ask for the said facility at the same time. The present practice is to charge each importer/exporter individually to make the payment of the overtime fee even though the work of all may be done during the time limit fixed for one. Since overtime fee adds to the cost of the importer or exporter it appears desirable that wherever a customs officer undertakes

work for more than importer or exporter during the same time period, the overtime charges should be equally apportioned between the parties concerned, thereby reducing the burden to the individual.

(iv) **Export valuation rules for export promotion schemes** – Customs Valuation Rules, 1988 apply only to valuation of imported goods. For valuation of export goods, there are no valuation rules. Whereas there appears to be no need for valuation rules for export goods in general, cases of over-valuation can not be ruled out in respect of goods entered for export under an export incentive scheme. At present, in the absence of standardized rules, each Custom House resorts to valuation of such export goods in its own way resulting in non-uniformity and subjectivity, which in turn gives rise to disputes and litigation on many occasions. A clear cut set of rules on export valuation will bring down the number of disputes on the area of export valuation of the goods. This would also ensure transparency and certainty in export valuation matters. Thus, there is a need to have in place valuation rules for determination of value of goods entered for export under an export incentive/promotion scheme.

(v) Customs to allow abandonment of warehoused goods - Presently, under the Customs laws, imported goods which have been warehoused are not allowed to be abandoned. This right should be available to the importers, as is the case in respect of other imported goods.

(vi) **Customs duty payment may be through cheques –** Facility of payment of customs duty through cheques would facilitate the genuine importers. It is seen that similar practice is followed in respect of payment of Income Tax. However, the stakes are considerably higher on the customs side as the acceptance of the cheque would entitle the importer to take away the imported goods. Accordingly, while recognizing that the facility needs to be extended, as a safeguard this may be first made available to importers who are registered with the Central Excise department.

(vii) **Confiscation provisions in respect of export goods -** Section 113 of the Customs Act, 1962 deals with the confiscation of export goods on account of mis-declaration, only if the goods are dutiable or prohibited or entered for export under claim of Drawback. Thus, when the goods under export are neither dutiable nor covered by Drawback and there is mis-declaration no action can be taken under the said section. Examples are exports under DEPB, DEEC, or other export promotion schemes or when the goods are covered by a White Shipping Bills i.e. where no benefit is claimed. Accordingly, it appears necessary that there should be no legal lacunae and customs should be empowered to take action even in case of such exports. For this suitable amendment would be necessary to the said section.

(viii) **Acceptance of Export Obligation Discharge Certificate (EODC) -** EODC Certificates invariably are issued by DGFT without affixing "seal" which is, however, insisted upon by Customs while accepting EODC, which causes delays. It is recommended that ideally DGFT and customs should develop an EDI link so that messages can be exchanged without loss of time. Even otherwise customs should accept the EODC produced by the exporter. In case of doubt the post-facto verification may be done from DGFT.

(ix) **Customs officers may be empowered to enforce IPR –** custom officers are not empowered to enforce the law on Intellectual Property Rights which is not in keeping with the international practice. No specific reasons could be ascertained for this deviation. At present, the IPR violations are to be first determined by the Registrar of Copyrights or Registrar of Trade and Merchandise Marks, and thereafter a notification is required to be issued under Section 11 of the Customs Act, 1962 whereupon the goods become liable to action (under the Customs Act). However, under TRIPS the border enforcement requires a mechanism such that a holder of IPR informs customs of a violation and requests it to suspend clearance in respect of counterfeit or pirated goods. Present law does not provide such an authority to customs. Incidentally, the same

goods may also be liable to action under TRIPS as well as Customs provisions and it is desirable that a common authority viz. customs adjudicate the matter. Accordingly, it is recommended that the customs should be authorized to enforce IPR, by a suitable amendment to the Trade and Merchandise Marks Act and the Copyrights Act.

4. Custom House Agents (CHAs)

4.1 Customs House Agent's Licensing Regulations, 1984 govern the functioning of the Customs House Agents. Whereas the CHAs provide an important role in facilitating both department and the importing and exporting community, at times complaints are also received against them. Further, it is seen that though the Commissioner of Customs is required to call for fresh applications each year this is not done regularly. Moreover there is a complex procedure for obtaining a CHA license and new entry becomes difficult. It is also found that a CHA registered for operation at one port can not easily do his work at other places. Finally, the charges for customs clearance work by CHAs were fixed long back in 1989 and since then, cost of all services, such as, documentation, warehousing and transport, etc. have gone up manifold. In fact, cases of double billing by CHAs have been noticed where they maintain one set of books in accordance with the prescribed rates while in reality, they had charged their clients at higher rates. Thus, there is a need to identify the areas of improvement so that the CHA community can perform in a professional manner for the benefit of the trade and industry. In this direction **the following recommendations are made** :

(i) CHAs should be licensed through an All India entrance examination to be conducted by Directorate General of Inspection, C.B.E.C. once a year at Delhi and at its Zonal Units for licensing of CHAs.

(ii) CHAs once licensed should be allowed to operate at any Custom House/Port/Inland Container Depot anywhere in the country subject to simple registration of the business premises with the jurisdictional Commissioner of Customs.

(iii) **Once a CHA licence is issued it should be valid for all time unless the CHA comes to adverse notice of Customs on account of misconduct, delay, etc. for which penal provisions, including suspension/revocation of Licence may be applicable.**

(iv) **Rates for CHA work should be determined by market forces, which will induce a healthy competition amongst CHAs resulting in competitive rates and better service and accountability towards the clients.**

(v) **There should be a review of the technical qualifications of the CHAs to include knowledge of computer, Prevention of Corruption Act, etc.**

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CHAPTER 4

CENTRAL EXCISE PROCEDURAL SIMPLIFICATION

1. Introduction

1.1 Being the single largest contributor to the tax revenues of the Government, central excise revenues and administration have a critical role in the Indian economy. Naturally, any set back or slow down in central excise revenue mobilization adversely impacts economic planning. Therefore, it is important to devise a suitable tax administration which facilitates voluntary compliance by the tax payer and leads to the collection of revenue at minimum cost.

1.2 In this regard a number of steps have been taken in the recent past to improve central excise administration. Some of these are :

(i) With exception of cigarettes, self assessment of central excise duty by the manufacturer without reference to or interaction with the department has become the norm of central excise administration.

(ii) Central Excise rules earlier numbering over 234 have been considerably simplified and replaced by new set of Central Excise Rules, wherein the number of rules has been reduced to only 72.

(iii) Payment of duty has been simplified with the introduction of a fortnightly payment system. As a measure of further relaxation the units in the small scale sector are required to pay duty on monthly basis.

(iv) Documentation is reduced to the minimum and largely reliance is placed upon the tax payers own records. Further, the filing of statutory return with the department has been made less rigorous by increasing the periodicity. Tax payers are required to file a simple monthly return and

those in the small scale sector have to furnish the return only on a quarterly basis.

(v) A statutory body has been set up for giving Advance Rulings on matters of classification and valuation of goods and applicability of notifications with the objective of introducing uniformity and certainty in central excise administration.

(vi) Computerisation has been initiated on a large scale in the and the emphasis is on effective monitoring, analysis of data base, and use of Information Technology to carry out day to day functions.

(vii) New PAN based excise registration has been adopted with the objective of moving towards on-line registration to facilitate the tax payer.

(viii) Manufacturer exporters have been facilitated by dispensing with the requirement of bonds and security. Further a simplified procedure has been introduced for self-credit of the duty on the goods exported. In respect of merchant exporters also the requirement of security for exports is not insisted upon.

(ix) Disputes with the tax payer have been sought to be reduced with the introduction of new valuation; rules and extension of the scheme of assessment based on Maximum Retail Price.

(x) To ensure speedy disposal of cases pending adjudication and in appeal a time period for deciding the cases has been prescribed in the law.

(xi) Selective Audit based upon risk assessment has been introduced.

(xii) For greater facilitation the administration has been brought closer to the tax payer by an increase in the number of Central Excise Chief Commissioners from 10 to 23, Commissioners from 61 to 92 and Commissioners of Central Excise (Appeals) from 18 to 71.

1.3 However, it is clear that while the direction is correct, the steps taken so far have not materially altered the general perception that the central excise administration is not tax payer friendly and the systems and procedures are even now far too complex. Therefore, much more need to be done. Importantly, to make a visible impact it is necessary to make fundamental changes without further loss of time. Accordingly, based upon the principles formulated by the Task Force the following recommendations are aimed at comprehensively changing the essence of central excise administration with the twin objective of tax payer facilitation and encouraging compliance for increased revenue.

2. Manufacture

2.1 Increasing scope of central excise levy

2.1.1 In terms of the Constitution provisions [Seventh Schedule, List 1, Entry 84] central excise duty is levied on all articles produced or manufactured (except alcohol for human consumption etc.). "Excise" in our context has, thus, been understood as a duty on "manufacture" of goods, and the expression "manufacture" has been the subject matter of many judicial decisions, and has attained a specific meaning under the law. Now, there are many processes which may not answer the strict definition of "manufacture", but yet result in significant value addition. As a result, such processes do not attract the central excise levy. However, it must be noted that by virtue of residual power under Entry 97 of List 1, the Parliament may levy a tax on such processes also. Interestingly, such a levy on act of 'manufacture' is unique in the sphere of indirect tax administration world over. What we have instead is Value Added Tax (VAT), with over 120 countries adopting one or the other variant of this tax.

2.1.2 In our context, as seen, central excise duty is levied on the manufacture of goods and 'manufacture' has been defined under Section 2(f) of the Central Excise Act, 1944. However, apart from this definition there are a number of deeming provisions under various Chapter Notes of the Central Excise Tariff Act, 1985, which also define 'manufacture'. Over the time Government has been tinkering with the said Chapter Notes in order to expand the scope of the term 'manufacture', particularly to include

activities such as packing, labeling and re-labeling in its ambit. As a result more and more activities, which basically are not 'manufacture' in the strict sense of the word but do add value to the product are being covered under the ambit of the central excise levy.

2.1.3 It appears that the traditional approach in defining the taxable event i.e. 'manufacture' has largely lost relevance given the fast changing technology and new emerging markets. In the final analysis what is material in the world of business is whether an activity has added value or not. Accordingly, it is the value addition which must be tapped for purposes of taxation. In this background, the present definition of manufacture resting basically upon the act of 'bringing into existence an article which has a different name, character and use' appears woefully inadequate. A modern tax system requires focus upon value addition, and the central excise must also eventually move towards this concept, which will also gradually pave way towards VAT. Thus, scope of central excise levy which is based upon the concept of tax based upon factum of production or manufacture, as at present, must expand. Besides, there are a number of disputes today whether a particular activity amounts to manufacture or not.

2.1.4 The implication is that the future of central excise lies in taxing any activity which adds value to the product. Of course, the idea is not to encroach upon the territory of sales tax. In this regard it is to be appreciated that even today the central excise levy is basically on the value addition but the critical difference is that the tax is levied only if manufacture takes place. What is now being proposed is that the tax would be levied whenever value addition takes place on account of some processing of the manufactured goods. However, the process must be capable of being distinctly identified. In other words, the concept of production or manufacture would require a re-look and this may have constitutional and legal implications. This has the following advantages :

(i) Concept of value addition is easy to understand and implement. It does not suffer from interpretation problems associated with the definition of 'manufacture';

(ii) It widens the tax base and would positively impact the tax to GDP ratio;

(iii) Value addition in contrast to 'manufacture' ensures against tax evasion and avoidance through sub-contracting or segregation of the value addition activities outside the manufacturing premises;

(iv) Basing central excise levy on value addition is a step closer to VAT; and

(v) Uncertainty in the minds of tax payers will be removed.

2.1.5 Accordingly, **it is recommended that through suitable legislative changes, the levy of central excise should be progressively based upon value addition to be applied only to the processing stage (of manufactured goods) while ensuring that the other areas of value addition not relating to the processing activity (such as Sales Tax) is not entered into and possibility of double taxation is avoided.**

2.2 Powers to notify act of 'Manufacture'

2.2.1 Charge of central excise levy is attracted when goods are produced or manufactured. Thus, the issue when manufacture is said to have taken place has oft been the subject matter of legal debates and judicial decisions. Simply put excisability of particular goods would depend upon the fact of their manufacture and marketability. The matter stands largely settled now and except for stray cases there is certainty in the minds of both tax administrators and the tax payer. In this background concern has been voiced in many quarters about the recent legislative amendments [section 2 (f) of the Central Excise Act, 1944] empowering the executive to rule upon what is manufacture and that the ruling would have retrospective effect over the past one year. In other words once the executive clarifies in a particular case that manufacture has taken place, by virtue of this provision it would be in a position to demand the duty from the tax payer on all production and clearances made over the past one year, which would be a heavy burden. The trade and industry is concerned that such power may be misused.

2.2.2 On a careful perusal of the said provision it is noted that this provision has been introduced only recently and has not been invoked so far. It appears that with the issue of what is manufacture having been judicially settled over the time there may in fact be no occasion to invoke this power. Moreover, there is a positive aspect, which is that should the power be exercised it would ensure uniformity of practice all over the country. Otherwise it is often the case that an issue is raised and decided against one tax payer whereas his competitors in other Commissionerates escape the proceedings. It is expected that these considerations would have weighed with the legislature while empowering the executive. At the same time due importance must be given to certainty in tax matters which boosts the confidence of the tax payer and is necessary for a higher degree of compliance.

2.2.3 It is recommended that the said provision should not be used routinely. Moreover, a suitable amendment is necessary so that it is applied prospectively.

2.3 Expanding definition of 'Manufacture'

2.3.1 Assessment based on the **Retail Sale Price** [Maximum Retail Price (MRP)] of goods covered under the Standards of Weights and Measures Act, 1976 and provided for under Section 4A of the Central Excise Act, 1944, has been found to be very effective. It has reduced disputes and brought about certainty in assessment. However, the Standards of Weights and Measures Act provides for certain relaxation of the condition of affixation of MRP on goods such as when the goods are sold in bulk quantities for actual industrial use. It is the apprehension that such relation may be used to avoid central excise duty. For instance, a manufacturer may clear the goods from the factory in bulk and get it re-packed outside into retail packages.

2.3.2 In order to prevent any misuse of the MRP provisions, **it is recommended that the wherever MRP based levy is applied on an item, the act of repacking, re-labelling and putting the item into unit container for retail sale may be deemed to be amounting to manufacture**.

3. Assessment

3.1 Confirmation of assessment

3.1.1 Correct assessment of duty is critical to the central excise administration. This entails correct determination of classification, rate of duty and valuation of the excisable goods. Presently we have a system of self-assessment whereby the tax payer determines his duty liability and pays the same suo moto. He later files a return with the Department indicating the production and clearances and duty paid.

3.1.2 It is the perception that the introduction of self-assessment in Central Excise has reduced responsibility of the Central Excise officers in ensuring the correctness of assessment including correct availment of Cenvat credit. By and large the officers feel that since the tax payer is responsible for self-assessment of the return their own responsibility is reduced to mere confirmation of mathematical accuracy. This is not correct. The C.B.E.C. had clearly laid down the responsibilities of the assessing officers right up to the level of Addl. Commissioner in ensuring correctness of assessment and availment of Cenvat credit by the tax payer. The instructions also empower the officers to call for any document to confirm the assessment of the tax payer. However, it is a finding that this is not being done properly, furthermore there is an absence of a monitoring mechanism and as a result proper checks are not carried out. In fact, the assessing officers take the stand that with the introduction of self assessment and the non-submission of invoices with monthly returns the responsibility of finding out short levy is on the Audit or Anti-Evasion.

3.1.3 It is the view that assessment should be the primary function of the Central Excise officers. Self assessment on the part of the tax payer is only a facility and cannot and must not be treated as a dilution of the statutory responsibility of the central excise officers in ensuring correctness of duty payment. No doubt Audit and Anti-Evasion have their roles to play but assessment or confirmation of assessment should remain the primary responsibility of the Central Excise officers.

3.1.4 It is recommended that the officers should be make responsible for assessments of ER 1 returns, and for this purpose clear cut instructions should

be issued. Some monetary limit may be fixed for confirmation of assessment by each level of Central Excise officer upto Additional Commissioner.

3.2 Valuation

3.2.1 Valuation of the excisable goods is an important exercise as the duty charged is mostly on ad-valorem basis. Over time, there have been commendable efforts to simplify the valuation norms for levy of central excise duty. The amendments to Section 4 have indeed brought about much needed clarity and certainty to the principles of valuation. Moreover the increasing use of MRP based assessment under Section 4A has increased certainty and is a welcome step. But, the change-over to new rules and the introduction of new norms and the increasing usage of MRP-based levy, may well lead to a new era of disputes, and, therefore, it will be in the interest of both, the Department and the industry, to address these issues proactively. It is appreciated that this is indeed what is being done, such as the recent clarification on matter of treatment of Sales Tax.

3.2.2 At present there are more than one method of valuation applied to the excisable goods, Transaction value, Tariff value and Value based upon Maximum Retail Sale Price (MRP). Transaction value is the most commonly adopted method. By and large no fresh issues have been thrown up in this area as a result of switching over to this method of valuation in July, 2001, from the earlier practiced method of 'normal price'. The transaction value method is tried and adopted the world over and there can be no two views on its acceptance in principle. However, it is noted that there are certain areas which require a clarification lest we enter into fresh disputes on valuation. Primarily these relate to cost of transport, margin of profit and determination of abatement under MRP based assessment etc.

3.3 Cost of Production

3.3.1 The answer to the question "what would constitute cost of production?", which is necessary to determine in order to value goods under rule 8 of the Central Excise Valuation Rules, 2000 is not very clear. In many cases, excise audit parties are directing the assessee to add advertising, marketing, Head Office costs, etc. It is the view of the trade that only the raw material costs, packaging material cost, energy and services cost

and factory overheads should form part of the cost of production. Head Office costs are in the nature of Corporate costs which have no direct bearing on the intermediate goods cleared for captive consumption. Further, advertising, sales and distribution costs are also not relevant in this case as such intermediate products are neither advertised nor sold in the trade. The sales and distribution expenses relate to finished goods marketed and sold and, therefore, hold no relevance to the intermediate goods.

3.3.2 Since different views are being taken by the field formation as to what constitutes cost of production, it would only be appropriate that the C.B.E.C. issues clear guidelines on the aspect of valuation of intermediate goods used captively to avoid disputes in the matter. It is understood that such guidelines (CAS4) on the cost of production for goods captively consumed are being issued by the Institute of Cost and Works Accountants of India.

3.3.3 It is recommended that the guidelines on determination of cost of production should be issued at the earliest and till such time all disputes be kept pending.

3.4 Margin of Profit

3.4.1 Under the Central Excise Valuation Rules, 2000, when the goods have been consumed captively by the assessee in the production or manufacturing of other articles or these are sold to the related person for his captive consumption, the duty is to be charged on 115% of cost of production as assessable value. It is the view of the trade that 115% is an abnormal margin as such profits are an exception. However, in the overall interest of ensuring certainty in taxation it was conceded that rather than individual determination of the profit margin, its standardization in the law is a better step. At the same time it was felt that since this is largely going to be a revenue neutral exercise as the recipient unit can claim Cenvat credit, it would be better to review the margin and reduce it. This step would positively impact the cash flow and benefit the industry. There is force in this argument.

3.4.2 It is recommended that the figure of 115% should be brought down to 105%. Moreover, there should be a moratorium on this figure, so that there is certainty in taxation.

3.5 Valuation based upon Retail Sale Price [Maximum Retail price (MRP)]

3.5.1 Section 4A of the Central Excise Act, 1944, provides for levy of central excise duty on the basis of retail sale price in respect of certain specified goods. Essentially, this provision is being enforced by issue of a Notification whereby goods are specified and the duty is chargeable with reference to the retail sale price thereof after giving certain abetment, as mentioned in the Notification. It is observed that notwithstanding certain questions on the rationale for levy of excise duty on the basis of a price over which the manufacturer has no control, the switch over to MRP based value and the increasing use of this method has been welcomed by the trade and industry. Interestingly, it marks a change in the mindset of the tax administrators who were traditionally not looking beyond the factory gate for determining the value of the excisable goods. MRP based levy also has an intrinsic advantage in ensuring certainty of determination and reduces disputes and has been welcomed by the trade and industry. Therefore, this is a step in the right direction. At the same time, it is necessary to see that the provisions do not provide any scope for disputes in future.

3.5.2 In this regard, the discussions with trade and industry have revealed that there is some apprehension in respect of the contents of "Explanation 1" given in the said Section 4A. Herein the definition of retail sale price has been given as "retail sale price means the maximum price at which the excisable goods in packaged form may be sold to the ultimate consumer……and the price is the sole consideration for such sale". The apprehension is that while the Explanation makes it clear that the price should be the sole consideration, it does not clarify that the sole consideration referred to therein is in respect of the manufacturer. In the normal course the manufacturer will have no control on the ultimate sale price and the term "sole consideration" will difficult to implement. It would also give rise to avoidable disputes. Hence, it appears appropriate to delete a reference to the term "sole consideration" and instead provide that there should be no consideration flowing from the buyer to the manufacturer.

3.5.3 The second issue relates to fixing of abatement from the MRP. Government, by issue of a notification, announces the percentage of abatement to be allowed from MRP in order to arrive at the assessable value for charging excise duty. The finding is that the determination of abatement is not a transparent exercise. For instance, the extent of abatement does not appear to take into account certain standard deductions (delivery

charges, secondary packing, etc.) and the changes in rates of various levies. Reportedly, the present quantum of abatement just takes care of the levies of excise duty, sales tax, octroi, etc. Further, the quantum of abatement which had been fixed at the time of bringing the commodities under Section 4A does not appear to have taken into account the subsequent developments such as the adoption of uniform sales tax rates by the State Governments, which has resulted in extra burden ranging from 15 to 20 per cent. No doubt the abatement is done on basis of industry averaging but the manner of its determination leaves doubts in the minds of the affected industry. It is the view that Government policies particularly in matters of taxation must not only be fair but should be transparently fair to all. Hence, wider consultation is required and the industry should be associated in the exercise.

3.5.4 In the aforestated background, the following recommendations are made as regards the MRP based levy :

(i) System of MRP based valuation may be expanded.

(ii) Explanation 1 to Section 4A should be amended to delete reference to the term "sole consideration" and it should only be provided that there is no additional flow back to the manufacturer over and above his selling price.

(iii) For further transparency in mechanism of fixing abatement C.B.E.C. is advised to consider setting up an advisory Committee (including representatives of Chambers of Trade and Industry Associations) on the subject.

4. Cenvat

4.1 Removing distinction between inputs an capital goods

4.1.1 At present, the Cenvat credit is admissible in respect of inputs which are brought into a factory "for use in or in relation to the manufacture of the final products". In contrast the Cenvat credit is admissible in respect of capital goods when these are "used

in the factory of the manufacturer". This distinction is a cause of many disputes and litigation.

4.1.2 No doubt the levy of central excise duty is on manufacture. However, there is no reason why the Cenvat credit must also be linked to the act of manufacture. The term manufacture is strictly interpreted and many legitimate business activities such as the use of a computer for calculation of duty may not get covered even though the said goods are indeed required to support the manufacturing activity. Actually, Cenvat credit can be viewed as an exemption and to remove all controversies, we need to allow the input credit on the basis of "use in the factory" rather than on the basis of "use in manufacture of final products". Incidentally, the grant of Cenvat credit on capital goods by using the yardstick of factory of the manufacturer has not led to any disputes and is time tested.

4.1.3 At the same time there may be a possibility of tax payers taking credit on items such as building materials, airconditioners used in guest houses etc, within the factory premises etc. Accordingly, this needs to be taken care of.

4.1.4 It is recommended that the Cenvat Credit Rules, 2002 should be amended to abolish the distinction between capital goods and inputs and allow credit on all inputs brought into the factory except for those figuring in a small negative list, such as office furniture, motor vehicles, MS, HSD, etc.

4.2 Cenvat credit on capital goods

4.2.1 At present, when capital goods are procured the recipient manufacturer is entitled to take 50% of the duty paid thereon as Cenvat credit in the year of their procurement. The balance 50% is availed the next year provided the goods remain in the premises. There is, however, a relaxation in respect of identified components of capital goods on which the entire credit can be taken in the first year itself.

4.2.2 A careful examination of the said provision reveals that this could only have been a measure to stagger the Cenvat credit so that the heavy inflow does not disturb the duty payable by the unit. For instance, in case of a new investment or a new factory the

Cenvat credit on the capital goods may be so large that the duty payable by the unit in cash i.e. PLA would be negligible or even nil as the entire duty can be paid through the debit of the accumulated Cenvat credit. Thus, the measure is basically an artificial method to have positive revenue. It is a moot point that even payment of duty through Cenvat credit is nothing but a payment of revenue, though for reasons unknown it is not considered so by the authorities. It is the view that such artificial measures go against the basic philosophy of Cenvat credit scheme. Any person should be entitled to full Cenvat credit of the duty paid so long as the items in question qualify for the credit. At the same time it is recognized that a sudden reversal of the present scheme would adversely impact the revenue in view of the significant amount involved – in 2001-2002 the 50% of the Cenvat credit on capital goods availed was to the tune of approximately Rs. 2500 Crores.

4.2.3 It is recommended that the Cenvat Credit Rules, 2002 should be amended to allow with effect from 1.4.2004 full credit of the duty paid on the capital goods immediately on receipt, as in the case of inputs. As an interim measure, 75% of the credit may be so allowed from 1.4.2003.

4.3 Cenvat credit to be allowed despite technical or procedural violations

4.3.1 Reportedly a large number of Cenvat disputes arise on account of technical or procedural violations or infringements. In such cases it is not in dispute that the said inputs are duty paid, have been received by the claimant for use in the manufacture of the final products, and the final products are dutiable. In the event it appears that while fulfillment of procedural conditions is important the substantive claim of the tax payer should not be denied. Where merited, penalty proceeding may be in order to ensure compliance of the procedures. Accordingly, it is necessary that a clear statement should be made that the procedural violations are not punished in terms of denial of substantive benefits so long there is no revenue loss.

4.3.2 It is recommended that a suitable provision should allow Deputy/Assistant Commissioner to condone technical lapses/ infirmities while allowing Cenvat credit.

4.4 Credit of duty on goods returned to the factory

4.4.1 Rule 16 (1) of Central Excise Rules provides for taking Cenvat credit on returned goods. Sub-Rule (2) provides for payment of an amount equal to the Cenvat credit taken under Sub-Rule (1), if the process carried out on the returned goods does not amount to manufacture. In this context, it is reported that there is no provision or clarification for the recipient of the said goods to take credit of the said amount on receipt of the goods.

4.4.2 It is recommended that an Explanation may be inserted in rule 16 to the effect that the amount paid on removal of returned goods can be taken as Cenvat credit in the hands of the recipients.

4.5 Levy of duty on scrap arising out of dismantled/ broken capital goods.

4.5.1 The Cenvat Credit Rules, 2002 provide that when inputs or capital goods are cleared as such then the manufacturer shall pay an amount equal to the duty of excise which is leviable on the said goods. However, in case capital goods are broken up or dismantled and then removed no duty is being charged. This is in view of the CEGAT orders that no manufacturing activity has taken place on account of dismantling of capital goods. Further, it can also not be said that the capital goods are being removed as such. It is the view that the absence of a provision to charge duty is liable to be misused.

4.5.2 It is recommended that a specific provision may be introduced to charge duty on the dismantled capital goods when removed from the factory.

4.6 Review of grant of Cenvat credit on deemed basis

4.6.1 Rule 11 of the Cenvat Credit Rules, 2002, provide that the Central Government may issue a notification declaring the inputs on which Excise duty or Additional Customs duty shall be deemed to have been paid at the specified rate or equivalent to such amount as may be specified and Cenvat credit of the same would be allowed. Accordingly, a number of notifications have been issued under the authority of this rule

indicating the deemed amount of duty which can be availed as Cenvat credit. These notifications are basically for inputs such as yarn used in the manufacture of fabrics and for fabrics used in the manufacture of specified articles of apparel and clothing accessories.

4.6.2 It is the view that as a policy Cenvat credit should be available on actual basis. No doubt, deemed credit appears attractive as it reduces the documentation since evidence of payment of duty need not be insisted upon. However, this is against transparency.

4.6.3 It is recommended that as a policy, Cenvat credit should not be allowed on deemed credit basis.

4.7 Recovery of Cenvat credit erroneously refunded

4.7.1 Rule 12 of the Cenvat Credit Rules, 2002, deals with recovery of Cenvat credit wrongly taken. As mentioned therein, the credit wrongly taken or utilized along with interest shall be recovered from the manufacturer by applying the provisions of Section 11A & 11AB of the Central Excise Act, 1944. These Sections provide for issue of demand notice for Central Excise duty not levied or paid or short levied or short paid or erroneously refunded.

4.7.2 In this regard, it is seen that in terms of rule 5 of the said Cenvat Credit Rules the refund of Cenvat credit can be given to the manufacturer in certain situations. However, in the event a refund is erroneously given there appears to be no provision to recover the same. No doubt, Section 11A would apply to a case of erroneous refund of Central Excise duty but by virtue of rule 12 of the Cenvat Credit Rules it would not apply in case of Cenvat credit erroneously refunded.

4.7.3 It is recommended that rule 12 of the Cenvat Credit Rules, 2002 should be amended to provide for recovery of Cenvat credit erroneously refunded.

4.8 Storage of inputs outside factory after taking Cenvat credit

4.8.1 There is no provision in the Cenvat Credit Rules allowing the recipient of the Cenvat inputs who has availed the credit to store the said goods outside the factory in case there is a shortage of space or for any other reason. Presently, the goods cannot be removed from the factory of manufacture unless the removal is for purpose of job work or these are being cleared permanently. It is the view that the absence of a suitable provision is causing genuine difficulties for the manufacturers who like to get the inputs at the best price by buying in bulk but use the inputs in smaller quantities. There are occasions when a particular input is procured for a specific purpose say, an export order which gets cancelled or postponed necessitating the need to hold the input stocks for a later date. Thus, the facility of storage of the inputs outside the factory would facilitate the trade and industry. It is also not a risk to revenue since a suitable procedure can be drawn up to identify the place of storage and account for the inputs.

4.8.2 It is recommended that Cenvat inputs maybe allowed to be stored outside the factory in an identified place of storage subject to procedural safeguards for due accountal of the inputs.

5. Exports

5.1 Self Sealing

5.1.1 Self sealing of container and export goods is allowed under Central Excise provisions subject to prescribed conditions and responsibilities imposed on the exporter which safeguards revenue. Normally these permissions require periodic renewal. At times the field formations are known to refuse this permission. In such situation the exporter has the option of getting the goods sealed by the central excise officers.

5.1.2 In so far as the sealing of export goods by the central excise officers is concerned, it is the view that this invariably causes delays as the officers may not always be present. Further, there is a rise in transaction cost on account of the fact that overtime has to be paid to the department for this work. In any case self-sealing or sealing by central excise officers does not provide a significant relief since the customs

at the port of export has the right to re-examine the goods. No doubt the risk attached to goods may be lower when the goods are sealed by the central excise officers. Taking into account all factors related to the sealing of export goods, the pros and cons it is the view that the exports should not be subjected to avoidable transaction costs incurred on account of sealing by the central excise officers. In any case there is a revenue safeguard since the Risk Assessment module at the port of export would take into account the fact that the goods are self-sealed.

5.1.3 It is recommended that sealing of export consignments by Central Excise officers should be replaced by self-sealing by the exporter. This should be granted as a matter of right and not on case to case basis.

5.2 Rebate of Duty.

5.2.1 As per rule 18 of the Central Excise Rules, 2002, rebate is granted on the amount of duty paid on such excisable goods or materials which are used in the manufacture of goods exported out of India. In accordance with the relevant notifications Nos. 40 and 41/2001-CE (N.T.), both dated 26th June, 2001 the rebate is granted by the Deputy Commissioner having jurisdiction over the factory of the manufacture or the Warehouse or the Maritime Commissioner of Central Excise.

5.2.2 In so far as the grant of rebate by the Maritime Commissioner is concerned, at present the exporters after obtaining the proof of export from the Customs officer at the port of shipment have to tender this document to the office of the Maritime Commissioner. Invariably this causes delays. On the other hand if the functions of the Maritime Commissioner are transferred to the Customs Houses located at the said ports the delays would get reduced. Further, such a system would have the following advantages:

(i) Reduction in the transaction costs of the manufacturer-exporters;

(ii) The proof of Export being signed by the Customs officer at the port of shipment would also ensure the genuineness of export within the same office; and

(iii) Reduction in the number of agencies and the paper work both for the department and the exporting community.

5.2.3 Another important issue relates to rebate of duty on specified mineral oils and products. Notification No. 40/2001 CE (N.T.), dated 26.06.2001, deals with the grant of rebate of central excise duty on goods exported. The basic idea is that the export product should not be burdened with domestic taxes. Normally, in the case of goods exported the whole of the duty is rebated. However, the said Notification provides that in respect of specified mineral oil products falling under chapter 27 of the schedule to the Central Excise Act, 1985, which are exported as stores for consumption on board an aircraft on foreign run, the rebate has to be reduced by a specified amount as follows:

S.No.	Description of excisable goods	Amount
1.	Motor Spirit	Rs. 48.88 per kilolitre at fifteen degrees of Centigrade thermometer.
2.	Kerosene and Aviation Turbine Fuel	Rs. 24.94 per kilolitre at fifteen degrees of Centigrade thermometer.
3.	Refined Diesel Oil, other than High Speed Diesel Oil	Rs. 60.00 per kilolitre at fifteen degrees of Centigrade thermometer.
4.	High Speed Diesel Oil	Rs. 24.94 per kilolitre at fifteen degrees of Centigrade thermometer.
5.	Vaporizing Oil	Rs. 50.00 per kilolitre at fifteen degrees of Centigrade thermometer.
6.	Diesel Oil not otherwise specified	Rs. 53.39 per kilolitre at fifteen degrees of Centigrade thermometer.
7.	Furnace Oil	Rs. 21.05 per kilolitre at fifteen degrees of Centigrade thermometer.

5.2.4 The rationale for reducing the amount of rebate in respect of the specified items, as above, is not clear. There is one view that this may have been done in order to take care of the fuel consumed during the domestic run of an aircraft on foreign drum. However, similar approach has not been adopted in the case of aircraft on foreign run using duty free imported fuel. Logically the custom duty should have been demanded on the fuel so used but this is not done. Thus, it is the view that the denial of rebate to the extent specified in the Notification does not appear justified. More so, when we note that the percentage of duty which is denied as rebate is nominal. Incidentally, full rebate of duty is being provided in respect of these items in the case of aircraft to Nepal.

5.2.5 The following recommendations are made to improve the system of grant of rebate :

(iii) The work of grant of rebate should be centralized at the Custom House itself. In the alternative, an EDI link can be provided between the Customs House and the Maritime Commissioner. This measure is in addition to the grant of rebate by the Deputy/Assistant Commissioner of Central Excise having jurisdiction over the factory of the manufacturer or warehouse, as at present.

(iv) Notification No. 40/2001 CE (N.T.), dated 26.06.2001 should be amended to provide grant of full rebate in respect of mineral oil products falling under chapter 27 of the schedule to the Central Excise Act, 1985, which are exported as stores for consumption on board an aircraft on foreign run.

5.3 All refunds/rebates to be directly credited to Bank account.

5.3.1 At present, refund/rebate is sanctioned by the competent authority and the payment is made by issue of cheque. The practice is that the cheque is physically delivered to the tax payer, and reportedly this is an avoidable contact point. On the other hand the exporting community is happy with the system of disbursal of the drawback by credit directly to their bank account.

5.3.2 It is recommended that in order to reduce contact points and speed up the disbursal of the rebate/refund, the same should be directly credited to the tax payers' own bank account.

6. Manner of payment of duty

6.1 Periodicity of payment of duty

6.1.1 At present, in terms of rule 8 of the Central Excise Rules, 2002 SSI units pay duty on a monthly basis while non-SSI units pay the same on a fortnightly basis. A

condition has also been imposed that Cenvat credit of inputs, raw materials etc. available as on the fifteenth day of the month alone should be utilized while discharging the duty liability for the fortnight. This increases the documentation on the part of the tax payer. It also increases the checks to be performed by the Department while doing the scrutiny of the prescribed return. Accordingly, it is the view that a uniform periodicity of payment of duty would be convenient to administer and would increase transparency. It would also reduce the number of duty payment challans and facilitate revenue reconciliation. Finally, it would be in line with the practice of monthly filing of returns by assesses. However, no change is suggested for the SSI sector.

6.1.2 It is recommended that fortnightly payment of duty may be replaced by monthly payment of duty.

6.2 Date of payment of duty

6.2.1 Explanation to Rule 8 of the Central Excise Rules 2002 dealing with manner of payment of duty clarifies that duty liability shall be deemed to be discharged only if the amount payable is credited to the account of the Central Government by the specified date. Also C.B.E.C. has clarified that the date of affixation of 'receipt stamp' on duty payment document (TR-6), against duly cleared cheque shall be treated as the date on which the amount is credited to the Central Government account. However, it is a fact that it is difficult to ascertain exactly when the amount paid is credited to the Government account. Moreover there is invariably few days delay in realisation of the amount when payment is by cheque. Such instances are treated as default in payment of duty and penal action is initiated against the assessee even though he has deposited the cheque by the due date. However it would be unfair if despite having deposited the duty amount by the due date and the cheque having been honoured, the tax payer is penalized on account of the delays in banking channel. In fact, on the Service Tax side and also in Income Tax Department the date of payment of duty is the date of deposit of cheque. This is considered a better method.

6.2.2 It is recommended that the date of payment of central excise duty may be prescribed as the date of presentation of the cheque to the Bank subject to its realization.

6.3 Default in payment of duty

6.3.1 Rule 8 (4) of the Central Excise Rules, 2002, provides that in case an assessee defaults in payment of installment of duty, as specified, then he shall forfeit the facility to pay the dues in installments for a period of two months starting from the date of communication of an order passed by the Deputy/ Assistant Commissioner or till such date on which all dues are paid, whichever is later. Further, during the period the facility is withdrawn, the assessee has to pay duty on consignment basis by debit to account current (PLA).

6.3.2 Three issues arise out of the above provision. Firstly, whether it is correct to deny the facility of payment of duty in installments. It is the view that this is too harsh and it should suffice that an assessee who has defaulted in timely payment of duty pays the due interest and penalty on account of the non-payment of duty on time. It is the finding that very often the present provision of withdrawing the facility altogether affects the affected industry and its various survival is in doubt. Accordingly, in the event an assessee has defaulted in payment of duty by the due date the law should provide for automatic calculation of interest and penalty, which can be fixed in terms of the quantum of delay. The facility should not be withdrawn.

6.3.3 The second issue is regarding the passing of an order by the Deputy/ Assistant Commissioner withdrawing the facility of payment of duty in installments. In the event it is considered that the facility must be withdrawn, though it is recommended that it should not be so, there should be an automatic system of withdrawal of facility. The passing of an order implies following due process including issue of notice, grant of personal hearing, etc. This defeats the objective. It should be legally justified to withdraw the facility when the default is noticed by issue of a simple communication, though the withdrawal does not appear proper.

6.3.4 The last issue relates to the present provision of payment of duty on consignment basis by debit in account current. In other words, during the period the facility of payment of duty in installments has been withdrawn the assessee cannot pay duty by using the accumulated Cenvat credit. It is the view that this is too harsh a measure. Government should be concerned with payment of duty and not whether it is being paid

through debit and account current or through Cenvat credit. Accordingly, it is the view that this condition should be withdrawn.

6.3.5 It is recommended that :

(i) The provision of withdrawing the facility of payment of duty in installments in case of default should be revoked.

(ii) There should be automatic charge of interest and penalty in the event duty is not paid on time.

(iii) In the event it is decided to retain the provision of withdrawing the facility the assessee should be allowed to pay duty during this period through Cenvat credit.

6.3.6 At the same time it should not happen that an assessee continues to default stating that he would pay the interest and penalty in due course. Accordingly, in such case the recovery proceedings under the law should be initiated.

7. Budget Day restrictions

7.1 Rule 32 of the Central Excise Rules, 2002, indicates the restrictions on removal of goods on Budget Day. Essentially it provides that between the time the Budget/ Finance Bill is presented and 2400 hrs midnight on the said day no excisable goods can be removed from a factory or warehouse unless specific permission is obtained from the Commissioner of Central Excise. Moreover, an application for removal of goods has to be presented before 1700 hrs on the working day immediately before the Budget Day.

7.2 Budget Day restrictions had been present in Central Excise law from the very beginning. Earlier, the restrictions were more rigid. Even at present, the net result is that on the Budget Day, clearances of excisable goods all over the country come to a

stand still. Reportedly, factories shutdown and there are no economic activities. The Central Excise officers also resort to physical verification of stocks and clearances from the factory, if permitted, take place under physical supervision. Expectedly, transactions costs go up and it is a fertile ground for corrupt practices. Evidently, the restrictions were earlier imposed to ensure against speculation and evasion of duty as during these times the central excise duty was usually revised upwards. Moreover during these times the central excise duty was discharged consignment wise. This is not the case now. In any case, it appears incongruous that the Budget, an instrument to boost economic activity starts with the complete stoppage of all such activity. As regard the likely misuse, no doubt, there may be small clearances of goods at lower duty (if the duty rates go up) but this should be ignored in the interest of encouraging free trade and commerce. Also, under the self-assessment system a procedure is in place to ensure proper accountal and discharge of duty.

7.3 It is recommended that the Budget Day restrictions are out of tune in present day world and should be removed

8. Removal of goods for job-work

8.1 Central Excise Rules, 2002 do not contain any provisions for removal of goods without payment of duty from one factory to another for the purpose of processing when the manufacturer is not working under Cenvat scheme. For instance, earlier rule 96E of the Central Excise Rules, 1944 provided a special procedure for removal of cotton yarn for processing like winding, doubling, reeling etc. or for conversion into hank yarn in plain Reel hank. Thus, the manufacturers not working under Cenvat scheme would have to pay duty on the goods at the time of removal to other factories for the purpose of further processing. This requires redressal.

8.2 It is recommended that there should be a provision for allowing the movement of dutiable goods without payment of duty to job worker even in situations when the principal manufacturer is not working under Cenvat Scheme.

9. Collection of information from tax payer

9.1 While studying the various contact points between department and tax payer, it was revealed that in order to collect information on central excise duty collections all large assesses are being contacted over telephone and through visits to ascertain the duty paid by them during the fortnight. Reportedly, this information is being collected on behalf of C.B.E.C. It is not clear how this information is made use of. In any case, a separate recommendation has already been made for shifting to monthly payment of duty. In the circumstance, it appears that the information on fortnightly payment of duty need not be collected as it increases contact points and causes harassment.

9.2 It is recommended that fortnightly statement of revenue paid, which is presently being collected from tax payers, may be discontinued. Further, as a policy, no information should normally be asked for (from departmental officers or industry) unless it is being obtained in the prescribed returns.

10. Dispute resolution

10.1 Section 11A of the Central Excise Act, 1944 provides for voluntary payment of duty, with interest, by assessees before issue of a Show Cause Notice. However, cases involving suppression, mis-declaration etc., with intent to evade duty are excluded. It appears that since the intention of the Government is to realize the duty at the earliest the assessee should be given the option of voluntarily depositing duty even in the case of fraud etc. However, to ensure that no undue advantage is taken of this facility, such cases should be subject to payment of interest and 25% penalty. In any case even at present after a long drawn out adjudication proceeding the assessee has the option of paying 25% penalty if he pays the confirmed duty within one month of the order determining the duty.

10.2 A related issue is that as a policy when department detects short levy or payment of duty it should have an open discussion with the assessee before proceeding with the issue of Show Cause Notice, if warranted. This will allow the assessee to exercise the option of voluntary payment of duty thereby saving on time and resource in adjudication proceedings.

10.3 It is recommended that :

(iii) Scope of Section 11A(2)(B), i.e. non-issue of SCN to be expanded to include cases of non-payment detected by Audit/ Department.

(iv) **Section 11A should be amended to provide for the issue of a Show Cause Notice which automatically collapses if the tax payer voluntarily pays the duty and interest and 25% penalty within a period of 30 days of the issue of the notice. This would apply to cases involving fraud, suppression etc. In such cases the Notice should also mention in its preamble that there would also be no prosecution proceedings. The provision regarding collapse of the Show Cause Notice should apply to 'other' cases but without the requirement of payment of 25% penalty.**

11. Filing of Returns

11.1 Every tax payer is required to submit a return in the prescribed form indicating the production and removal of the goods and other relevant information including duty paid. This is supported by a copy of TR6 challan which evidences the deposit of duty in the Bank. Whereas, an assessee is required to furnish this return by the 10th of each month (for the preceeding month) an assessee in the small scale sector is required to furnish this return by the 20th day following each quarter (for the preceeding quarter). Two issues are raised in respect of the filing of return. Firstly, the duty has to be paid by the 5th of the following month and it becomes difficult to finalise the return in only 5 days thereafter. Secondly, the furnishing of the return is a contact point which is avoidable. Hence, steps must be taken in the interest of transparency and tax payer facilitation

11.2 In this regard a perusal of the return and a study of the present system shows that on-line filing of return would greatly facilitate both department and assessee. However, there are two constraints in moving towards this mechanism. Firstly, digital signatures are not recognized. Secondly, the submission of the hard copy of the TR6 challan requires manual filing of return. In so far as, the submission of the TR6 challan

is concerned it is felt that this can be dispensed with. Presently, this document is used to reconcile the payments by matching with the copy of TR6 challan received separately by the PAO from the Bank. Instead the matching could be done on the basis on declaration of duty paid to TR6 on the return with the TR6 copy with the PAO. In so far as digital signature is concerned, steps have to be taken for its recognition.

11.3 It is recommended that :

(i) Date of filing return may be shifted to the 15th. of the close of the month/quarter, as the case may be for all tax payers i.e. including those in the SSI sector. However, the large units would furnish on-line or otherwise, by the 6th of each month, the information of total duty paid.

(ii) As a first step towards on-line filing of returns the monthly/quarterly submission of TR 6 challans may be discontinued and steps should be taken to eventually allow on-line filing of returns. The details of TR 6 Challans will be mentioned in the returns.

12. Voluntary filing of documents by tax payers

12.1 Sometimes the tax payer would like to voluntarily file some documents in connection with his manufacturing activity with his jurisdictional excise department even though the same are not statutorily prescribed. This is done as a matter of abundant caution so as to preempt allegation of suppression of facts and creating hardship and loss through imposition of fine and penalty. Such a refusal appears unfair and unwarranted. Voluntary filing of documents and papers to safeguard the tax payers interest cannot be denied. Moreover, this has no risk to revenue and instead helps in dispensing justice.

12.2 It is recommended that it must be made binding on the field officials to accept documents from the tax payers and give an acknowledgement in writing, if needed, in order to safeguard tax payers interest.

13. Arrest

13.1 Arrest provision in central excise as contained in Section 13 of the Central Excise Act, 1944 has been reported to be misused to the detriment of tax payer confidence. Reportedly there are many cases when the officers at the cutting edge have threatened the tax payer with the use of this provision for their personal gain. There is no doubt that a tax evader deserves no leniency but the finding is that the vast body of the honest tax payers remain in constant fear of the misuse of this provision. There is, accordingly, a need to review the provision.

13.2 In this regard an attempt was made to ascertain the best international practices. By and large it was seen that the law is severe on the tax evader. Accordingly, it was also examined whether in our context certain safeguards could be built into the provisions so that the honest tax payer is not harassed and the provision is not misused. One safeguard could be that the arrest is made with the written sanction of the Commissioner and another that the Citizen Charter clearly indicates the rights of the arrested person. However, due cognizance was given to the fact that the large number of the taxpayers and the potential tax payers particularly in the small scale sector do not have access to the information and the provision could still be misused. In this background, keeping in mind all factors of which the most important is to restore tax payer confidence in the tax administration it is the view that the power to sanction arrest should not be exercised by the departmental officer. This is also in line with the best international practices.

13.3 It is recommended that the arrest in central excise cases, if warranted, should be made with the sanction of a Magistrate. This would require suitable amendment to the Central Excise Act, 1944.

14. Tax Clinics for Small Scale Sector Manufacturers

14.1 A critical element of tax payer facilitation is the proper dissemination of information and guidance in the compliance of the legal provisions. This is all the more necessary in respect of our small scale manufacturers who are typically one–man shows and cannot keep abreast of the changes in the law and procedures. In fact, it is the

absence of healthy interaction between the taxpayer and the tax administrators that often leads to compliance issues. It is desirable that the confidence of the small scale manufacturer should be restored for which an institutionalized mechanism is necessary. Importantly, it is the tax administrators who must reach out to the small scale manufacturers. Expecting a small scale manufacturer to leave his business and enter the portal of the Commissionerates may not yield results as the mentality is that he would rather avoid the interaction. The interaction which is now proposed would be a step towards educating the small scale manufacturers about their legal responsibilities, guiding them in the conduct of their tax matters and breaking the communication wall which has distanced the small manufacturers for the tax administrators.

14.2 It is recommended that by 1st April 2003 each Central Excise Commissionerate should establish one Tax Clinic for the Small Scale Sector, under the charge of Deputy/Assistant Commissioner to guide small scale manufacturers. This Cell should closely coordinate with the Small Scale Manufacturers Associations. The number of such Clinics can be increased later based upon the experience.

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CHAPTER 5

EXPORT PROMOTION

1. Introduction

1.1 Sustained export growth is crucial for maintaining and accelerating the GDP growth momentum, increasing employment and alleviating poverty. Since full liberalization of imports and sharp reduction in transaction costs were expected to take time to implement, several export promotional schemes were introduced in the last two decades. In light of the recent changes introduced in removal of all quantitative restrictions in imports and substantial reduction in import duties and the present proposals to introduce Universal Green Channel and full implementation of EDI (in customs clearances), it is an opportune time to take stock of all the schemes and to take a view to remove some of them which may have outlived their roles. However, in the transition period, as also suggested by the Prabhu Committee, export incentives need to be maintained so as not to lose the export momentum.

2. Viable export strategy

2.1 It is the view that a viable export strategy must rest upon two basic premises. Firstly, to be competitive in the international market, the export product must match, if not better, the competition in terms of pricing and quality. Secondly, the exporter must have an incentive to enter the highly uncertain export market. Both these objectives are achieved through wide-ranging facilities, infrastructure, financing, income tax relief, trade facilitation, etc. and indirect taxes play a critical role. Taking up indirect taxes, it is evident that the strategy so far has been to grant customs and central excise duty exemptions on the raw materials, inputs etc. used in the export product. Particularly on the customs side this leads to making available the international high quality raw materials, inputs etc. at the international price and our exporters are thus not disadvantaged viz. a viz. their competitors abroad. Moreover it ensures that the price of the export product is not loaded with any tax element.

2.2 Neutralizing the tax element in export products is an internationally accepted methodology to encourage exports. However, multiple schemes such as Drawback, DEPB, Advance Licence/DEEC, DFRS, EPCG and EOU/EPZ/SEZ schemes cause difficulties in administration and are liable for some misuse. Accordingly, on a comprehensive review of the present schemes and taking into regard all relevant factors and the best international practices **it is recommended that the export strategy should focus upon the following schemes :**

(iv) SEZ and EOU schemes – This is for the grant of duty exemption on all goods (capital goods, raw materials etc.) required by the units for their export production.

(v) Advance Licensing (actual user) scheme - This would grant duty exemption to actual users on capital goods, raw materials etc. used for export production subject to post-clearance intelligence and audit-based verification.

(vi) Drawback scheme – Here, the relief from duties on the inputs, raw materials, capital good etc. would be provided through a mechanism of refund of the duties paid.

3. SEZ and EOU schemes

3.1 In so far the SEZ and EOU schemes are concerned, the trade and industry do not have any significant conceptual disagreement with their design. A policy decision has also been taken to convert the existing EPZs into SEZs. The focus is correctly placed on the SEZ scheme which has been conceptualized with care taking into account the experience of implementing similar scheme world-wide. However, upon taking the SEZ scheme as the role model (for the EOU scheme) it is the view that certain measures are required to be taken in order to derive the full potential of the SEZ and EOU schemes.

3.2 Codification of laws and procedures relating to SEZ and EOU/EPZ schemes

3.2.1 The SEZ and EOU/EPZ schemes has a common philosophy and common objectives. Therefore, by and large the procedures are the same. The one critical difference is that whereas the EOUs are 'stand alone' units the units in the SEZ/EPZ are in a well defined enclave. However, a perusal of the supporting customs and central excise duty exemption notifications and procedures reveals a confusing scenario. This is since there are an unduly large number of notifications (over 50) and circulars and instructions (over 300) in existence. It can well be contemplated that both the tax administrators and the units themselves would have a lot of doubts in view of the sheer volume of relevant material. It is also quite possible that cases of misuse of the scheme, which are on the rise in recent years are on account of the absence of codification of the law and procedures in respect of the said schemes.

3.2.2 **It is recommended that the C.B.E.C. must immediately work upon consolidating the numerous notifications, circulars and instructions, on both customs and central excise side in respect of the SEZ and EOU/EPZ schemes. This may be done by 1st April 2003. Ideally, all the notifications should be combined into one, and the circulars and instructions issued as a compendium, subject wise**. Future changes, if any, must be included in the said compendium from time to time so that at any one point of time the units as well as the administrators have up-to-dated information available with them. Not only will this ensure transparency it would reduce the scope of misuse.

3.3 Access to DTA

3.3.1 Initially no DTA sale was allowed to the EOUs, one reason why these were called '100%' EOUs. However, in view of the fact that access to international market may not always be available DTA sale was allowed in a limited way as a buffer, in 1988. However, over time the extent of DTA access has increased, touching a figure of 50% at present. The DTA access is allowed on payment of duty on the goods sold in the DTA. With few exceptions, the EOU/EPZ units which use wholly indigenous raw materials pay duty equal to the central excise duty on the said goods (provided the same is not nil) whereas the other units (i.e. which use imported raw materials) pay duty equal to 50% of the customs duty in the like goods, as if imported. There is one view that there appears to be little or no

justification to grant the benefit of concessional duty on DTA sale (i.e 50% of the customs duty) to the units which in any case avail the benefit of procurement of required capital goods, raw materials etc. free of customs and central excise duties. This also places the competing DTA units at a disadvantage.

3.3.2 In this regard a perusal of the SEZ scheme reveals that in so far as DTA access is concerned the units therein are treated as if these are outside India and there is no restriction on their access to DTA. At the same time the goods sold in DTA are subjected to payment of full customs duty, in like manner of imports into the country. As earlier seen, the SEZ scheme has been conceptualized in line with the best international practice and there is appreciable common ground between this scheme and the EOU scheme. Therefore, taking a cue from the SEZ scheme but at the same time noting the concern of the EOU/EPZ units which use wholly indigenous raw materials, **the following recommendation is made as regards the facility of DTA access to the EOU/EPZ units subject to the unit meeting the requirement of the EXIM Policy as regards the eligibility of access to DTA** :

(iii) EOU/EPZ units using wholly indigenous raw materials - status quo to be maintained i.e. DTA access of 50% on payment of duty equal to the central excise duty unless the central excise duty is nil in which case duty paid will be equal to 30% of the customs duty on like goods, as if imported.

(iv) Other EOU/EPZ units - 100% DTA access subject to payment of full customs duty on like goods, as if imported.

4. Drawback scheme

4.1 Drawback scheme provides for rebate of the duty chargeable on the imported or excisable materials, components, packing materials etc. used in the manufacture of the export product. It basically neutralizes the incidence of indirect taxes (customs and central excise) on the export products through the refund of the said duty. The mechanism is to announce the 'All Industry' rate of Drawback for the export products in the form of a schedule, which is determined on annual basis for a large number of export goods. For this purpose, the Drawback Directorate seeks information on consumption

norms, the international and local values of the inputs, and the duty levied thereon from the Export Promotion Counsels, Associations and Organizations. Thereafter, the workings are pre-audited by the officers of CAG. Thus, the rate of Drawback is worked out on the basis of statistical study taking into account the average indirect tax borne on each of the export goods. However, when the export product is either not figuring in the schedule or the individual exporter is not satisfied with the Drawback rate and feels that his product has suffered higher input taxation, there is provision for fixing a 'Brand' or Special Brand' rate of Drawback.

4.2 It is the view that the Drawback scheme should be in the forefront of the export promotion schemes as it is transparent, upfront and has lower risks of leakage. However, it imposes a cash-flow burden on exporters, and must, therefore, necessarily efficiently provide disbursal of the Drawback amount without delay if it is to be popular. At the same time the scheme is also not comprehensive such that it does not include in its ambit the capital goods and also various other State level taxes, which are borne by the export goods. On the other hand, though exemptions eliminate the cash-flow burden on qualified exporters completely, but at the price of higher risks of leakage. Thus, as a policy they should only be applied to exporters who meet very restrictive qualifying criteria, such as a high threshold of exports to total sales and a good track record of tax compliance. In the present situation in India there is a strong case to reduce the multiplicity of schemes and rely chiefly on an efficient Drawback system duly revamped to eliminate the reported disadvantages. Recent initiatives such as the credit of Drawback sanctioned directly to the bank account of the exporter, through EDI, and the sanction of Brand rate of Drawback within 15 days subject to ex-post facto verification of the declaration made by the exporter have removed some of the difficulties associated with the scheme. However, there is scope for further improvement.

4.3 Increasing transparency of Drawback scheme

4.3.1 As seen, the methodology of fixing the 'All Industry' rate of Drawback is to obtain data from on consumption norms, values of the inputs, and the duty levied thereon from the Export Promotion Counsels, Associations and Organizations. Thereafter, the workings are pre-audited by the officers of CAG. However, besides routine correspondence, there is no formal mechanism for consulting the Department of Commerce in the matter, which appears surprising since the work of export promotion is

allocated to this Department. Moreover, all Export Promotion Counsels, Associations and Organizations work in close interaction with the Department of Commerce. Thus, it would enhance the credibility of the Drawback scheme and improve transparency if the Department of Commerce is formally made a part of the process of fixing All Industry Rate of Drawback.

4.3.2 It is recommended that C.B.E.C. may work out a mechanism to formally associate a representative of the Department of Commerce in the process of fixing the All Industry rates of Drawback.

4.4 Expanding scope of Drawback scheme

4.4.1 Drawback has been considered as amongst the most effective schemes to neutralize the domestic taxes on export goods. Therefore, the Task Force has made certain recommendations to further improve this scheme and remove the deficiencies noticed. However, as seen the domestic taxes on export goods are basically taxes on inputs and raw materials and taxes on capital goods. So far capital goods are outside the scope of Drawback scheme. Furthermore, the present scheme seeks to neutralize the central indirect taxes (customs and central excise) whereas it is a fact that there are a large number of State and Local level taxes incurred on the export goods. Thus, an effective long term export promotion scheme would be one which neutralises all domestic taxes whether imposed at central, state or local level and on all factors of production (inputs, raw materials, capital goods, etc.). Therefore, there is a case for expanding the scope of Drawback scheme in this direction. In so far as the inclusion of State level taxes in the Drawback scheme is concerned the matter would get simplified once State VAT is place. However, as regards, the extension of the scheme to capital goods, the modalities would have to be worked out carefully. Certain issues such as the use of the said capital goods for domestic production, etc., would require to be resolved.

4.4.2 It is also noted that Drawback scheme envisages the rebate of the duty paid on the inputs, raw materials, etc. In other words, the duties have to be first paid and then rebated/refunded. This would, no doubt cause cash flow problems particularly in respect of capital goods wherein the duty amount may be significant. Therefore, it appears that a parallel scheme of allowing duty free procurement of capital goods should continue, as a part of the Advance Licencing (actual user) Scheme.

4.4.3 It is recommended that through suitable legislative changes the scope of the Drawback scheme should be expanded to provide for rebate of all duties – central, state and local – and on all goods which go into export product including capital goods. Similar action should be taken to include capital goods in the Advance Licencing (actual user) Scheme.

4.5 Furnishing of non-availment of Cenvat certificate

4.5.1 Availment of Cenvat credit and Drawback are mutually exclusive benefits. Accordingly, it is provided that while claiming Drawback the exporter should produce a certificate of non-availment of Cenvat credit. In fact to make the matter abundantly clear certain entries of the Duty Drawback schedule specifically provide for the non-requirement of this certificate when the goods are exempt for central excise duty (e.g. proviso of general note No. 8 of Duty Drawback Schedule – Handicrafts (including handicrafts of brass artwares), handloom products or leather and other products). The requirement of the non-availment of Cenvat credit is insisted upon with each and every shipment. The consignment–wise insistence upon production of the required certificate increases the contact points and transaction cost. However, it is the view that customs should trust the exporter to make a correct declaration. Further, if the requirement of the certificate is dispensed with, the disposal of Drawback claims will also speed up.

4.5.2 It is recommended that Customs should accept self- declaration from the Merchant Exporters that their supporting manufacturers are not registered with Central Excise and they do not avail Cenvat benefit. Similar self-declaration should be accepted from manufacturer-exporters. Such claims may be subjected to post disbursal verification on basis of intelligence and risk assessment techniques.

4.6 Sanction of Drawback on grant of Let Export order

4.6.1 Section 75(1) of Customs Act, 1962 provides that exporter shall be granted Drawback in respect of goods which have entered for export and in respect of which an order permitting clearance and loading thereof for exportation has been made under Section 51 by the proper officers. In fact, Section 75 had been amended in 1983 to

enable the payment of Drawback as soon as the order permitting clearance for exportation has been made by the proper officer. In the EDI system, however, Drawback is sanctioned only after Export General Manifest (EGM) is filed and Shipping Bill is reconciled with the EGM. As seen, delays in sanction of Drawback occur due to the late filing of the EGM and also due to errors during reconciliation (of Shipping Bill details and EGM) because of mistakes. Thus, sanctioning the payment of Drawback only after the EGM is filed and reconciled has led to innumerable disputes and pendencies.

4.6.2 In this regard it is noted that EGM is essentially required to confirm the actual export of the goods after Let Export order has been given. In other words the EGM helps to account for the goods and confirms their export. However, once the goods have been entered for export these are out of the control of the exporter and whereas it is possible that in few cases the export may be delayed or may not take place, this is a remote possibility. In any case, the law provides for raising of demands in case Drawback has been wrongly sanctioned and the revenue is safeguarded. Thus, keeping in mind exporters interest in quick sanction of Drawback and that the risk to revenue on account of non-export after the goods are entered for export is minimal, it appears appropriate that the sanction of Drawback is not held up on account of either delay in submission of EGM or errors on account thereof. The matching of the Shipping Bill with EGM may be a post-facto activity and steps may be taken to recover the Drawback sanctioned if in few remote cases the export has not taken place for some reason.

4.6.3 It is recommended that that Drawback should be sanctioned on the basis of Let Export Order without waiting for the EGM.

4.7 Brand Rate of Drawback

4.7.1 As per the procedure prescribed in regard to fixation of Brand Rate of Drawback, where no amount or rate of Drawback has been determined in respect of any goods or the exporter is not satisfied with the amount determined he may, within 60 days (or extended period of 30 days) from the relevant date apply to the Central Government for the determination of the amount or rate of Drawback. For this purpose the exporter is required to required to state all relevant facts including the proportion in which the materials or components are used in the production or manufacture of goods and the

duties paid on such materials or components. Based upon the information given and subject to verification thereof the Drawback Directorate determines the amount or rate of Drawback in respect of such goods.

4.7.2 In this regard the finding is that steps have been recently been taken to expedite the fixing of Brand Rate of Drawback on the basis of the exporters application subject to post-facto verification. Notwithstanding it is observed that delays continue to occur and it is worthwhile to explore alternatives to give relief to the exporter. One way is to make available some of the Drawback amount once the Let Export Order has been given. This amount could be on the basis of the All Industry Rate of Drawback since Brand Rate of Drawback would be invariably higher. The differential amount may be released after the Brand Rate of Drawback is determined. It is expected that this system would greatly increase the liquidity of the exporters and the additional work load would not be so much.

4.7.3 Another issue is that Brand Rate or Special Brand Rate of Drawback is fixed by the Directorate of Drawback, C.B.E.C. on an application made by the exporter. This is done on the basis of the declared input-output ratio and duty burden on the goods followed by post-facto verification on random basis. However, it is reported that in case an exporter is dissatisfied with the determined Brand Rate or Special Brand Rate of Drawback no mechanism is provided for redressal. Brand Rate or Special Brand Rate has an impact on exports. Accordingly, it is necessary that an exporter must be fully satisfied that he is getting the export incentive correctly. Absence of a redressal mechanism is against the exporters interest.

4.7.4 The following recommendations are made in respect of improving the mechanism of sanction of Brand rate of Drawback :

(i) In cases where the exporter has applied for fixing the Brand Rate of Drawback, the amount at the All Industry Rate of Drawback may be immediately released once the Let Export order is given. The balance amount may be released upon the determination of the Brand Rate of Drawback.

(ii) Drawback Rules should be modified to provide for an appeal to CEGAT in case an exporter is dissatisfied with the Brand Rate or Special Brand Rate of Drawback fixed for him.

4.8 Deputy/Assistant Commissioner (Exports) to sanction Drawback

4.8.1 In the existing system Deputy Commissioner (Export) and Deputy Commissioner (Drawback) are separate. Whereas the former deals with the passing of export consignments these are subsequently sent to Deputy Commissioner (Drawback) for sanction of Drawback, in case the export is under claim of Drawback. Invariably the new officer raises unnecessary queries and documents have to go to and fro the two officers. It is the view that all procedural requirement for Drawback such as production of Cenvat certificates etc. should be scrutinized at the time of Let Export. Once the Shipping Bill is passed and Let Export order given, the Drawback claim should be sanctioned subject to post facto ensuring that the goods have been actually exported. It is expected that this would further speed up the disposal of Drawback.

4.8.2 It is recommended that the Deputy Commissioner (Export) may be made fully responsible for "Let Export" and also sanction of Drawback amount.

4.9 Blocking of Drawback

4.9.1 At present the Drawback Rules provide that in the event the exporter does not furnish proof of remittance of sales proceeds within 6 months of exports the amount availed as Drawback has to be returned. This is being enforced on the strength of XOS statements received from RBI. It is seen that once the XOS statement is entered into the system the software is so developed that it automatically blocks further disbursal of Drawback to the exporter concerned. In fact the blockage is so complete that even if the outstanding is a nominal amount all future Drawback claims amounting to Crores of rupees would get blocked. This is a cause of hardship to the genuine exporter who may be in a position to finally satisfy the customs that the foreign exchange has been received. The present procedure is also not sound on equity as the amount blocked has no relation to the amount of Drawback under dispute.

4.9.2 It is recommended that there should be an immediate software modification such that amount of Drawback blocked should not at any one point of time exceed the amount under dispute.

4.10 Management of XOS data

4.10.1 At present, RBI compiles the report of outstanding remittances for exports made under various schemes every six months and sends the same to the nodal Custom House in the form of XOS (Export Outstanding Statement). This statement is sent to the nodal Customs House under each Zonal Office of RBI, which in turn segregates the data manually for each of the concerned Custom House/port/airport/ICD/CFS of export. Thereafter, the concerned Customs officers are required to issue a notice to the exporter to recover Drawback on the unrealized remittance.

4.10.2 The volume of data in the XOS is phenomenal. To illustrate, XOS of only RBI, Delhi contains around 55,000 shipping bills. Such a volume is not amenable to manual sorting. Further, whereas the existing format of XOS provides details of name, address of exporter, number of shipping bill, G.R. number and amount outstanding, it does not provide the following critical information :

(i) Port of export; and
(ii) Scheme under which exported.

4.10.3 It is, therefore, not surprising that invariably there is delay in linking the XOS statement with the port/airport concerned and export benefits wrongly availed can not be easily recovered. At the same it is learnt that each Custom House/port/airport/ICD/CFS is having a unique Code number. Were the XOS to mention the Code number the matter of identifying the outstanding remittance with the Custom House/port/airport/ICD/CFS and exporter concerned would be much simplified. Further, there appears to be no sound reason why the information continues to be dealt on manual basis. Electronic mode of receipt of information would facilitate sorting besides ensuring faster action to recover the outstanding export benefits.

4.10.4 **For expeditious recovery of inadmissible export benefits, it is recommended that the Export Outstanding Statement (XOS) must include a reference to the Code Number of the Custom House/port/airport/ICD/CFS of export. There should also be electronic exchange of information between the RBI and the nodal Custom House.**

4.11 Confirmation of receipt of remittance

4.11.1 The Drawback Rules provide for recovery of Drawback in cases where the sale proceeds of the exported goods are not realized. It is specified that this verification has to be done on the basis of intimation from the RBI in the form of a Export Outstanding Statement (XOS). The XOS is received on a periodic basis, normally once in six months, after which verification is carried out and demands raised where the foreign exchange remittance has not been realized. Very often these demands are kept pending as exporters claim that foreign exchange has since been realized and would be reflected in the ensuing XOS.

4.11.2 It is recommended that to avoid un-necessary issue of demand notices, the Customs may accept from the exporters themselves Bank Realisation Certificates as a proof of realisation.

4.12 Duty Drawback on composite items

4.12.1 As per General Note No. 11 of Duty Drawback Schedule, in the case of export of composite items constituent material should be visibly distinguishable and their weights should be unambiguously verifiable. That means unless one piece of each item or entire consignment is broken, the weight cannot be verified for some of the handicrafts items. For such items, at the field level, problems are being faced and the Drawback for the composite items is being denied.

4.12.2 It is recommended that as a general policy the weight declared by the exporters should be accepted. Verification should be done only in case of doubt or there is intelligence to the contrary.

4.13 Credit of Brand Rate of Drawback into Bank

4.13.1 On issue of the Brand Rate (or Special Brand Rate) letter by the Directorate of Drawback, the exporter has to get it registered at the Custom House of export. After registration, a Quantity release order is issued to the Drawback section from where the Drawback amount is released after feeding the data into the computer system, which is linked with the shipping bill details of exports made. This procedure is time consuming, taking approximately 3-4 months before the Drawback amount is credited in the account of exporter. Sometimes shipping bill details are also not readily available, which causes further delay. It appears that a short-cut is necessary to expedite the grant of Drawback. This could be achieved by merging the steps of registration and the issue of Quantity release order.

4.13.2 It is recommended that after issuance of Brand Rate (including Special Brand Rate) letter, a copy should be forwarded to Customs EDI system for data feeding. The amount of Drawback should then be credited automatically in the exporter's bank account as in case of claim of All Industry rate of Drawback.

4.14 Opening of Bank accounts for Drawback

4.14.1 Under the EDI system and even otherwise, the exporter is required to open a Bank account at an identified Bank and the Drawback amount is directly credited to the said account by the Customs. It has been reported that this arrangement is causing difficulties and increasing the transaction cost for the following reasons:

(i) An exporter who has exports through more than one port/airport has to open that many number of Bank accounts. This entails various formalities, keeping minimum deposit etc.

(ii) When the exporter is located at the interior away for the place of export, the Drawback amount is first received at the designated Bank and subsequently transferred to his own account at the place of his business. This invariably take time and costs the exporter in terms of bank commissions etc.

(iii) When the Bank is located far away the exporter has often to incur wasteful expenditure to ascertain whether the Drawback amount is credited or not.

4.14.2 Accordingly, while the present system of direct credit of Drawback to the designated Bank has its advantages for the exporters who are in the same city it has resulted in increase in transaction cost for other exporters. In this regard, a system whereby the designated Bank transfers the Drawback amount direct to the tax payers Bank account wherever located has obvious advantages and resolves the reported difficulties in the present system being followed by customs. There is no reason why the Banks should not be willing to carry out this additional work as they collection of sizeable revenues is a source of income for them. In the alternative, the exporter would not mind paying the additional bank fees, if any, for the facility of receiving the Drawback amount at this own Bank.

4.14.3 It is recommended that at the option of the exporter C.B.E.C. should work out an arrangement with its designated Bank which, when authorized, should send a mail transfer of the Drawback amount direct to the tax payer's bank account, wherever located.

4.15 Interest on delayed sanction of Drawback

4.15.1 Reportedly the sanction of Drawback gets delayed at the hands of the customs and this handicaps the export effort. Further, in the event the grand to refund is delayed the department is liable to pay interest thereon. However, there is no such provision in respect of delay in sanction of Drawback. It is the view that the exporter should not be penalized on account of delays by the department.

4.15.2 It is recommended that in case, the sanction of Drawback is delayed beyond a period of one week of the receipt of listed documents, the Department should be liable to pay interest on the amount of Drawback. On its part the C.B.E.C. should list out the documents required for sanction of Drawback, which should be made known to the exporters.

5. Duty Entitlement Pass Book (DEPB) scheme

5.1 As a policy, export promotion should largely rest upon an efficient scheme of Drawback. However, there are presently some difficulties in the Drawback scheme which contribute to delay in the sanction of Drawback. The delay causes a cash flow problem for the exporter which has to be avoided. Accordingly, certain measures have been suggested to improve the Drawback scheme. On its part it is recognized that DEPB is presently largely meeting the requirement of the exporters. It is also seen that the matter of having a long term scheme which efficiently meets the requirement of the exporters and boost exports has been recently examined by the Prabhu Committee set up by the Ministry of Commerce. After detailed examination of the pros and cons of the various schemes it recommended that DEPB should be merged with Drawback. The Task Force endorses this view. The merged scheme should basically rest upon the Drawback model. It is expected that by this time the Drawback scheme would have been further improved to reduce delays and provide immediate relief to the exporters.

5.2 It is recommended that DEPB should be merged with the Drawback scheme from 1st April 2005.

6. Coordination between DGFT and Customs

6.1 It is often reported that there is a need to promote the coordination between DGFT and C.B.E.C. and its customs field formations as otherwise hardship is caused to the importing and exporting community and there is also increase in transaction costs. Instances were reported of delay in registration of DEPB books by customs as they had not received the copy from DGFT, non-acceptance of the DGFT instruction unless the supporting customs notification were issued etc. It is the finding that the grievances are genuine. Effective implementation of the policy provisions is very important to cut delays and achieve export performance.

6.2 From the point of the view of the exporters and importers the Government is one, and so it should be. Both DGFT and Customs are two arms of the Government and it is necessary that they operate together and in harmony while giving effect to Government policies. At the same time it is appreciated that at the field level the individual officer of

customs (or DGFT) are bound by their individual laws and would hesitate to act on the basis of a DGFT order unless specifically so authorized to do so under their own law. Thus, the remedy lies in improved coordination between the two departments. Broadly, the difficulties which are faced at the field level and by the industry can be categorized as follows :

(i) Non-issue of supporting customs notifications despite policy announcement - Invariably it is noticed that there is significant time gap between the EXIM Policy announcement on 1st April each year and the issue of the relevant customs and central excise duty exemption notifications. The notifications are issued after a few months and then too with contents inconsistent with the EXIM Policy provisions. At times the notifications are simply not issued which nullifies the DGFTs policy announcements.

(ii) Non-receipt of documents relating to licensing by the customs - For instance, it is reported that the manufacturer exporter experience difficulties in getting registration of DEPB at the customs port on account of the fact that the Customs authorities may not have got their copy from DGFT.

6.3 The first issue is really one of coordination between two arms of the Government, which has a bearing upon both the delay in release of duty exemption notifications and their contradictions with the EXIM Policy provisions. The matter requires urgent attention. Ideally consensus should be evolved on the Policy prescription before it is announced and the attempt should be to make no changes, which in any way dilute or modify the concessions given earlier, which affect the trade and industry adversely.

6.4 It is recommended that towards improved coordination between the DGFT and customs the following steps may be taken :

(i) Duty exemptions, which are in general a critical component of the export promotion schemes, should be notified along with the EXIM Policy announcement. For this purpose the EXIM Policy should be

made available to the Department of Revenue by 15th of March each year.

(ii) Both Customs and DGFT should make use of EDI technology for exchange of information, which would cut the delays.

(iv) There should be an institutional arrangement to resolve the co-ordination problems between the DGFT and Customs. The recommended structure is as follows :

(a) 'Export and Import Co-ordination Committee' co-chaired by Member (Customs), C.B.E.C. and DGFT and having as its members J.S. (Customs), C.B.E.C., J.S. (Drawback), C.B.E.C, Additional DGFT, Director (Customs), C.B.E.C. and Joint DGFT and members of Exporters', Importers' and CHA Associations. The Committee would meet once in a quarter to examine and resolve all co-ordination issues. It would also oversee the work of the Regional Export and Import Co-ordination Committees.

(b) 'Regional Export and Import Co-ordination Committee' at each of the ports/airports/ICDs/CFS. This Committee would be chaired by Chief Commissioner of Customs. Senior most member of the DGFT at the port/airport/ICD/CFS would be a member. The Committee would also include all concerned departments and agencies such as custodians, banks, etc. and members of Exporters, Importers and CHA Associations. The Committee would meet once in a quarter to resolve all co-ordination problems. It is expected that since the customs is the chief implementation agency of the DGFT policies this

Committee under the Chief Commissioner would ensure early resolution of the problems.

7.5 It is understood that in some places similar bodies do meet but the result is not satisfactory. Hence, there is a need to place the Committees on a firm footing, as proposed above. **These Committees should be notified in the EXIM Policy and the C.B.E.C. Circular**.

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CHAPTER 6

AUTOMATION OF INDIRECT TAX SYSTEMS AND PROCEDURES

1. Introduction

1.1 It is clear that the success of an efficient tax administration rests upon making full use of the potential of automation and related technologies. The bottom line is that change shall, and indeed must, be automation driven. This is also the philosophy underlying the many recommendations of the Task Force in the various matters relating to the Indirect taxes. Internationally too, risk profiling and assessment is heavily dependent upon the use of computers, and Information Technology is revolutionizing the work on trade facilitation.

1.2 The major benefit of an automation programme is experienced in the area of trade facilitation. Automation leads to quicker clearances, standardization of procedures, reduced discretion, less interface and faster decision making, all of which greatly benefit the trade and industry. At the same time, compliance issues are not neglected and, in fact, there is far greater control, though unobtrusive, which is desirable. Thus, internationally, on the customs side cargoes, containers, and goods are being tracked around the globe by a variety of automatic identification devices. EDI and electronic commerce are replacing the tedious paper trail and signatures. Most countries are considering the use of smart cards, and satellite tracking system whereby containers are locked electronically and tracked via satellites. It is the view that India with its army of first-rate IT specialists can certainly take the lead in this transformation rather than take the back seat with outmoded practices. The same goes for reform of the central excise administration, which should follow the best international practices and remove most discretionary powers and rely on a transparent, simple, and objective system based on trust, aided by full use of information technology to collect revenues and punish entities who dodge compliance. The use of automation for higher level policy planning is also evident as the computers capture the required data error free.

1.3 In this regard, it is appreciated that C.B.E.C. has taken some steps towards increased use of technology in the conduct of the day to day operation in the Custom Houses. This is particularly evident in the case of customs with the spread of EDI from port to port. Interestingly, not only does EDI speed up decision making, it also ensures accountability as each transaction is time stamped. Recent initiatives on the Central Excise side, such as on-the spot issue of Registration Certificate by use of web based applications are also promising. However, much more needs to be done and at a far quicker pace. In fact, C.B.E.C. itself appears to be lagging behind in terms of infrastructure and use of computer information. Ideally the C.B.E.C. should have available on line access to all Custom Houses and Central Excise Commissionerates. This would obviate the need of calling for information from time to time. This would also speed up decision making. Further, an arrangement for video conferencing between the C.B.E.C. and the field formations would allow the senior field officers to remain in their station and not come to Delhi often. This would be a facility to the trade and industry as the absence of the officers adversely affects the disposal of work.

2. Automation driven tax administration

2.1. The essential requirement of any successful automation process is the standardization of information and absence of frequent changes. Accordingly, it is imperative that a conscious decision must be taken for imposing self-discipline and not making frequent changes in laws, procedures and rates of duties (through exemptions). Once the procedures are standardized and stable the automation can be done and it would deliver results. However, a successful automation programme rests upon committed administrative support backed by significant financial investment.

2.2 The following recommendations, which encompass legislative, administrative and financial areas, are made for an automation driven tax administration.

(i) All Customs and Central Excise Commissionerates should fully automate their processes by 1st January 2004. This requires a Commissionerate-wise work programme to identify the requirement of each station in terms of resources required.

(ii) **EDI must be expanded to cover each Customs and Central Excise Commissionerate by January 2004 for on-line processing of returns and applications (for e.g. refund), risk analysis, profiling and management, message exchange with related agencies, etc. In this direction, one major port and one airport should be made fully EDI operational by 1st April 2003.**

(iii) **C.B.E.C. and its Directorates should be included in the automation programme. All processes should be automated by January 2004.**

(iv) **Facility of video conferencing between the C.B.E.C. and the Chief Commissioners should be created.**

(v) **Research capabilities in TRU should be enhanced by intensive automation and development of new software tools, particularly in the context of emerging challenges once VAT is introduced and integration of Service Tax and Central Excise take place.**

(vi) **On-line filing of returns and documents should be encouraged. For this, Service Centers may be established with a computer link to the Customs and Central Excise Commissionerates for providing the facility. For instance, Excise-Return data is at present entered by the data-entry-operators of the Department. In order to improve the data accuracy and timely capture of data, entry of the particulars by the assessees through a web-based application at their own premise or at Service Center should be allowed.**

(vii) **Telephone help-line system should be made available in all Custom Houses and Central Excise Commissionerates for providing information support to trade in respect of status of pending documents/claims and other information on procedures etc. In the long run this should become a centrally operated facility.**

(viii) **Implementation of the automation programme in a time bound manner requires four dedicated teams to oversee the timely implementation of this work, one for Customs, other for Central Excise, the third for Service Tax, and the last for automation of C.B.E.C. and its Directorates. These should be created in the Systems Directorate, from the staff available consequent to cadre restructuring. The teams would work under the Commissioner, Systems and lay down the road map for automation including resource requirement.**

(ix) **Sufficient resources must be made available at one go to the C.B.E.C. for the automation project. This step will obviate the necessity of taking sanctions and seeking release of funds each time. Importantly, the resources should include an element for an 'Upgradation Fund' for the timely upgradation of the hardware and software on regular basis.**

(x) **To the extent possible, the automation work should be out sourced as it is not within the core competence of the department. On the other hand India is a leader in software and full use must be made of the local available expertise.**

(xi) **Senior officers of the Department must take an active interest in computerization by using computers and relying upon the information generated. They should also ensure its use by others. In short, there has to be better ownership at senior levels.**

(xii) **Systems wing of C.B.E.C. should be strengthened (in terms of both manpower and resources) to ensure immediate dissemination of information through an updated website.**

(xiii) **Simplification, standardization and stability of law and procedures are essential prerequisites of a successful automation programme.**

(xiv) Providing lead-time for software changes when laws are changed is essential for successful automation. For example, a notification must not come into force immediately from the date of its issue but from the next day. Similarly, new procedures should be implemented after a time gap of at least 30 days.

(xv) All procedures must be devised in consultations with the systems personnel who can advise on their adaptability to computerization.

(xvi) Multiple levies create complexities in development of software and retrieval of data. Accordingly, there must be an attempt to reduce the number of levies. Similar is the case in respect of multiple rates of duties. By and large an item should be subject to one duty rate.

(xvii) Levies and exemptions must be aligned to tariff headings. At present levies and exemptions are, at times, announced with reference to the description of the goods. Since the descriptions are not standardized, it creates difficulty in automation.

(xviii) Automated processes should provide for bifurcation of total duty paid into individual heads. In other words, for each Tariff Heading read with the exemption notification, there should be one duty amount to be deposited by the importer. Once deposited, the system should do the further allocation of this amount under the respective duty heads. Presently this work is done by the tax payer. For this purpose to facilitate the tax payer, C.B.E.C. should come out with a Working Schedule indicating the break up of the duties.

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CHAPTER 7

IMPROVING INDIRECT TAX ADMINISTRATION

1. Directorate of Anti-dumping and Safeguards duties

1.1 Section 9A of Customs Tariff Act, 1975 empowers the Government to impose Anti-dumping duty when any article is exported from any other country in India at less than normal value. Section 8B of the same Act empowers the Government to impose Safeguard duty when any goods are imported into India in such increased quantities and under such conditions so as to cause or threaten to cause serious injury to domestic industry.

1.2 At present the power to register and investigate cases and recommend Anti-dumping duty is vested with the Director General of Anti-Dumping under Ministry of Commerce and Industry. However, on receiving the findings and recommendations from the said authority, the Ministry of Finance, Department of Revenue issues necessary notifications imposing the Anti-dumping duty, which is also levied and collected by Customs officers. On the other hand, the power to register, conduct enquiry and recommend appropriate Safeguard duty lies with the Director General, Safeguard functioning under Ministry of Finance. On the basis of his recommendation, the Ministry of Finance, Department of Revenue issues notification imposing safeguard duty, which is enforced by Customs officers.

1.3 India has an impeccable record in meeting WTO commitments. Alongwith its impressive record in removal of all quantitative restrictions in one stroke, the stage is set for making the anti-dumping body most modern. Towards this objective, reliance on an independent body and a transparent mechanism is critical to conduct an efficient review of cases pertaining to matters such as injury determination, dumping margin, etc. related to safeguards and dumping.

1.4 It is recommended that an independent body such as the Tariff Commission should be suitably strengthened to conduct the work of investigations such as injury determination, dumping margin, etc. relating to Safeguard duties and Anti-dumping.

2. Advance Ruling

2.1 The stated objective of setting up the Authority on Advance Ruling is to meet the "need for foreign investors to be assured in advance of their likely indirect tax liability." The mode of foreign investment envisaged in the legislation is through the joint venture route i.e. investment by a non-resident in collaboration with another non-resident or a resident, or a resident in collaboration with a non-resident. Secondly, as per the existing provisions, the Authority can deliver advance rulings on select issues viz. classification of goods under the Customs and Excise Tariffs, principles of valuation and applicability of exemption notifications.

2.2 In so far as the eligibility of persons to ask for advance ruling is concerned, it is the view that investment through joint ventures is only one method adopted by foreign investors. In fact, foreign direct investment (FDI) through joint ventures is a small component of foreign investment, and the most common method of FDI is through wholly owned subsidiaries of foreign companies. Such companies are presently precluded from seeking an advance ruling on their proposed activity which may attract indirect tax liability. Thus, to avail full advantage of the advance ruling mechanism it is necessary to broaden its scope to allow the ruling to be given in respect of wholly owned subsidiaries of foreign companies.

2.3 As regards the determination of net duty liability, a few aspects under the Customs and Central Excise Acts which have a direct bearing on this issue have been left out of the purview of the Authority. These relate to notifications issued under the Finance Acts in respect of duties collected as excise or customs duties, and notifications issued under the Customs Tariff Act. These elements have a bearing on the overall duty liabilities of a foreign investor. Ideally, the scheme of advance ruling should be comprehensive to include the foreign investor's indirect tax liabilities are concerned. This would include liability net of Cenvat credit. Thus, it appears necessary to expand the scope of the Authority on Advance Ruling to allow comprehensive coverage to foreign investors in respect of their indirect tax liability.

2.4 It is recommended that suitable legislative changes may be made to include within the ambit of the Authority on Advance Ruling:

(ii) A wholly owned subsidiary Indian company, of which the holding company is a foreign company, proposing to undertake an activity in India, and

(iii) Notifications issued under the Finance Acts in respect of duties collected as excise or customs duties, and notifications issued under the Customs Tariff Act.

(iv) Admissibility of Cenvat credit.

3. Prosecution of individuals

3.1 Section 9AA and Section 140 of the Central Excise Act, 1944 and the Customs Act, 1962 respectively contain provisions for criminal prosecution of individuals for offences committed by Companies. These two sections are in identical phraseology. Therefore, referring to Section 9AA(1) it is provided herein that if an offence is committed by a company, then "every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company", as also the company, shall be deemed to be guilty and accordingly liable to be proceeded against and punished. However, if he proves his ignorance of the offence or that it was committed in spite of his due diligence, he shall not be liable to be punished. Thus, every person who is brought in the ambit of this provision is presumed guilty until proved innocent. Notwithstanding it is provided vide Section 9AA(2) that if it is proved that such offence was committed with the consent, connivance or negligence of any director, manager, secretary or other officer, then they are also liable to be proceeded against and punished.

3.2 The implication of the above mentioned provisions is that whereas a director, secretary or manager can be punished if there is proof of their consent, connivance or negligence, they are presumed innocent until proved guilty. In fact, the C.B.E.C circulars are also to the effect that prosecution should be launched against directors and others only if there is sufficient proof of their involvement in the offence. It is only those people who are directly entrusted with the responsibility of payment of duty and such other

compliance with the provisions of the Act, who must fall under section 9AA(1), and accordingly subject to the presumption, which they can discharge by proving otherwise. However, the said provision is wide in its scope and can include even persons who have no connection with the acts complained, but by virtue of their designation, are "in charge of and responsible for the conduct of the business of the company". Thus, for every single contravention, however minor it may be, every member of the senior management regardless of his non-involvement, is exposed to criminal proceedings, resulting in harassment and, sometimes, arrest and detention. It appears that there is a need to ensure against excessive prosecution while seeing that the guilty persons do not escape, which is taken care of by Section 9AA(2).

3.3 It is recommended that the prosecution provisions under the Central Excise and Customs laws be suitably amended to restrict their applicability to the persons actually responsible for the offence.

4. Adjudication and Appeal

4.1 Issue of Show Cause Notice

4.1.1 Show cause notices for demand of duty from the tax payers are issued under Section 11A of the Central Excise Act, 1944 and Section 28 of the Custom Act, 1962. It is provided thereunder that, in the case the duty to be demanded is over Rs. One crore the Show cause Notice will be issued with the prior approval of the Chief Commissioner and in all other cases i.e. when the duty to be demanded is less than Rs. One crore the Commissioner's approval is required. The Show Cause Notice is thereafter adjudicated by the competent officer, may be Assistant/Deputy/Additional/Commissioner, as the case may be. This is a fairly recent development and earlier the Show Cause Notices for demand of duty were issued by the same level officer, as the one entrusted with the adjudication thereof. For instance, if the case fell within the competence of the Additional Commissioner for adjudication an officer of the same level would issue the Show Cause Notice.

4.1.2 In this regard, it is observed that the present system has eroded the confidence of the tax payers in the system of quasi-judicial adjudication. After a Chief

Commissioner or Commissioner level officer has approved the Show Cause Notice the adjudicating officer, who is a junior functionary, does not usually have the confidence to disagree with the findings of the senior officer. As a result, the duty demand gets confirmed. Even otherwise, the tax payers do not have much confidence in the neutrality of the adjudicating officer and the present position makes it worse. Thus, the present system has given rise to increased litigation as the pro-revenue orders of the junior functionaries are contested in appeal. This matter requires redressal.

4.1.3 It is recommended that in order to restore the confidence of the tax payers, Section 11A of the Central Excise Act, 1944 and Section 28 of the Customs Act, 1962 should be amended to restore the earlier position of issue of Show Cause Notice for demand of duty by an officer of the level competent to adjudicate the case.

4.2 Pre-deposit of duty at first appeal stage

4.2.1 At present appeals against adjudication orders passed by officers up to the level of Addl. Commissioners lie before the Commissioner of Customs or Central Excise (Appeals). Section 35F of the Central Excise Act, 1944, provides that one of the conditions of hearing an appeal is that the appellant shall make a pre-deposit of the amount of duty in question. In fact, the appeal may not be admitted unless this is done. Reportedly, the insistence on pre-deposit is causing hardship on trade and industry more so in view of the fact that the orders of the adjudicating authority are generally pro-revenue which in most cases are subsequently set aside. It is also reported that most cases do not get finally settled at the level of Commissioner (Appeals) and insistence on pre-deposit causes cash flow problems.

4.2.2 It is the finding that indeed the majority of cases are being decided at the level of CEGAT. The success rate of the Department is also not very high. In this background the pre-deposit of the duty blocks the tax payers funds and in a large number of cases has to be returned. There is also no provision for payment of interest on this amount.

4.2.3 It is recommended that pre-deposit of duty should not be taken at the first stage of appeal, i.e. at the level of Commissioner (Appeals). This would require suitable amendment to the said Section 35 F.

4.3 Stay Orders passed by CEGAT

4.3.1 A recent amendment in Section 35C of the Central Excise Act, 1944 provides that in case a Stay Order is passed by the CEGAT and the case is not finally disposed within a period of 180 days, the stay stands vacated automatically. Similar position is there in respect of the customs cases. It appears that this change was introduced to expedite the disposal of cases since stay orders impact the recovery of revenue. However, looking at it from the point of view of the tax payer and the circumstances governing the grant of stay, it is evident that this provision would work against the interest of the justice and equity. A stay is normally granted when there is merit in the appeal and the operation of the adjudication order would be prejudicial to the tax payers interest. It is logical to assume that the circumstances granting this stay would not materially change in the sixth month period. Hence, if the stay is automatically vacated the tax payer would no doubt file another application for continuance of stay. This would unnecessarily raise the work load of CEGAT.

4.3.2 It is recommended that the relevant provisions should be modified to provide for the finalisation of the case (wherein stay is granted) within a period of six months so far as it is possible to do so. This would act as a signal to the CEGAT to decide the cases in a time bound manner. The provision that the stay is automatically vacated when the case is not finalized in six months should be revoked.

4.4 Appointment of Departmental Counsels

4.4.1 At present the Government appoints Standing Counsels which take up the brief for the revenue when cases are heard by the Tribunal, High Court and Supreme Court. It has been reported that in certain cases involving high revenue stakes or complex law points it is desirable to appoint a counsel from outside the approved panel. This is particularly so, when the opposite side is a big corporate and has at its disposal the best

legal brains. It is the view that considering the revenue stakes and the fact that some cases may have long term bearing on revenue, the Commissioners concerned should have the discretion to appoint the special free counsels. Today this is possible though a time consuming procedure requiring the approval of the Ministry. Often, the opposite party manages to get relief through stay, etc., while the process of appointing special fee counsel is not complete. It is the view that the present procedure must change. In this regard, it is learnt that on the Income Tax side the Commissioners are authorized to appoint special fee council upto certain monetary limits (of fees). This system could be followed in the Indirect tax side

4.4.2 It is recommended that suitable measures may be taken to authorize Commissioners of Customs and Central Excise to appoint Special Fee Counsels upto a certain monetary limit. The Chief Commissioners may also be suitably authorized for appointment of Counsels beyond the monetary limit prescribed for Commissioners.

4.5 Institution of SDR/JDR in Settlement Commission

4.5.1 Settlement Commission has been in place for some time. Now increasing number of cases involving high revenue stakes are coming up for settlement. In contrast to the arrangement at CEGAT where the Department has a presence in terms of its representatives, there is no departmental representation at the Settlement Commission. As per the present arrangement, it is the Settlement Commission which is entering into a correspondence with the concerned Customs or Central Excise Commissionerate to get a report whenever a case comes up before it. On their part the Commissionerates follow an ad-hoc approach and at times the departmental view point is not adequately presented. Considering the revenue stakes and the increasing popularity of the Settlement Commission, it appears justified to have an institutional mechanism to represent the department in the cases before the Settlement Commission.

4.5.2 It is recommended that in like manner of CEGAT, Departmental representatives should be appointed at the benches of the Settlement Commission. Subsequently, this practice can be replicated in case of Authority for Advance Rulings.

5. Strengthening Internal Audit

5.1.1 Central Excise officers are empowered to conduct audit of the tax payers business activities to ensure adherance to the rules and correct discharge of duty liability. Further, rule 22 (3) of the Central Excise Rules, 2002 provides that every assessee shall, on demand make available to the audit party deputed by the Comptroller and Auditor General of India (CAG) the specified records maintained by him. Thus, CAG staff also audits the central excise tax payers. In this regard, Article 149 of the Constitution provides that "the Comptroller and Auditor-General shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament……". Furthermore, vide Sections 10 to 20 of the Comptroller and Auditor-General's (Duties, Powers etc.) Act, 1971 the duties of CAG appear to relate to compilation of accounts of Union and States, and general provisions relating to audit such as audit all accounts and transactions of the Union and the States, audit all trading, manufacturing, profit and loss accounts and balance sheet etc. kept in any department of the Union or the State etc. It also provides for audit of Government companies and corporations and certain authorities or bodies only.

5.1.2 An audit objection invariably results in issue of a duty demand notice against the tax payers, an indicator of dispute and which gives rise to uncertainty. Therefore, it is in the interest of all concerned that disputes should not arise but having arisen should be settled without delay. As seen, one reason for issue of the notice is the objection and observation of the CAG. This is in order when the duty demands are issued in the situation the department agrees with the findings of the CAG. However, notices referred to as 'protective' demands are also issued to protect the revenue even when the Department does not agree with the CAG. These notices are kept pending in the Call Book for years until the issue is decided between C.B.E.C. and CAG, which no doubt adversely affect the tax payer. Incidentally, C.B.E.C. has issued instructions that when the Audit objection runs contrary to its orders issued under Section 37B of the Central Excise Act, 1944 and Section 151A of the Customs Act, 1962 (laying down the correct classification and valuation of goods) or its circulars or instructions, no protective duty demand need be issued. This is a step in the right direction and should reduce the number of duty demands being issued.

5.1.3 In this regard the finding is that internal audit by the Department is now being done in accordance with a recently developed programme of audit titled “EA 2000”, which relies chiefly upon the tax payers own records and documents to confirm the compliance of the rules and procedures and payment of central excise duty. Reportedly the results of EA 2000 have been good, in terms of safeguarding revenue and also in ensuring the audit does not disrupt tax payer’s business activities. However, there is still some apprehension in the minds of the taxpayers that the Audit teams are driven by revenue targets and conduct their business with the objective of raising a demand for duty. Another area of concern is that visits by different audit teams (Department and CAG) to the tax payers’ premises disrupts their work. Finally, the tax payers would like early resolution of issues between the Department and CAG so that duty demands are not kept pending for long.

5.1.4 It is the view that as the Central Excise officers are in any case responsible for ensuring the correctness of the duty payment and visit the tax payers premises to conduct audit for this purpose, the repeat visit for the same job by the CAG officers may not be necessary. EA 2000 has also shown good results and has been accepted by the tax payers. Incidentally, CAG does not visit the Income Tax and Customs tax payers and earlier the provision now found in rule 22(3) was not there in the central excise law. It also appears necessary to create an environment of greater certainty in taxation matters and resolve areas of differences of opinion between C.B.E.C. and CAG. Thus, there must be greater interaction between the two. This would also strengthen internal audit of the department. Once this is done the disputes would firstly not arise and if at all they arise would be quickly resolved. Interaction between the officers of both the sides would lead to appreciation of each others view points and the resolution of differences in a harmonious way. It would result in less paper work, reduction in issue of duty demand notices and a tax payer friendly administration. This would benefit the tax payers.

5.1.5 It is recommended that the following steps may be explored to strengthen the system of audit for the benefit of both revenue and the tax payer:

(i) Instruction may be issued that Audit should be participative and a fact finding mission with the objective of guiding the tax payer; the attempt should be to evolve a consensus on the issues and Audit

teams should not be empowered to issue show cause notices for duty demand.

(ii) C.B.E.C. and CAG should identify posts within their organizations to be occupied by the officers of the other department on deputation.

(iii) Rule 22(3) of the Central Excise Rules, 2002 may be amended to exclude reference to audit party deputed by the CAG so that they need not visit the tax payers premises.

6. Trade facilitation

6.1 Standing Committee on Procedures

6.1.1 Customs and Central Excise procedures are being changed rather frequently. Invariably, the procedures are framed in consultation with the field officers and there is no apparent involvement of the trade and industry. As a result, each new procedure is invariably accompanied by representations from the tax payers. These are then examined and at times the procedures are suitably modified and at other times no action is taken on the ground that the new procedure must be allowed to settle down. As a result the present system of evolving new procedures, even if these are presumed to be trade friendly, create uncertainty and generates additional work. It is the view that there should be an institutional mechanism to frame new procedures.

6.1.2 Furthermore, new procedures come into effect from the date they are brought to the notice of field formations. Each instruction contains a direction to the field formations to issue suitable public notices/ trade notices to inform the trade. Not only does this catch the trade by surprise but it may also happen that a procedure has been in force but is not complied with for the reason that the trade may not have come to know about it. Invariably, such situation also leads to compliance issuance and disputes. Also, the Departmental Systems personnel are unable to modify their software, if required. It is the view that this matter requires remedy.

6.1.3 In the circumstance, keeping in mind that the objective of tax administration should be to provide certainty and transparency, **the following recommendations are made in so far as introduction of new procedures are concerned:**

(i) An institutional mechanism, namely Standing Committee on Procedures chaired by Chairman CBEC and including trade and industry representatives, should be established to identify and resolve the problem areas in present procedures and evolve new procedures on a need basis. This Committee should meet once a quarter.

(ii) A new procedure should come into force after minimum 30 days of its announcement.

6.2 Fixing of revenue targets

6.2.1 A major area of concern, both for trade and departmental officers is related to the annual ritual of fixing of Commissionerate-wise revenue targets by the C.B.E.C. There are two issues here. First is the fixing of the target itself. No doubt the targets are necessary for the revenue administration to closely monitor the revenue inflows and it also sensitizes the Commissionerates to their primary responsibility of revenue collection. However, the problem area is that invariably the targets are unrealistically fixed on the higher side. This is revealed on a perusal of the performance viz. a viz. the targets and it is seen that it is an exceptional year when the targets are achieved. It is also reported that the targets are fixed for the total revenue, ignoring that the major share is on account of revenue from POL, which is largely, even today, the subject matter of Government policies on pricing. As a result, there is tremendous pressure on the Commissionerates to achieve the unrealistic targets.

6.2.2 An outcome of the revenue target fixing exercise is that on the customs side the Commissionerates invariably clamp down on disbursal of Drawback and refunds during the last quarter of the financial year. This happens since the disbursal is treated as an outflow of revenue and the net revenue realised comes down. Importers are also made to deposit customs duty in cash instead of using DEPB. Similarly on the central excise

side the tax payers are 'persuaded' to pay duty through cash (PLA) and not use the accumulated Cenvat credit for the same. Refunds are also stopped. These are extra legal measures. As seen, the Commissionerates tend to raise all sorts of technical objections on the drawback and refund claims so that the disbursal does not take place during the financial year in question. This entire exercise is avoidable as it is basically revenue neutral. The withheld amount (of drawback and refunds) is promptly released the beginning of the new financial year. Also at times the tax payer is encouraged to make excess payment of duty with the promise that the same would be refunded at the beginning of the new financial year. In fact for these reasons, on the central excise side there is hardly any revenue realisation (in PLA) in the first quarter of the new financial year since the tax payers use the blocked Cenvat credit to pay the duty.

6.2.3 The present system of withholding drawback, refunds and not allowing the central excise tax payers to use Cenvat credit is disturbing. Drawback is an export facilitation measure and denial or withholding drawback causes a set back to the export efforts. Actually the Commissionerates must be encouraged to disburse drawback and facilitate increased exports. Similarly withholding of refunds and not allowing utilization of Cenvat credit to pay duty create cash flow problems for the trade and adversely affects business by either holding up clearances or puts tax payers to severe financial pressure. It is high time that it is realised that payment of duty through Cenvat credit is also duty realization.

6.2.4 On a careful examination of the matters **the following remedial action is recommended:**

(i) Revenue targets must be fixed realistically. The target must be broken into POL and Non-POL which would enable the Commissionerates to make realistic attempts to reach the target through legal measures and trade facilitation.

(ii) On the customs side, as an export facilitation measure, the revenue target should be fixed by including Drawback disbursed and refund sanctioned. This will ensure against blockage of Drawback and

refunds. It would also encourage the Commissionerates to release Drawback in order to meet the target.

(iii) On the central excise side the revenue target should take into account duty paid through both Personal Ledger Account (PLA) and Cenvat credit. Refunds sanctioned should also be taken into account. This will ensure against stoppage of payment through Cenvat during revenue drive and withholding of refunds.

6.2.5 The above measures would boost tax payers confidence in the administration and also reduce the pressures on the departmental officials. All in all a healthy tax compliant environment would be created.

6.3 Harmonization of commodity classification

6.3.1 At present, various Government departments and agencies use their own methods of classification of the goods for taxation or statistical purposes or for deciding the importability or exportability or for any other purpose. For instance, DGFT, Customs, Central Excise, Directorate General of Commercial Statistics and Intelligence, State Sales Tax departments, Central Statistical organization etc. all use different commodity classification codes. Except Customs the codes of the other agencies are not aligned with the internationally adopted HSN.

6.3.2 Multiplicity of classification codes causes hardship to the trade and industry besides coming in the way of establishing a common market. Internationally a common classification is adopted for all trade related transactions. Common classification helps in simplifying procedures and documentation and facilitates trade. It also encourages increased use of electronic data processing which is otherwise not possible. Common classification codes also help in obtaining specific data on need basis more easily and sharing it between various agencies.

6.3.3 It is understood that C.B.E.C. has taken the initiative to prepare an 8-digit Common Commodity Classification Code for both central excise and customs as a standard unit of measurement for all trade related activities, in consultation with other

concerned Ministries and Departments. This is appreciated as a step in the right direction.

6.3.4 It is recommended that the 8-digit Common Commodity Classification Code should be implemented at the earliest and latest by 1st April 2003. This should be used by all other agencies (DGFT, DG, CIS, custodian, etc.) also.

6.4 Standardization of service standards

6.4.1 Besides the need for tax payer friendly procedures there is also the need for uniform application of such procedures. It is often reported that different Custom Houses and Central Excise Commissionerates have different practices which is not know o the trade and industry and, at times, gives rise to compliance issues. Hence, it is necessary that there should be standardization of procedures. Also it is very important that there is in place an institutionalized mechanism to periodically review the procedures and the way work is done. It is noticed that very often the systems are personality based and upon the transfer of an officer the new incumbent starts his own procedures and the system changes over night. No doubt the tax payer is legally bound to collect the duty and the tax administrators to collect the same. However, the tax collectors must appreciate that the tax payer is a customer for them. In other words, it is important to set in place high standards of service for customer satisfaction and maintain them over the time. Standardization of the procedures across the Commissionerates in different parts of the country is equally important. This would improve compliance, certainty and tax payer confidence.

6.4.2 It is recommended that a time bound programme should be initiated for the ISO Certification of all Custom Houses and Central Excise Commissionerates – to be started in 2003 and completed by 1st January 2005. This presupposes standardization of procedures.

6.5 Banking

6.5.1 Banks play a critical role in the tax administration through facilitating payment of duty and its reconciliation. So far the payment of duty is being made in the nominated

public sector banks. At present, the policy of one Commissionerate - one bank is followed. This has obviously given rise to complaints of monopolistic behaviour and poor service. The move to EDI based reconciliation of duty payment has also not picked up so far, though certain positive moves have been made in this direction. Accordingly, in order to exploit the facilities of modern automated banking for enhanced convenience of the tax payer and the revenue **the following recommendations are made :**

(i) Multi-banking should be encouraged by recognizing new banks including private sector banks to handle receipt of Government revenue.

(ii) A pre-condition to the appointment of the banks should be establishment of an EDI link with the Custom House/Central Excise Commissionerate to facilitate reconciliation of revenue.

(iii) Banks should have the responsibility of issue/transfer of refund checks/amount direct to the tax payers bank account on the basis of a release advise form the Commissionerate.

(iv) Option of payment of duty through debit card and the like should be explored for implementation.

(v) Appointed banks should give the tax payer the option of internet banking for deposit of duty and transfer of funds.

6.6 Uniformity of interest rates

6.6.1 At present, there is great disparity between the interest payable by the tax payer (to the department) on the duty short levied or short paid or not levied or not paid and the interest payable by the Department (to the tax payer) on the delayed refunds. Whereas the tax payer is required to pay interest at the rate of 15% per annum the Department pays interest at the rate of 8%. Not only is there no equity, the disparity causes concern that the Government is not treating the tax payer as an equal partner in the economy. In fact, there is also an absence of uniformity in the rate payable by the

tax payer. For instance, in the case of warehoused goods the interest payable is 24%. Whereas the vires of charging higher interest and giving lower interest is not questioned it appears that in the interest of boosting tax payer confidence in the fairness of tax administration the disparity need to be removed. Also there is some confusion whether the interest payable is simple interest or compounded. Finally, it is contended that the rate of interest is too high and must move with the PLR.

6.6.2 It is recommended that :

(i) The interest payable by the tax payer and the department may be made uniform.

(iii) The interest so determined must be uniformly applied in each and every situation where it is decided to charge interest.

(iv) The law should itself clarify that the interest is simple and not compounded.

(v) The rate of interest should be reviewed each year at the time of the Budget and brought in line with the prevailing market rate. Rate determined should not be changed during the year.

6.7 Unjust Enrichment

6.7.1 The Constitutional validity of Section 11B, as amended in 1991, has been upheld by the Supreme Court in the case of Mafatlal Industries. However, it is seen that in certain cases which have been judicially held to be outside the scope of the said provisions the tax payers are asked to produce all sorts of documents and establish the duty burden has not been passed on to their buyers. This causes harassment. Without going into the merit of the legislation it appears that the net result has been to reduce tax payer satisfaction, increase contact points and discretion on the part of the departmental officers. Thus, it merits defining certain situations wherein the tax payer should be given the benefit of refund of duty without going into the question of legality thereof. This

would also reduce the transaction cost and avoidable interface between the industry and the Department. This is possible through suitable legislative changes.

6.7.2 It is recommended that the provision in respect of Unjust Enrichment may be amended to the effect that it would not apply when the refund arises in respect of provisional assessment, goods captively consumed and pre-deposit of duty.

6.8 Non-Receipt of Applications

6.8.1 Presently there are no Dak receipt counters at most of the Excise Offices. As a result a tax payer is not able to deposit any application/document and get an acknowledgement. The problem is more acute in Central Excise Range offices as the Excise Inspector/Range Superintendent may not always be available in their office.

6.8.2 It is recommended that the system of receipt and acknowledgement of dak and correspondence should be reviewed and it should be ensured that a receipt counter manned at all hours during office hours is positioned at an easily accessible place. In the case of small offices where there is a paucity of staff, a Mail box should be provided and acknowledgements issued next day. Every correspondence should be acknowledged and timely replies sent.

6.9 Codification of circulars/ instructions

6.9.1 At present there is no practice of codifying the many instructions and circulars issued by the C.B.E.C. from time to time. As a result there is confusion in the trade and industry and also the departmental officers regarding the latest position on any aspect of law and procedure. This leads to absence of uniformity besides giving rise to disputes. It appears that the solution lies in organizing the issue subject-wise booklets including all relevant circulars and instructions. This would also help in weeding out those which are redundant. Importantly, this should not be a mere reproduction or compilation of Circulars and instructions. Effort should be made to state the legal position in simple and clearly understood language. Once this is issued future changes should simply be inserted at the relevant page. For instance, future instructions should mention ‘replace paragraph AB on page XYZ’. This mechanism would ensure updated

instructions/procedure are available at all times with the trade and industry and the departmental officers.

6.9.2 It is recommended that C.B.E.C should codify all circulars/ instructions in one cover, subject-wise by 1st April 2003.

6.10 PAN as the common identifier in taxation matters

6.10.1 It is essential that for identification of the tax payers and also for exchange of information on the tax payer between different government departments/agencies, there should be a common identifier. It is observed that C.B.E.C has already started using the PAN issued by the Income Tax department as the common identifier for central excise purposes. This should be extended to customs also.

6.10.2 It is recommended that C.B.E.C should ensure by 1st April 2003 that all its tax payers are entered into its computer record on the basis of PAN.

6.11 Search, Seizures and Summons

6.11.1 In order to bring the focus back on transparency and accountability it appears necessary to introduce certain changes in the present system of search, seizure and summons. These are expected to restore the confidence of the tax payer in the tax administration. **The recommendations are as follows:**

(i) Central Excise officers should not be required to wear uniform. This would change the mind set on both side (Department and taxpayer) and contribute to freer communication.

(ii) Videography should be done whenever statements are recorded and searches made.

(iii) Seizure of documents and records adversely affect the conduct of business. Accordingly, these should be mandatorily released upon the completion of adjudication.

7. C.B.E.C. Administration

7.1 Tenure of Chairman, C.B.E.C.

7.1.1 The Chairman, C.B.E.C is in charge of collection of major share of the total tax revenues of the Government. He is in overall charge of administering the tax administration in respect of Customs, Central Excise and Service Tax and some element of Narcotics. Being the head of the Customs Administration Chairman, C.B.E.C. represents the country in all International forums such as WCO. Thus the continuity in the post of Chairman. C.B.E.C. is of critical importance.

7.1.2 In this regard it is observed that invariably an officer is appointed as Chairman., C.B.E.C when he has scarcely a few months to go before superannuating. As a result he is hardly in a position to give long term direction to the department. The officer is not able to give shape to policies of long term importance to the revenue and an element of ad-hocism creeps in, which is detrimental to the tax administration. Consistency and long term vision are essential for a administration, and much more important in tax administration.

7.1.3 As long term measures to give stability and direction to the indirect tax administration, which is so critical for the economic well being of the country it is recommended that Chairman, C.B.E.C. should be selected on criterion of merit cum seniority and once appointed (at whatever age before 60 years) should have a minimum tenure of 2 years.

7.2 Financial autonomy

7.2.1 C.B.E.C. has no financial autonomy and has to obtain financial sanctions for expenditure from the Financial Adviser (Finance) who is entrusted with the Budget of the Department and reports administratively to the Secretary Revenue. All the field formations of the C.B.E.C. are necessarily required to first take the clearance of the C.B.E.C. in respect of their expenditure proposals, and then obtain the sanction of the Finance wing. This often impacts the projects which works against efficient tax

administration and tax payers facilitation suffers. It is the view that as a major revenue earning Department, C.B.E.C. should be given financial autonomy. Further Chief Commissioners should have financial powers and Commissioners should have enhanced financial powers.

7.2.2. It is recommended that a mechanism may be found to give C.B.E.C. financial autonomy. The Chief Commissioner and the Commissioners may also be given enhanced financial powers.

7.3 Improving office infrastructure

7.3.1 Customs and central excise officers and the taxpayers are partners in the economic development of the country through the payment and collection of taxes. It is often the case that the taxpayers – importers, exporters, corporate heads, foreign nationals have to visit the customs and central excise offices for the conduct of the tax related businesses. Reportedly, the majority of offices are in bad shape in terms of basic infrastructures and amenities. Most are also in rented accommodation and there is little scope for carrying out improvements. Not only does this distance the tax payers from the tax administrators it also create an unhealthy mind set in the officers who work in unsatisfactory environment. Therefore, it is necessary to develop a corporate culture which is customer friendly by improving the office accommodation of the customs and central excise officers.

7.3.2 It is recommended that the C.B.E.C. should evolve a time bound strategy to improve the office accommodation as follows:

(i) A Task Force should be set up to standardize the requirement of a modern customer friendly office (model office) which should

(ii) Furnish its report by 31st January 2002. The report should include financial estimates.

(iii) Based on the report of the Task Force, the C.B.E.C should ask the Chief Commissioners to identify the shortcomings in each of their

offices in their jurisdiction by 1st April 2003 and send a consolidated proposal to C.B.E.C.

(iv) By 1st August 2003, a model Commissionerate (Customs and Central Excise), Central Excise Division and Central Excise Range office should be set up in each of the Chief Commissioner zones.

(v) C.B.E.C. should seek financial sanctions and replicate the model offices by upgrading the existing offices and purchasing land, building, etc., where necessary. The entire exercise should be time bound, so that by 2005, modern offices are in place in each Commissionerate.

(vi) Modernisation of C.B.E.C and its Directorates should be done by setting up a Task Force to identify the areas of improvement and thereafter taking time bound action.

(vii) Facility of video conferencing between the C.B.E.C. and the Chief Commissioners should be created.

(viii) Research capabilities in TRU should be enhanced, particularly in the context of emerging challenges once VAT is introduced and there is integration of Service Tax and Central Excise.

8. Human Resource Development and training

8.1 Human resource development is an important ingredient in administration. Training is essential for upgrading skills and change in mind-set for tax payer facilitation. This is all the more important when the environment in terms of policies and procedures and tax payer expectation is changing rapidly. C.B.E.C. is already having an institutionalized training programme run by NACEN and the Commissionerates also conduct in-house training programmes from time to time. However, the common perception is that much more need to be done in the training the officers, particularly at the cutting edge, in two key areas. The first is the use of computers and the second is

the change in mind set. Particular attention needs to be paid to change in mind set at the cutting edge.

8.2 It is also important to appreciate that a long term institutional arrangement is necessary for sustained progress in human resource development. Once the resource centers are identified, C.B.E.C. should enter into a Memorandum of Understanding with them so that the continuity of the arrangement is maintained. Accordingly, **it is recommended that :**

(i) **The infrastructure available for training at regional level should be upgraded. Training should be accorded priority and sufficient infrastructure needs to be created to impart training especially in areas of use of information technology, managerial skills and attitude changes at the cutting edge level. Each Chief Commissioner of a Zone should have an in-house training center equipped with latest training aids and adequate infrastructure to take care of the training requirements in addition to the proposed regional training centers in the Cadre Restructuring proposal.**

(ii) **The C.B.E.C. should make full use of the technical assistance of multilateral agencies such as World Bank, Asian Development Bank and World Customs Organization, especially their reform and modernization projects and programmes, that support customs reform through training in diagnostic study and in customs needs analysis. These help domestic customs authorities implement the required changes that have been identified and evaluate their impact on trade facilitation and customs compliance.**

(iii) **A relevant UN body to be contacted for assistance is the Center for Facilitation of Procedures and Practices for Administration, Commerce, and Transportation (CEFACT- UN/ECE).**

(iv) **Group 'B' and 'C' officers who are at the cutting edge should be given training to change the mind-set for bringing about pro-client/customer orientation.**

(v) **Entry level training to officers who are promoted from Group 'B' to Group 'A' should be mandatorily provided at NACEN, for a minimum period of 3 months covering both Customs & Central Excise. This is essential as officers promoted from Customs are often posted to Excise Commissionerates and vice versa.**

(vi) **Cadre training should be compulsory in respect of all Group 'A' officers and periodical refresher courses should be organized to impart training of managerial skills.**

(vii) **Senior Group 'A' officers of the rank of Commissioners and above should be deputed to attend Executive Development Programmes in premier management institutes in the country such as, IIM, IIFT, ASCI etc.**

(viii) **Group 'A' officers should be exposed to the tax administrations abroad and international best practices in training followed to enhance their skills.**

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CHAPTER 8

REVENUE AUGMENTATION, TAX LEVIES AND RATES

1. Tax to GDP Ratio

1.1 Falling tax to GDP ratio in general, and similar trend in respect of indirect tax to GDP ratio, in particular is a matter of serious concern, more so when the ratios are falling in the post liberalization era, since early 1990s, when the expectation was to the contrary. There can be no two views that structural and fiscal policy changes over the last decade have been necessary as otherwise the country would have been isolated in the world economy. However, the falling ratios alert us to the fact that much more need to be done than has been done so far and also that a re-thinking is clearly warranted on certain critical issues if the trend is to be quickly reversed.

1.2 On the subject, it is interesting to study the initiatives taken by countries which were similarly placed as ours in the pre 1990s but which have made significant strides in achieving a higher tax to GDP ratio in the last few years (1996 to 2000), such as Brazil, China and Turkey. The common aspect of the reform process in all these countries was to expand the tax base (focusing on consumption expenditure), rationalize tax structure and improve efficiency of tax administration. An important element in relation to tax structure was to focus on incentives, exemptions and distortions. No doubt India too has followed this general direction but not with the same results.

Trends in tax to GDP ratio in select countries (1996-2000)

	1996	1997	1998	1999	2000
Brazil	11.00	12.00	12.50	14.40	14.80
China 1/	10.20	11.10	11.80	13.00	14.10
Turkey 2/	15.00	19.05	20.21	21.28	22.03

1/ Revenue performance of Centre, Provinces, and Municipalities.
2/ Tax to GNP ratio

Customs Revenues, tax to GDP ratio and average collection rate

Year	Revenue (Rs. Cr.)	Growth (%)	GDP (Rs.Cr.)	Tax - GDP ratio	Average collection rate(%)*	Imports as a % of GDP (at market price)	Revenue foregone on export promotion schemes (Rs. Cr.)
1990-91	20644	N.A.	573444	3.6	74	5.01	N.A.
1997-98	40193	(-)6.2	1522574	2.6	27	12.5	13157
1998-99	40668	1.2	1740935	2.3	23	11.5	15492
1999-2000	48420	19	1929641	2.5	22	12.4	18166
2000-01	47542	(-)1.8	2087988	2.3	21	13.0	21658

* **Percentage of total customs revenue to the total value of imports**.

Central Excise Revenues and tax to GDP ratio

Year	Revenue (Rs. Cr.)	Growth in Excise revenue (%)	GDP (Rs. Crs.)	Tax - GDP ratio
1990-91	24514	5.73	573444	4.3
1997-98	47962	6.56	1522574	3.2
1998-99	59246	11.02	1740935	3.1
1999-2000	61902	16.26	1929641	3.2
2000-01	68526	10.70	2087988	3.3

1.3 As seen, between 1990-91 and 2000-01 the customs revenue to GDP ratio has fallen from 3.6 to 2.3 and the central excise revenue to GDP ratio from 4.3 to 3.3. One does not have to look far to find the reasons for the reduction and some of the reasons are :

(ii) The rate of reduction in duty rates (both customs and central excise) has been much higher than the rate of growth of GDP.

(iii) On the customs side, the reduction in rate has not led to higher revenue in view of lower than expected increase in volumes of import.

(iv) On the central excise side the contribution of manufacturing sector in total GDP has declined and whereas contribution of services has gone up and this sector is not being taxed comprehensively.

1.4 It is but evident that there is an urgent need to arrest the trend of falling indirect tax to GDP ratio if an impact is to be made on the fiscal deficit. Broadly, this calls for action in two areas of tax policy. First is the tax structure including its coverage and second is tax implementation. In so far as the former is concerned, the following measures are necessary, which are subsequently detailed in respect of each of the indirect taxes :

(i) Widen the tax base by reviewing and removing to the extent possible the duty exemptions – as a general principle, duty exemptions tend to create pressure groups, increase discretion and do not always ensure benefits reach the target. The exemption, when merited (such as in case of life saving goods and sovereign imports of security/strategic interest) should be replaced by a more transparent method of ensuring the relief to the target group, through budgetary support.

(ii) The types of tax levies should be brought down to the minimum - too many levies create distortion and inefficiencies in administration, raising compliance issues.

(iii) Move towards a maximum number of three rates of duty in central excise to be achieved in two years and fewer rates from present 20 rates in Customs, in stages. Fewer number of rates and moderate rates would encourage compliance, reduce discretion and create an efficient tax administration.

(iv) Expand coverage of Service Tax and integration of central excise (goods) and Service Tax legislation - It is the expectation that in the long run the service sector would contribute significantly more to the GDP, and even at

present it is the single largest contributor. Therefore, for improvement in tax to GDP ratio the scope of Service Tax must necessarily expand.

(v) VAT should be implemented to reduce cascading effects of taxes.

2. Customs Tariff and Exemptions

2.1 Multiplicity of levies

2.1.1 At present, besides the Basic Customs Duty, we have the following levies :

(i) Additional Duty of Customs (loosely referred to as Countervailing duty or 'CVD')
(ii) Special Additional Duty of Customs (SAD)
(iii) Additional Duty of Customs on Motor Spirit
(iv) Additional Duty of Customs on High Speed Diesel Oil
(v) Export Duty
(vi) Cesses on Exports
(vii) Anti-dumping/Safeguard duties

2.1.2 As a policy, multiplicity of levies must be reduced. Accordingly, it is recommended that there should be only three types of duties, viz. Basic Customs Duty, Additional Duty of Customs (or Countervailing duty) and Anti-dumping/Safeguard duties. All other duties should be removed. However, removal of SAD should be linked to implementation of State level VAT, where SAD would get replaced by the State VAT to be levied on imports.

2.2 Multiplicity of duty rates

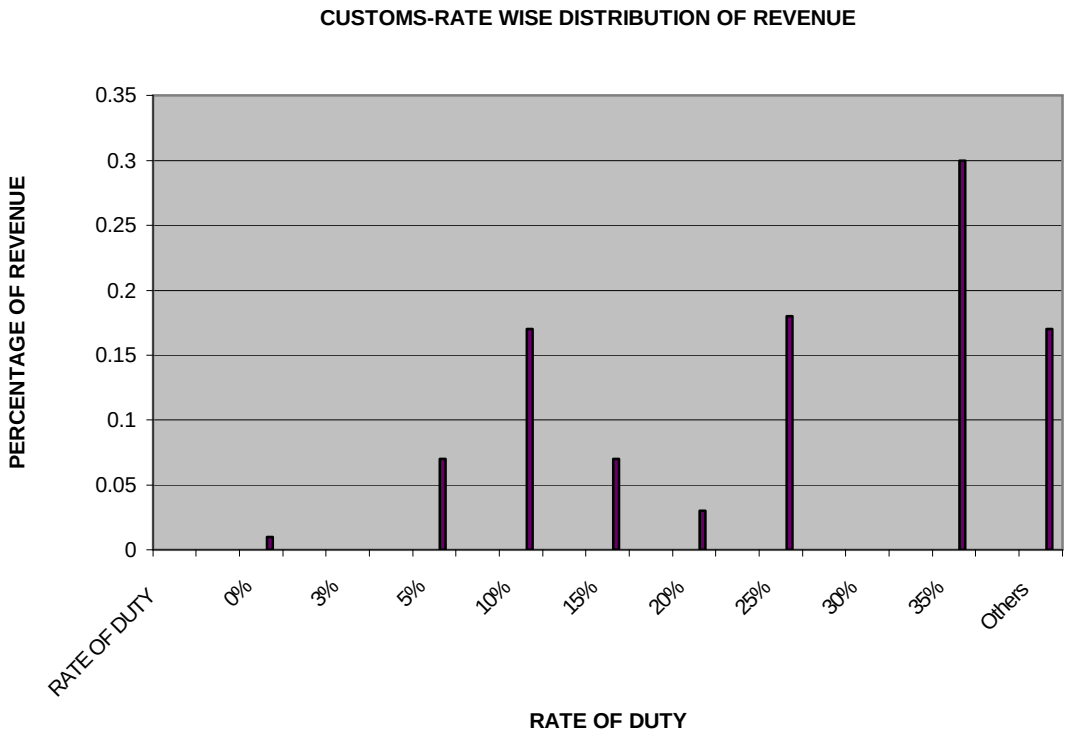
2.2.1 It has been the avowed objective of the Government to reduce the peak rates of customs duty to the ASEAN levels. This is not merely an attempt to follow the other faster growing developing economies but a pragmatic approach to move towards a modern economy producing efficiently according to its dynamic comparative advantage.

To achieve this, India needs a large volume of imports which are necessary for technology upgradation. These imports have largely to be paid for by a high level of exports which require import at world prices. That imports are necessary for exports and the development of an economy is a settled proposition and the answer lies in encouraging imports without quantitative barriers, without licensing, and having moderate tariffs. However, revenue considerations are known to affect the pace of reduction of tariffs in most countries, especially developing countries which are heavily dependent upon indirect tax revenues. But experience of successful trading economies have shown that sheer increase in volume of imports has more than offset the fall in revenues on account of cuts in tariff rates, though there may be a transition period. This has to be balanced by a comprehensive reform of the tax system.

2.2.2 The customs tariff, completely aligned to HSN contains 99 chapters wherein all the goods are classified. Each Chapter contains a number of goods and against each Tariff Heading or Sub-Heading the rate of duty is indicated. As seen, the customs duties has continued to remain most complicated even after several years of reforms since 1991. This can be seen from the rates of duty, which are 20 in number (182, 160, 150, 105, 100, 85, 75, 70, 65, 50, 45, 40, 35, 30, 25, 15, 10, 5, 3, and nil). 30% rate is the median rate i.e. the most common rate. Besides some items are subjected to specific duties. It, however, must be conceded that in general rates of import duties higher than the median rate apply to agricultural products. As most countries adopt higher input duties on agricultural products, the multiplicity of rates because of such compensation need not necessarily be called an aberration.

2.2.3 The difficulties in administering such a large number of rates are evident. Importantly the large number of rates lead to discretion which should be best avoided in taxation. Further, such a large number of duty rates can only contribute to complexities of clearance procedures. Accordingly, it is the view that a modern tax system should be based upon the minimum number of duty rates. In fact, even at present, the major share

of revenue comes from few rates only. Hence, it is necessary to quickly move to the least number of duty rates.



2.2.4 The Task Force had contemplated a 2-tier duty structure to be achieved by 2004-05, 10% for raw materials, inputs and intermediates and 20% for final goods. During discussions with the trade, it was brought out that there are definitional problems as to what constitutes raw materials and what constitutes final goods because the intermediate for one industry may be raw material for another industry. While one section of the trade was of the view that there should be uniform rate of tariff on all imports, the other view, which was equally powerful, was that there should be a differential duty structure so as to give more protection to the domestic industry which is burdened with additional cost on account of various factors not related to tariff, like high sales tax, octroi, higher interest rates and power costs and to compensate for such increases, a duty differential is essential. Some trade associations also pointed out the anomalies in the duty structure such that the final product attracts the same duty as raw materials.

2.2.5 The Task Force feels that while a uniform tariff would be ideal as it removes all distortions and makes the administration simple, there is no denying that certain disadvantages are faced by the industry and, therefore, a 3-tier duty structure may be considered for adoption. Through suitable grouping of the goods, it can be ensured that this does not give rise to any classification disputes. The problem of raw materials, intermediates, etc., can be sorted out by having a lower duty on goods which are used for further manufacture, as distinct from finished goods which are basically meant for consumer consumption without the need for any further processing. Such finished goods can attract the peak rate of duty. Even today, countries like Malaysia and Indonesia charge import duty of 15% to 30% on consumer durables. The Task Force thus recommends a duty of 20% on finished consumer goods. As regards anomalies, the Task Force subscribes to the view that an anomaly arises only when the input tax is more than the tax on the finished product. What is relevant is effective rates of protection and not the nominal rates. Because of the demand of the industry for a large duty differential in the nominal duty rates on these inputs and final products, the Task Force would like to address some of the misconceptions. There is an excellent exposition of the concept of Effective Protection in the paper "Towards a Competitive Economy : VAT and Customs Duty Reform" by Dr. Arvind Virmani. The Task Force with sincere acknowledgement to Dr. Arvind Virmani would like to reproduce the relevant portions of the report:-

"*The protection that directly affects any individual producer is the effective protection rate application to his production operation. Any given producer uses a variety of inputs to produce output. In the process he adds value to the inputs he has bought from others. The process of production is in effect the process of adding value to the inputs, using capital and labour (factors of production). The effective protection that the producer gets on his process of value addition depends on the value added proportion, the average import tariffs/duties on the inputs used and the tariff on the output. A simple formula based on these parameters can be used to calculate the effective protection rate (EPR) based on these three parameters. This can be illustrated through a simple example.*

Consider an internationally competitive producer who produces output using only one input. Assume that the input-output ratio for this item is 0.7%. Then the value added

ratio is 1-0.7=0.3. In other words for every $1 of output produced he has a value added of $0.3. Let the exchange rate of the rupee against the dollar (Rs. per $) be any number, which we can denote as e. Then the value added by this globally competitive producer measured in rupees is equal to Rs.0.3 e.

Now consider an Indian producer of the same item, who has a tariff rate of 20% on his output and 15% on his input. The "landed cost" of his imported input will be equal to Rs.1.2 e while the "landed price" of the imported output which competes with his domestically produced output will be Rs.1.15 e. The amount of margin available to the producer (inclusive of wages to be paid to labour) is the difference between the "landed cost" of the output minus the "landed cost" of the inputs used in producing this output. This value is equal to,

*1.2e-0.7*1.15e=0.395 e*

per unit of output produced by the domestic producers. This is also equal to the value added at domestic prices. The effective protection rate is therefore defined as the difference between this margin and the global value added as a percent of the global value added, that is,

EPR=0.395 e/0.3 e-1=0.316

Thus the effective protection rate for this particular producer is neither 20% (the nominal protection rate) nor 5% (20%-15%) but 31.6%.

The higher the effective protection rate the greater the room for inefficiency. The EPR therefore measures the degree of inefficiency that the domestic producer can have in value addition as a percent of the global efficiency norm of value addition in the production of this item. In the above example the producer can be 40% more inefficient than the globally efficient producer.

The variation of the effective protection rate with different input ratios and input tariffs is illustrated in greater detail in Table 2a and Table 2b. These show the set of cases in which the peak rate of duty is 20% with not even one item having a higher duty.

Part I of table 2a illustrates the case of a producer subject to a tariff rate of 20% on his output, but with tariffs on inputs ranging between 0% and 20%. The average input tariff can therefore lie anywhere between nil and 20%. The first row shows that if all inputs used by the producer have an import duty of 20% then the effective protection rate is also 20% no matter what the proportion of value added. This result also implies that a uniform rate of import duty/tariff of 20% ensures an effective protection of 20% for all. Similarly a single uniform rate of basic customs duty of 10% as proposed by us will ensure that all producers of all goods have an effective protection of 10% (last row of part II of this table).

The other rows of part I illustrate the variation in effective protection rate (EPR) arising from differences in proportion of value added and differences in the average tariff rate on inputs. The effective protection rate is inversely related to the proportion of value added by the producer and the average tariff rate on inputs used by the producer. Thus EPR rises as we move from the northwest corner to Southeast corner of the table. For all goods at the peak rate of duty (20%) the effective protection rate ranges (in the table) from 20% to 400%[1]. Even if the average input duty is only 5% points less than the output duty (i.e. 15%) the effective protection can be higher than 100%(2nd row). A two-tier duty structure with consumer goods at 20% can result in some having an EPR of 200%. Thus with a varying rate of import duty on inputs, the effective protection rate can be quite arbitrary and random

The second important lesson from this table is that the producers who add the least value tend to get the highest protection. This can be illustrated by considering a case in which all raw material and intermediate goods have customs duty rate of 10% while most consumer goods have a customs duty rate of 20%. For this latter set of goods the effective protection increases from 21% if the value added ratio is 0.9% to an EPR of 30% if the value added ratio is 0.5% to 110% if the value added ratio is 0.1(3rd line, part I, table 2a). In other words the higher the use of imported/importable inputs the higher the level of effective protection.

In contrast to part I, where the produced item was subject to the peak duty of

[1] In general it can even be higher

20%, in part II the item has an output duty of 10%. Thus the average input duty can be higher than the output duty. This can give rise to the problem of negative protection, i.e. instead of protecting the product, the structure ends up penalizing and discouraging the domestic production of some group of commodities. Part II of table 2a shows that negative protection arises when the value added proportion is low and the average input duty is higher relative to the output duty (north east corner of the table). For instance negative protection is seen to arise when the value added proportion is less than 0.5(50%) and the average input duty is 20%(1st row, part II).

The table also shows that negative protection can arise even if the average input duty is even 1% point higher (11%) than the output duty (3rd row of part II). Thus any effort to offer higher effective protection to favoured commodities can result in negative protection to those not so favoured.

Part III of Table 2a shows the effective protection that results from tariff exemptions (i.e. zero tariff). In this case there is negative effective protection if there is even one input that has a positive import tariff. This is irrespective of the degree of value addition in this situation.

There is only one normal situation in which exemption does not create negative protection. That is an exemption, which is available for inputs used for export production. In this case as the product is competing in the international market its output tariff is implicitly zero, while all exempted items are going into its production only. Thus effective protection is also zero in this case.

Table 2b shows the range of effective protection rates that can arise if the peak rate is 20% and there are only three import tariff rates (10%, 15% and 20%) and no exemptions. The weighted average tariff on inputs can lie anywhere between 10% and 20% (e.g. 11% or 18%). Items with a tariff rate of 10% are likely to have negative protection if the value added ratio is less than 0.5. Similarly items with a tariff rate of 15% are likely to be vulnerable to negative protection if the value added proportion is less than 0.25. At the same time effective protection can range as high as 100% (or higher). Items with a tariff rate of 20% and input rates of 10% may have even higher effective protection rates of the order of 200%.

Table 2(a): EFFECTIVE PROTECTION RATE [EPR] : Variation with value added & Input tariff

			Value Added					
Average	0.9	0.7	0.5	0.4	0.3	0.2	0.1	0.05
Input			Input ratio					
Tariff duty	0.1	0.3	0.5	0.6	0.7	0.8	0.9	0.95
I	Output Tariff =	20%						
20%	20%	20%	20%	20%	20%	20%	20%	20%
15%	21%	22%	25%	28	32%	40%	65%	115%
10%	21%	24%	30%	35%	43%	60%	110%	210%
5%	22%	26%	35%	43%	55%	80%	155%	305%
0%	22%	29%	40%	50%	67%	100%	200%	400%
II	Output Tariff =	10%				Negative Protection		
20%	9%	6%	0%	-5%	-13%	-30%	-80%	-180%
15%	9%	8%	5%	3%	-2%	-10%	-35%	-85%
11%	10%	10%	9%	9%	8%	6%	1%	-9%
10%	10%	10%	10%	10%	10%	10%	10%	10%
III	Exemption: Output Tariff =	0%				Negative Protection		
10%	-1%	-4%	-10%	-15%	-23%	-40%	-90%	-190%
5%	-1%	-2%	-5%	-8%	-12%	-20%	-45%	-95%
1%	-0.10%	-0.4%	-1%	-2%	-2%	-4%	-9%	-19%

Table 2(b): Three Rate Structure (10%, 15% & 20%) : Effective Protection Rates

	Items with Tariff = 10%					Negative Protection		
20%	9%	6%	0%	-5%	-13%	-30%	-80%	-180%
18%	9%	7%	3%	-1%	-7%	-20%	-58%	-133%
15%	9%	8%	5%	3%	-2%	-10%	-35%	-85%
11%	10%	10%	10%	9%	9%	8%	6%	1%
10%	10%	10%	10%	10%	10%	10%	10%	10%
	Items with Tariff = 15%							
20%	14%	13%	10%	8%	3%	-5%	-30%	-80%
18%	15%	14%	13%	11%	9%	5%	-8%	-32%
15%	15%	15%	15%	15%	15%	15%	15%	15%
11%	16%	17%	20%	22%	26%	33%	56%	101%
10%	16%	17%	20%	23%	27%	35%	60%	110%
	Items with Tariff = 20%							
20%	20%	20%	20%	20%	20%	20%	20%	20%
18%	20%	21%	23%	24%	26%	30%	43%	68%
15%	21%	22%	25%	28%	32%	40%	65%	115%
11%	21%	24%	30%	34%	42%	58%	106%	201%
10%	21%	24%	30%	35%	43%	60%	110%	210%

Note : It is assumed that there are no exemptions."

2.2.6 With this background we can start addressing the issue of the desirable structure of tariff rates. While the Task Force is in agreement with the need for simplifying the tariff by reducing multiplicity of rates, the need for giving some protection beyond the nominal rates also cannot be completely ignored. The Task Force is aware that imported goods are not subjected to all the domestic taxes which domestic goods are subject to. But this can be taken care of with the introduction of VAT, which is supposed to more or less reflect the various taxes currently being imposed. Further, it is the view that basic raw materials should attract the lowest rate and the highest rate should be made applicable to the finished consumable goods. Finally, it is also of the view that we need to eventually come down to rates of 10% and below, which is the trend in the ASEAN States, to make our economy competitive. We must have rates comparable to ASEAN States by 2006-07. However, as mentioned earlier, even in countries like Malaysia and Indonesia, consumer durables attract duty at more than 10%.

2.2.7 As regards automobiles, the Task Force notes that since the quantitative restrictions were removed only last year, the manufacturers will need more time to adjust to reduction of the import duty rates. Even in countries like China, customs duty on new vehicles vary from 70% to 80%. In Indonesia, it varies between 75% to 200% and in Malaysia, the rates vary from 70% to 105%. Present rates of duty on automobiles thus do not require any substantial change for the present. Today, a duty higher than the median rate applies to defective steel plates mainly to check imports of prime material in the guise of seconds. A higher rate on such materials is thus justified.

2.2.8 The Task Force also notes that in respect of goods covered under the IT Agreement, the rates of import duty on a number of items including computers and cellular phones will have to come down to zero. It is, therefore, essential that domestic industry in this sector is able to get raw materials also at zero rate in such eventualities. The capital goods for this sector also need to be given special consideration in order to help this industry to successfully compete with imports. In particular the cellular phones industry has been prone to smuggling and Government had reduced the customs duty to 10% with zero CVD duty in this year's budget. Under the IT Agreement, the import duty

will have to come down to zero. Therefore steps are necessary to give encouragement to the domestic industry to manufacture cellular phones in the country

2.2.9 In the discussions with the trade, there was a very strong plea for reducing the import duty on crude petroleum and naphtha to zero, which is the rate presently prevailing in the ASEAN countries. These are basic raw materials for petrochemical industry, and the trade has prayed for immediate reduction. The Task Force finds considerable merit in this suggestion. With the dismantling of the Administered Price Mechanism, it is essential to allow the prices of the petroleum products in the domestic market to be determined on the basis of import parity price. To protect consumers, the import duty has to be brought down from the present levels. At the same time, as crude is the basic raw material for other petroleum and chemical products there has to be a duty differential. In this regard, it is observed that the international practice is that the differential is around 2 percentage points with the value addition normally around 10-15%. Accordingly, taking into account all factors including profit margin of refineries, the value addition and need to keep the product prices reasonable for the consumers, the road map for duty structure on petroleum has to be kept distinct from that of other products. The Task Force also recognizes that the effective rate of protection in refining sector is much higher than the nominal protection, as the value addition is only about 10%. As seen from the chart for effective protection, with an output tariff of 20% and input tariff of 10%, with a value addition of 10%, the effective rate of protection is as high at 110%. If along with the reduction of duty on crude to 5%, the duty on the petroleum product is brought down from 20% to 10% this will still give a 55% effective rate of protection. Revenue loss on account of reduction of import duty in the petroleum sector may be made up through suitable increase in excise duty on petroleum products, namely, diesel and petrol. The Task Force, however, feels that duty reduction on crude petroleum should be in phases.

2.2.10. The above analysis is mainly for industrial goods. The Task Force is of the view that agricultural goods stand on a different footing where various other factors like subsidy, market intervention measures, minimum support prices make it necessary to look into each item individually. The Task Force is not equipped to take on this function and recommends that a separate group with the requisite expertise may be set up to look into the duty structure for such products. The Task Force thus has not given any

recommendation with regard to the road map for import duty structure on agricultural products, etc. At the same time, the Task Force also recommends that such duty should not exceed 150%.

2.2.11 In the aforestated background the following recommendations are made :

(i) O% - for items like life-saving drugs and equipments, sovereign imports (defence and security related goods etc.) and imports by RBI.

(ii) For other goods -

By 2004-05 :-

- **10% for raw materials, inputs and intermediate goods.**
- **20% for consumer durables.**

By 2006-07 :-

- **5% for basic raw materials like coal, ores and concentrates, xylenes, etc.**
- **8% for intermediate goods which will be used for future manufacture (capital goods, basic chemicals, metals etc.).**
- **10% for finished goods other than consumer durables**
- **20% for consumer durables.**

[The duty reduction to the level of 5%-8%-10% should start only after introduction of State VAT so that imported goods are also made subject to the same State VAT (in lieu of SAD) by way of Additional Duty of Customs.]

(iii) Motor vehicles - nominal reduction in the duty from 60% to 50%. The import duty on second hand cars may continue at the existing rates. Higher import duty on defective steel items may continue.

(iv) Cellular phones - the exemption from CVD may be withdrawn but the basic import duty may be reduced to zero in 2003-04. The SAD on this item should also be abolished, so that the total incidence of duty goes up only marginally.

(v) 2003-04 : - 8% on crude oil.

- 15% on the petroleum products.

2004-05 : - 5% on crude oil.

- 10% on the petroleum products.

(vi) Higher duty rate upto 150% for specified agriculture products and demerit goods.

2.2.12 A word of caution is warranted in the move to the suggested rates of duty. In the event, if the import duty on a particular item is currently high, say, 30% and it has to move to 10% then certainly a sudden reduction to 10% in just 1 year would upset the domestic industry and it would also not be desirable from the point of view of revenue. Thus, certain high rate-high revenue items may require a more gradual move towards 10%. **Hence, it is recommended that as a general policy, the downward revision of duty rates should be in stages of (–) 5% each year.** However, it is quite possible that Government chooses to move to the identified lower rate at a faster pace particularly in areas where domestic manufacture is not adequate and imports are necessary. All endeavour should be made to move to the identified rates of duty, as above by 2004-05. **Further, having regard to our commitment to reform, it is recommended that to the extent possible, for no item should the present duty rate be increased, unless the item is charged to nil duty, in which case a minimum duty of 5% can be imposed. Some increases may be resorted to only on administrative consideration to avoid multiple rates depending upon end use.**

2.3 Customs duty exemptions

2.3.1 Whereas the customs tariff indicates the peak rate of duty, also called the tariff rate of duty applicable on a particular item, it is not the case that this is the duty actually leviable when the said item is imported. The leviable duty also called the effective duty is determined in the context of the duty exemption notifications, if any, issued in respect of the said item in terms of Section 25 of the Customs Act, 1962. Thus, on account of an exemption an imported item may be subjected to a duty lower than that prescribed in the tariff. At times, the duty payable may even be nil. The exemptions are mainly of three types as follows :

(i) General exemptions which are non-conditional and can be availed by all importers.

(ii) General exemptions which are subjected to conditions such as end-use.

(iii) Ad-hoc exemptions, which are issued in respect of specific imports for security, strategic or charitable purposes - the number of ad-hoc duty exemptions are coming down, no doubt, due to the effect of the legislative change, in 1999, restricting the scope of the exemptions to imports of strategic, secret interest or for charitable purposes.

2.3.2 At present, the said exemptions can broadly be placed into the following categories:

(i) Importer specific – e.g., Government (defence and police) etc.

(ii) Project and purpose specific – e.g. training, educational, research, Oil exploration etc.

(iii) Social and health sector/objective specific – e.g. handicapped persons, charitable and social welfare organizations, donations and gifts, medicines, drugs and hospital equipments etc.

(iv) Export related – e.g. samples, packaging materials, durable containers, advance licence, passbook etc.

(v) Sports related – e.g. sports goods, prizes, medals and trophies.

(vi) International commitments – There are a number of international agreements that bind customs duties. These include the GATT/WTO bound rates, contractual commitments such as oil exploration contracts, Information Technology Agreements, exemption to privileged persons, organizations, authorities and foreigners, preferential areas etc.

(vii) Others – e.g. exhibitions, seminars, or expeditions, re-imports.

2.3.3 A duty exemption naturally has revenue implication. On their part conditional exemptions also invariably necessitate imposition of regime of certification, verification, discretion, etc., which adversely impact the clearance of goods, result in higher administrative costs, use of discretionary powers, and raise compliance issues on account of misuse. Exemptions are also nothing but a subsidy, and in fact, a discretionary subsidy. Thus, aside from the obvious impact on the tax to GDP ratio, the duty exemptions have undesirable side effects. The fact that exemptions also cause loss of transparency is another aspect of serious concern for the policy makers.

2.4 End-use based exemption

2.4.1 At present, there are a large number of exemptions subject to the condition of end-use, which is sought to be confirmed by the requirement of production of a certificate from a competent authority, usually a Government Officer, that the imported goods are meant for the declared use. To illustrate, in case of sports goods the certification would be done by Sport Authority of India and in the case of IT products by the Information Technology Ministry. There are around 33 such certification agencies. There can be no two views that involvement of multiple agencies would only increase the transaction cost besides contributing to delays in customs clearance.

2.4.2 Besides the problems associated with certification, the end use based notifications require the customs to ensure the goods are indeed meant for the stated use. This is invariably accomplished by calling for literature of the imported item. As a result queries are raised and till the literature is produced and perused the goods cannot be released. Thus, the end use based exemption notifications do not facilitate quick customs clearance and also militate against on-line appraisal and clearance of imported goods. Therefore, as the intention is to expedite the clearance of the goods and that too without examination, to the extent possible, the solution lies in removing all the end use-based exemptions, which necessitates the calling of literature and certificates from different departments.

2.4.3 On the subject, it is increasingly been noticed that there is a move towards removing the requirement of execution of bonds with the customs authorities for the fulfillment of post import conditions. This is a welcome step as it reduces delays in clearances and also transaction costs. However, it is not the case that the bonds are being removed altogether. What is being provided is that such importers must follow the provisions of Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996. Invariably this entails the importer to obtain registration with the central excise authorities, followed by execution of bond, filing application for import of goods, maintaining records for verification, obtaining case by case permissions for import etc. Hence, the new procedure is merely a substitute for the system of end-use bonds as instead of the execution of the bonds with the customs authorities the importer registers with the central excise authorities and must satisfy this authority that the goods have been used for the intended purpose.

2.4.4 It is the view that the present procedure is not desirable. Such procedure only increases the contact points and the cost of compliance. On principle it should suffice that customs clear the goods on the basis of the importer's declaration and if misuse is detected on the basis of intelligence or post clearance audit checks, the duty should be recovered along with interest.

2.4.5 As a policy end-use based exemptions must be avoided. However, when this is not possible the customs clearance procedure must provide for the grant of the exemption without insistence upon literature and certification and the customs would

reserve the right to carry out a post clearance audit check based upon risk management tools i.e. not as a matter of routine. This is also in line with the best international practices.

2.4.6 To sum up, criticizing all duty exemptions would be a simplistic approach. Exemptions do serve a number of objectives by ensuring that the imported goods are not only available but also at less cost. Exemptions also serve to stimulate domestic economic activity by making available a level playing field. However, it is also true that exemptions once granted tend to continue even if the objective has since been met and even if alternative and more transparent mechanism is available for achieving the desired objective. Exemptions tend to distort the opportunity cost and in the long run adversely impact competitiveness. Invariably the exemptions are conditional and also impact the pace of clearance on account of necessity of verification process. Overall falling tariffs and India's commitment to bringing down the customs rates of duties to international standards by 2004-05 must also influence the decision whether a particular exemption merits continuance or not.

2.4.7 It is recommended that the grant or continuance of exemptions must be judged against the following criterion and if this done it would widen the tax base, improve the tax to GDP ratio and improve the tax administration:

(i) As a policy, all exemptions must be removed except in case of :

(a) Life-saving goods.

(b) Goods of security and strategic interest.

(c) Goods for relief and charitable purposes.

(d) International obligations including contracts.

(ii) As a general policy, when exemptions are removed but the relief is justified, the targeted beneficiary may be assisted by upfront transparent budgetary support based on a prior stated objective criteria. By such method, the expenditure would be subject to

Parliamentary scrutiny and there would be public debate besides CAG audit.

(iii) In case an exemption is justified, it should not be end-use based conditional exemption. However, in the event the end-use condition cannot be avoided, the confirmation of end-use should be done on the basis of selective post clearance checks by using Risk Assessment techniques. It should not be based upon the Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996, as the implication in terms of registration with central excise, execution of bond etc. increases contact points and the cost of compliance.

(iv) As a general policy, there should be no exemption from Countervailing duty (CVD), which is at par with the duty paid by the domestic manufacturers of similar goods, including in cases where the exemption from basic customs duty is merited. An exemption from CVD places domestic industry (including potential industry) at disadvantage and discourages domestic investment in these areas, which is not desirable.

(v) Best international practices should be one criteria for determining the requirement of otherwise of an exemption.

2.5 Nature of tax rates - specific versus ad-valorem

2.5.1 A perusal of the Customs tariff shows that for a few items there are specific rates of duty. While the administrative convenience of specific rate is not debatable, these are out of place in an economy seeking to maximize its revenue through buoyancy. A modern tax system should not have specific rates at all. Specific rates also do not allow for buoyancy in revenue on account of price changes. **Accordingly, as a policy there**

should be a move away from specific rates towards ad-valorem rates. These findings would also apply to the central excise notifications, to the extent relevant. Textile fabrics are, however, particularly, sensitive to valuation, and after protracted negotiations, a regime of ad-valorem and specific duty, whichever is higher has been introduced. This should continue keeping in view the importance of this sector.

2.6 In the light of the above recommendations, the suggested customs duty structure on imports is given in Annexure 'A'. Since agricultural products stand on a different footing, the Task Force has refrained from suggesting the proposed rates for these items and recommends an Expert Group may be set up for the same. The Annexure has attempted to cover all goods but in the event certain items may have been left out inadvertently, the duty rates on such items may be fixed in the light of the principles laid down earlier.

3. Central Excise Tariff and Exemptions

3.1 Multiplicity of levies

3.1.1 At present there are more than one type of levy administered by the central excise department other than the Cenvat (Central Value Added tax) duty. These other duties include :

(i) Special Duty of Excise (SED) - levied under authority of Finance Act(s).

(ii) Additional Duty of Excise (AED) – levied under authority of Additional Duty of Excise (Goods of Special Importance Act, 1957) on specified goods, sugar, fabrics and tobacco products. This duty is in lieu of sales tax.

(iii) Additional Duty of Excise (AED) – levied under authority of Additional Duty of Excise (Textile & Textile Articles) Act, 1978 on specified fibres, yarn and fabrics.

(iv) Additional duty on Motor Spirit and High Speed Diesel – levied under authority of Finance Acts.

(v) National Calamity Contingent Duty - levied under authority of Finance Act.

(vi) Cess – levied under various enactments such as Jute Cess Act, Tea Cess Act, etc.

3.1.2 It is well known that multiplicity of levies does not contribute to ease of administration. Invariably separate accounts are to be maintained by the tax payer and the tax collector, which pushes up the cost of compliance. Further, the complexities caused by multiple levies also give rise to errors and disputes. In fact, in cases when an item is subject to more than one levy we often have audit pointing out that one or the other levy was not paid. Even conceptually it is not at all clear why we should continue to have the AEDs, which are basically imposed in lieu of sales tax, for those items which would be subjected to VAT, though there may be a case for continuing with it in respect of some items. In general terms so long as this levy continues it would be difficult to move to VAT. Accordingly, in order to have a simple administration which has as its advantage reduced complexities and compliance costs, it is desirable that as a policy there should not be multiple levies.

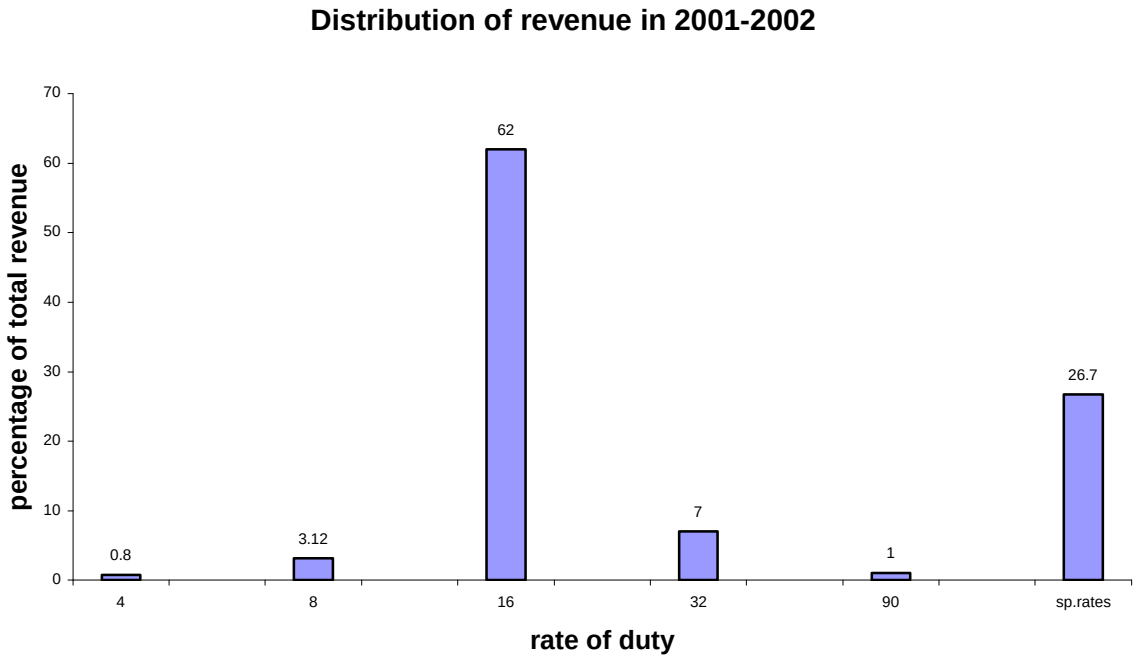
3.1.3 It is recommended that as a policy, we should review all levies and have only one levy, i.e. the Cenvat. Some exception, however, has been suggested for the textile and petroleum sector.

3.1.4 An alternative scenario is proposed if for some reason it is not found possible to remove multiple levies at one go. At present, both the tax payer and his counterpart, the tax collector indicate the tax paid under each of the levies separately and subject the same to calculations to confirm the correctness of the payment. This system is not conducive to efficient implementation and given the large number of transactions, mistakes can not be ruled out. It appears that so long as the total tax is correctly paid, the tax payer should not be bothered with the task of giving the break up. This is a job strictly for the administrators who have to later divide the tax proceed under various accounting heads. Accordingly, it should be provided that when a product attracts multiple levies only the total levy (i.e. one figure only) should be indicated against the particular item. This amount would be paid and the system should further break it up into the individual heads. This would save the tax payer and the tax administrator the exercise of carrying out all sorts of complex calculations. Of course, one problem in this

system would be that at present, under the Cenvat Credit Rules, the credit of a particular duty can be used to pay the same duty on the final goods. Thus, the tax payer must know the element of each duty for this purpose. This can be done by indicating the break up of the total duty (in percentage terms) into its respective heads – in like manner of the Drawback Schedule. In fact, it is learnt that earlier a 'working schedule' was being prepared for similar purpose. As stated, however, the ideal solution is to have a single levy.

3.1.5 It is recommended that till such time as there are multiple levies, there should be a working schedule indicating the total tax payable on a particular product and the system should internally segregate the same into the respective levies.

3.2 Multiplicity of duty rates



3.2.1 In so far as the multiplicity of rates on the central excise side are concerned, it is appreciated that recently steps have been taken in the general direction to reduce the multiplicity. For instance, the number of duty rates has been reduced substantially, from 11 rates in 1997-98 to a single rate of 16% at present, except in few cases. Whereas a single rate has many advantages domestic economic considerations do not always

permit so. However, it is certainly true that the endeavour should be to have as few number of rates of duty as is possible.

3.2.2 The question of having a single rate of duty for all goods except tobacco products was debated at length. In this regard the VAT structure of a number of developed countries has been examined. The finding is that multiplicity of rates persists in VAT also – with one medium rate for most items, a higher rate for luxuries and a reduced rate for food products. All these countries also levy excise duty on mineral oils, tobacco products and alcohol, which is in addition to the VAT. Besides, they also have exemption for small traders. The VAT structure for some of these countries are as under:-

Belgium

Super reduced rate - 1% (for gold)

Reduced rate - 6% (certain food stuff, agricultural services and pharmaceutical products)

Parking rate - 12% (on certain services)

Standard rate – 21%.

Germany

Reduced rate – 7% (for food, printed matter, health services and public transport)

Standard rate – 16%

France

Minimum rate – 2.1% (medicinal products and newspapers)

Reduced rate – 5.5.% (particularly for agricultural products and most food stuffs)

Standard rate – 20.6%

Ireland

Lowest rate - 0% (books, food stuff, clothing for children).

Minimum rate - 3.6% (supply of live stock)

Reduced rate - 12.5% (energy and certain services)

Standard rate - 21%

Netherlands

Reduced rate - 6% (goods and services which can in general be regarded as necessities).

Standard rate – 17.5%

U.K.

Lowest rate - 0% (food items, passenger transport, children clothing, newspapers).

Reduced rate - 5% (domestic and charity, fuel and power).

Standard rate -17.5%

Basically in all the countries, a large number of products which are considered as necessities are exempt from VAT.

3.2.3 Having regard to the international practices and considering the spread of duty rates in our country presently vary from 0 to 32%, it is the view that there is no great merit in having a single rate of Cenvat on all goods and a 3-tier duty structure with the lowest for food and necessities and highest for luxuries and a standard rate for all other goods may be adopted. If the items are carefully grouped it should not create any problems of classification. Additional taxes by way of surcharge or a SED may be levied on petroleum and tobacco products. In the meetings with various Chambers of trade and industry the common refrain was that any reduction, simplification or alignment of the rates should be resorted to at the earliest and not phased over 3 to 4 years. The Task Force finds considerable merit in these suggestions.

3.2.4 It is also noted that exemption of excise duty in fact acts adversely against the domestic manufacturers because of the taxes paid on the inputs. Therefore, even if the final product is exempt, it bears an effective duty incidence which may work out to 5 to 6% or even more because of the input taxes. This makes imports relatively cheaper. To remedy the situation, the exemptions need to be removed. This will ensure that the protection of the domestic manufacturers vis-à-vis imports is increased, while broadening the tax base. This will ensure that exports can be easily stripped of all taxes and protection of domestic manufacturers will increase without any significant increase in their present liability since credit can be taken of all input duties Some exemptions will, however, continue on other rational considerations.

3.2.5 During interactions with the trade, there was a common refrain that the cumulative domestic taxes (central and state) are very high, and there is a need to bring down the duty rates. The example, of China was cited where the total incidence is reportedly 17%. The Task Force is of the view that there is a need to bring down the Cenvat rate. While it may not be possible to bring down the total incidence to 17% (as State levies are also involved, and tax to GDP ratio also needs to be raised), a Cenvat of 14% would ensure that total incidence is around 20%. A Cenvat of 14% at wholesale level would translate to about 8-10% of the retail price to consumers (we are not concerned with industrial raw material as the manufacturers will get the tax credit) depending upon the commodity, and this coupled with the State VAT (which is expected to be around 10-12%) would bring down the total duty incidences in the range of 20%. This will compare favourably with the VAT rate of 21% in Belgium, 20.6% in France, and 21% in Ireland as well as with the Asian economies. The Task Force thus recommends that the median Cenvat rate showed be brought down from 16% to 14%.

3.2.6 **In the aforestated background, the following recommendations are made for the central excise duty structure:**

(i) **0% - for life-saving drugs and equipments, security items, food items, necessities and the like, agricultural products.**

(ii) **6% - for processed food products and matches.**

(iii) **14% - standard rate for all items not mentioned against other rates.**

(iv) **20% - for motor vehicles, airconditioners and aerated water.**

(v) **Separate rates for tobacco products and their substitutes (like Pan Masala).**

(vi) **The specific rate of excise duty of Re.1 per kilo on bulk tea today translates to about 1% in ad-valorem terms. Raising it to 6% may not be desirable, more so when coffee is already exempt from**

excise duty. Thus, bulk tea may also be exempted from duty. This is anyway a plantation product.

(vii) Specific duty on cement may continue as most of the clearances are to the depots where the prices vary from day to day and ad valorem levy would necessitate provisional assessments, and may result in uncertainty.

3.2.7 Accordingly, **it is recommended that the road map of duty rates should lead towards the identified duty rate (for the product) through a mechanism of (+) 2% or (+) 6% or (+) 8%, as the case may be or (-) 4% each year, depending upon its current rate of duty.** To illustrate :

Duty rate at 0% or Nil

Year 0 (2003-04) - from 0 % to 6% (with Cenvat)

Year 1(2004-05)– from 6% (with Cenvat) to 14% (with Cenvat)

Duty rate at 4%

Year 0 (2003-04) - from 4% (without Cenvat) to 6% (with Cenvat)

Year 1(2004-05)– from 6% (with Cenvat) to 14% (with Cenvat)

Duty rate at 32% (except Pan Masala)

Year 0 (2003-04) - from 32 % to 28%

Year 1 (2004-05) – from 28% to 24%

Year 2 (2005-06) – from 24% to 20% (20% will be the parking rate for motor vehicles, air conditioners and aerated waters).

Year 3 (2006-07) – from 20% to 14% (except for motor vehicles, air conditioners, and aerated waters).

3.2.8 The above mentioned approach to the identified duty rates may be taken as the general rule. However, **it is recommended that Government may move down to the long term rates even quicker, in case there is adequate revenue buoyancy from other tax proposals such as taxes on services sector.**

4. Central Excise duty structure for Petroleum sector

4.1 Petroleum occupies a very important place in the economy in view of its direct and indirect use in practically every sphere of economic activity but also in terms of its direct impact on the revenues of the Government as it is the single largest source of revenue. At present central excise duty rates on petroleum products vary from 14% to 30% - 14% for HSD and 30% for petrol – with 16% being the rate for other petroleum products. Petrol and HSD also attract cess/ surcharge. After the dismantling of the APM, the oil companies now decide on the prices periodically taking into account the behavior of the international oil market. Obviously, therefore, as and when the prices fluctuate, it is expected that the domestic prices would also be fixed accordingly and in fact this is happening. Such periodical revisions in the prices make administration of ad-valorem levy difficult. Replacing ad-valorem levy by specific duties would ensure certainty in the duty, which the refineries would have to pay. This would facilitate assessment and would also be administratively convenient. The need for ascertaining the market cost, inland freight, margin, etc. would also be obviated. In fact, apart from the Cenvat, these products are already subjected to cesses/surcharge, which are specific, and, therefore, it will be convenient if the Cenvat component which is ad-valorem is also converted into specific rates.

4.2 Another important issue relating to levy of central excise duty on petroleum products is that of warehousing. Normally, whenever excisable goods are cleared from the factory, excise duty is to be paid. But an exception has been made in the case of petroleum products. Petroleum products can be removed from the factory of production to a warehouse or from one warehouse to another warehouse without payment of duty. This facility has given rise to certain administrative problems particularly with respect to treatment of transit losses. The verification of re-warehousing of non-duty paid petroleum products is time consuming and involves physical verification and substantial scriptory work. With the proposal for introduction of monthly payment of duty, the proposed

privatization of this sector and the introduction of specific duty rates, the present facilities for movement of petroleum products without payment of duty would seem to be anachronistic and there is no reason why petroleum products should not be treated at par with other goods. This would also obviate the problems of transit losses, which today result in disputes.

4.3 It has also been brought to the notice of the Task Force that the present duty exemption on kerosene encourages adulteration of petrol and diesel, which attract higher excise taxes. Similarly LDO (Light Diesel Oil) has also a potential to substitute diesel in certain operations. Therefore, a remedy lies in reducing the duty price differentials between the various products, which would disincentives adulteration.

4.4 In the light of the above discussion, the following recommendation is made in respect of the duty structure of the Petroleum sector :

(iv) Central excise duty on petroleum products, particularly HSD and motor spirit, may be fixed at specific rates. But keeping in view the importance of the petroleum sector to the revenue, there should be a quarterly review of the specific duties by joint discussions between the Department of Revenue and Ministry of Petroleum so that the duty rates can be adjusted to take account of fluctuation of prices in the prevailing quarter.

(v) Central excise duty on kerosene may be raised by Rs.1/litre. An additional duty of Rs.1/litre may be imposed on LDO to make the duty at par with diesel.

(vi) Warehousing facility for petroleum products should be withdrawn.

5. Central Excise duty structure for Textile sector

5.1 The Task Force has paid special attention to the duty structure on textiles in view of its importance in the economy and also the complexity in the form of series of

exemptions because of attempts to reconcile the various sectoral conflicts. There are broadly the following stages of production in the Textile sector :

- Fibres – natural (like cotton), artificial (like viscose), synthetic (like polyester)
- Yarn spun from the fibres and also filament yarn (artificial and synthetic)
- Knitted and woven fabrics (unprocessed)
- Processed fabrics
- Readymade garments

5.2 Textile and textile products attract duty in terms of the Additional Duties of Excise (Goods of Special Importance) Act, 1957 [AED (ST)] and Additional Duties of Excise (Textiles & Textile Articles) Act, 1978 [AED (TTA)]. While AED (ST) is leviable @ 4% ad valorem on fabrics, AED (TTA) is leviable on fibres and yarns @ 15% of Cenvat.

5.3 In so far as the fibres and yarns are concerned the duty structure and exemptions are as follows :

(i) All fibres and yarns attract Cenvat of 16% ad valorem, except for cotton yarn (not containing synthetic staple fibres or filament yarns) which attracts Cenvat of 8% (with Cenvat credit) and polyester filament yarn which attracts 32% ad valorem [16% Cenvat + 16% SED] respectively.

(ii) There is a plethora of exemptions on fibres and yarns and broadly, the exemptions apply to the following items:

(a) Carded wool (lefa) for making hand spun yarn of upto 10 counts;

(b) Woolen yarn of upto 10 counts in plain (straight) reel hank form for manufacturing carpets;

(c) Yarns purchased by registered handloom co-operative societies (NHDC & State Government HDC) for use only on handlooms;

(d) Yarn of polyester staple fibres containing cotton and consumed by KVIC for manufacturing Poly Vastra;

(e) Yarn subjected to multiple (folding), cabling or air-mingling manufactured in a factory which does not have facility for producing single yarn;

(f) Dyeing/printing/bleaching/mercerising of cotton /woolen (not containing man-made staple fibres) yarns;

(g) Yarns subjected to beaming, warping, wrapping, winding, reeling; and

(h) Twisting of filament yarns.

(iii) Silk and silk products are exempt from excise duty. Blended silk yarn (containing less than 85% silk), however, attracts 16% adv. [it is exempt from AED (TTA)].

(iv) Following yarns attract specific duty :

(a) Dyeing/printing/bleaching/mercerizing of spun yarns (Chapters 51, 52, 55)-Rs. 2.50 per kg Cenvat + AED (TTA).

(b) Dyeing/printing/bleaching/mercerizing of filament yarns (Chapter 54)-Rs. 9 per kg Cenvat + AED (TTA).

(c) Textured yarn (including draw twisted & draw wound yarn) of polyesters manufactured by an independent texturiser-Rs. 2.50 per kg Cenvat + AED (TTA).

(v) Specific rates have been worked out so that duty is leviable on the value addition; as such yarn processors may find it difficult to take credit of input taxes as they work mostly on job work basis on behalf of traders.

(vi) Fibres and yarns are generally not covered under the SSI duty exemption scheme except for woolen and shoddy yarn.

5.4 The duty structure and exemptions in respect of Fabrics are as follows :

(i) Fabrics (Chapters 51, 52, 54, 55, 58, 60 & certain fabrics of Chapter 59) attract an 'aggregate' duty of 12% ad valorem [8% CENVAT + 4% AED (ST)]. Fabrics of flax, ramie and other vegetable textile fibres (Chapter 53) attract effective excise of 12% adv. [no AED (ST)].

(ii) Unprocessed (grey) fabrics attract optional 'aggregate' duty of 12% ad valorem. However, once a manufacturer of grey fabrics opts to pay duty, he has to do in respect of all clearances till he opts not to pay duty.

(iii) Textile fabrics generally are not covered under the SSI exemption scheme.

(iv) Following grey fabrics attract compulsory excise duty of 12% ad valorem :

(a) Woven pile & chenille fabrics of cotton & man-made fibres;

(b) Terry toweling & similar woven terry fabrics of cotton & man-made fibres;

(c) Gauze; and

(d) Knitted/crocheted fabrics of a width not exceeding 30 cm and containing elastomeric yarn.

[The general SSI exemption has been extended to these fabrics.]

(v) Grey and processed knitted/crocheted fabrics of cotton attract optional 'aggregate' duty of 12% ad valorem.

(vi) Processed knitted/crocheted fabrics of man-made fibres attract 'aggregate' duty of 12% ad valorem.

(vii) Grey knitted/crocheted fabrics of man-made fibres attract optional levy.

(viii) Broadly, following fabrics are exempt from duty :

(a) Khadi (hand spun yarn woven on handlooms) & Poly Vastra (hand spun yarn, containing cotton & polyester, woven on handlooms):

(b) Fabrics woven on handlooms and processed by a factory owned by Apex/registered Handloom Co-operative Society, State Govt. HDC, KVIC, etc.,:

(c) Fabrics processed without the aid of power. However, woven fabrics of wool/cotton/man-made fibres, even if subjected to specified processes with the aid of power in a factory, are exempt from Cenvat, provided that the factory does not have the facilities of carrying out bleaching/dyeing/printing with the aid of power ("hand processing" sector);

(d) Fabrics woven on handlooms and processed without the aid of power/steam;

(e) Cotton fabrics processed without the aid of power/steam;

(f) Narrow woven fabrics of cotton and man-made fibres;

(g) Fabrics of cotton/man-made fibres woven in prisons and processed outside;

(h) Pleated/embossed fabrics and fabrics subjected to dew drop process; and

(i) Indian National Flag.

(ix) While in the case of excisable goods, input tax credit is allowed only on the basis of documents evidencing duty payment, in the case of textiles, a special dispensation has been given by way of “Deemed Credit” whereby the users can take credit on a deemed basis without production of duty paying documents. The salient features of the scheme are, as follows :

(a) Independent textile processors manufacturing cotton and man-made fabrics are eligible for deemed credit @ 33 1/3 % and 66 2/3 % respectively of aggregate duty leviable on such fabrics;

(b) Deemed credit and actual Cenvat credit can not be availed simultaneously on the same consignment of grey fabrics;

(c) Composite mills can avail of deemed credit when they manufacture processed fabrics from grey fabrics not woven in the said composite mill (job work). The rates are 26% and 60% of the aggregate duty leviable on cotton and man-made fabrics respectively. This is because composite mills avail of actual Cenvat credit in respect of other inputs (dyes, chemicals, consumables, packaging materials), while independent textile processors are not permitted to avail of actual Cenvat credit on the same; and

(d) Deemed credit is allowed in respect of texturised yarn (including draw twisted and draw wound yarn) of polyesters @ Rs. 18 per kg to a composite mill manufacturing processed textile fabrics (Chapters 52/54/55) and fabrics of cotton/man-made fibres (Chapters 58/60).

(x) Embroidery attracts duty under the compounded levy @ Rs. 45 per metre length of the machine per shift.

(xi) Industrial fabrics (Chapter 59) continue to attract Cenvat of 16% ad valorem. Tyre cord fabrics also attract specific AED (ST) of Rs. 10 per kg.

(xii) Jute and goods of jute are exempt from excise duty.

5.5 The duty structure and exemptions in respect of Garments and Made-ups are as follows :

(i) Woven articles of apparel (Chapter 62) and other Made-up textile articles (Chapter 63) attract Cenvat of 12% ad valorem.

(ii) Knitted articles of apparel (Chapter 61) attract optional Cenvat of 12% ad valorem.

(iii) Following goods are exempt:

(a) Undergarments, clothing accessories, raincoats;

(b) Woven garments made of handloom fabrics;

(c) Made up textile articles of handloom fabrics; and

(d) Blankets of wool/shoddy yarn of value upto Rs. 150/sqrmtr.

(iv) Salient features of scheme of central excise levy on Ready-made garments is as follows :-

(a) Tariff value of 60% of the retail sale price that is declared or required to be declared on the retail packages under Standards of Weights and Measures Act, 1976 has been fixed in respect of garments;

(b) General SSI exemption is applicable to garments;

(c) Liability to pay excise duty and fulfill excise formalities has been fixed on the person (merchant manufacturer/brand name owner) who gets garments manufactured on his account on job work

basis, unless he authorizes the job worker to do so and the job worker so authorized undertakes to do so;

(d) In order to enable such person to avail of Cenvat credit, the manufacturer/producer of garments includes the person who is liable to pay excise duty on the same; and

(e) Manufacturer of woven garments are eligible to avail of deemed credit @ 20% of the duty leviable on the finished product, without production of duty paying documents, subject to non-availment of actual Cenvat credit on inputs; and

(v) Metallic yarn (imitation zari), adhesive tape of width not exceeding 20 cm and tubular knitted gas mantle fabric for use in incandescent gas mantles attract excise duty of 4% ad valorem without Cenvat credit facility.

(vi) Imported fabrics, garments and other textile made ups attract CVD of 16% ad valorem.

5.6 The multiplicity of rates and the plethora of exemptions make the textile sector extremely vulnerable to evasion of duty. Apart from this, the deemed credit facility is not strictly in accordance with the rationale of the Cenvat credit scheme. Particularly, the exemption given to handloom sector has been misused in the past and in the recent Budget, exemption to hank yarn, which is used by the handloom sector but reportedly diverted to the power loom sector was withdrawn and replaced by a system of subsidy targeted at the intended beneficiaries. The Task Force would like to stress that in the case of other handloom sector also (except when it is processed without the aid of power or steam), the exemption should be withdrawn and replaced by a transparent system of subsidy which will ensure that benefit goes to the right persons for whom it is intended.

5.7 In the aforestated background, **the following recommendations are made as**

regards the central excise levy on Textile sector :

(xiv) **A uniform duty of 16% (to be reduced to 14% in 2004-2005) on all fibres and yarns by raising duty on cotton yarn from 8% to 14% and bringing down the duty rates on polyester filament yarn. The duty on polyester filament yarn to be brought down to 14% in four installments.**

(xv) **A uniform duty of 12% on all fabrics,(knitted or woven) which are not processed, till 2004-2005.**

(xvi) **All exemptions should be removed except for the following :**

(a) **Fabrics woven on handlooms(unprocessed);**

(b) **Fabrics processed without the aid of power or steam. Articles of yearn, strip, twine, cordage, rope, cables (56.07/09) manufactured without the aid of power;**

(c) **Handloom fabrics (whether cotton, woollen, etc.) certified, as khadi as well as Polyvastra;**

(d) **Silk yarn spun from silk waste and manufactured without the aid of power;**

(e) **Woolen yarn spun without the aid of power;**

(iii) **Fabrics processed without the aid of power or steam (but using power for certain specified processes) may be brought under the SSI exemption, when the present exemption is removed;**

(iv) **Dyeing/printing/bleaching/mercerizing of filament & spun yarns without aid of power or steam in a factory which does not have the facilities for producing single yarn;**

(v) Yarns manufactured without aid of power;

(vi) Jute and jute products (being natural fibres and used mainly for industrial purposes. These are extremely eco-friendly), and also impregnated, coated, covered or laminated with plastics;

(vii) Strips of jute (5806.39);

(viii) Rot proofed jute products, laminated jute products and fire resistant jute products; and

(ix) Blankets of wool/shoddy yarn of value not exceeding Rs. 150 per square metre.

(xvii) Processing of woolen fabrics (woven on powerlooms), not containing worsted yarn or made of shoddy yarn or melton cloth (made of shoddy yarn), where the fabric value does not exceed Rs. 150 per square metre.

(xviii) Synthetic fabrics, manufactured from shoddy yarn and consumed in the factory of production for manufacture of shoddy blankets of value not exceeding Rs. 150 per square metre.

(xix) Captive consumption of Printing frames for use in printing of fabrics(Administrative convenience)

(xx) Following full exemptions may be withdrawn, and the items brought under the general SSI duty exemption scheme, if not already covered:

(a) Sisal and manila twist yarn, thread, ropes and twine (Ch. 53/56), if consumed within the factory where it is produced for

manufacture of sisal and manila products falling under Ch. 53, 56, 57 or 63;

(b) Hair belting of wool (5806.39); and

(c) Raincoats, undergarments & clothing accessories.

(xxi) Exemption to all other handloom fabrics processed by any agency may be withdrawn and replaced by an outright transparent subsidy similar to the hank yarn subsidy scheme.

(xxii) Excise duty on coated and bonded fabrics (Chapter 59) should be rationalized to 16% (and subsequently to 14%) instead of 21% (16% + 5%) as at present.

(xxiii) The deemed credit schemes should be immediately withdrawn, and credit given only on production of duty paying documents. The Task Force recognizes that Textile industry is to a large extent controlled by traders. With the withdrawal of the deemed credit scheme, if the users are to avail of the credit of duty paid on inputs, all down stream manufacturers would have to come under the excise net. This might create some problems for the power looms which can, however, be obviated if the supplier of yarn to the power looms is deemed to be the manufacturer, so that all excise formalities including taking of credit undertaken by the traders. Similar dispensation can be made in the case of processed fabric in cases where the traders send grey fabrics to the processors for further processing. Such scheme already exists in the garment sector. Needless to say, the procedure for payment of duty by the traders will have to be simplified so as to encourage the acceptance of the scheme. However, optional levy on unprocessed fabrics may continue.

(xxiv) **There may be a problem when the general SSI duty exemption for ready-made garments is removed, as in that case, even tailors may have to be brought under the excise net. To overcome this, it can be provided that when ready-made garments are made on job-work basis for use and not intended for sale, no excise duty should be charged.**

(xxv) **As regards rate structure, the existing 12% rate may continue till 2005, as a commitment has already been made in this year's Budget to that effect.**

(xxvi) **The Additional Duty of Excise (Goods of Special Importance) Act, 1957, should be amended from 2005 in respect of textile fabrics so that like any other goods, the States can levy sales tax on such goods also.**

6. Central Excise duty exemptions

6.1 Central Excise duty exemption notifications are issued under the provision of Section 5A of the Central Excise Act, 1944. In like manner to the Customs duty exemption notifications, these also provide relief to the tax payer such that the tariff rate of duty need not be paid and only the concessional (or nil) duty has to be paid. A review of the exemptions reveal that over the past 5 years there has been nominal decline in the number of exemptions. However, it is worth noting that the total number of exemptions is not a correct reflection of the number of products being exempted from levy of excise duty. This is due to the fact that one exemption may contain a large number of products spread over a large number of product classifications. For instance, duty exemption notification No. 6/2002-C.E., dated 1.3.2002 is applicable to over hundreds of items, some of which are indicated by their generic descriptions and the actual number of items would be so much more.

6.2 It appears evident that monitoring duty exemptions to ensure that these are issued on sound principles and withdrawn when the objective is met is a critical task for the Government, which impacts the tax to GDP ratio. However, review of duty

exemptions does not appear to be done though the ground realities warranting exemption may have undergone change. Also some exemptions may lead to distorted investment decisions as the industry believes that the exemption will continue *ad infinitum*. It appears that an exemption when issued to meet a specific objective should be reviewed periodically with change in ground conditions. The continuing grant of exemption may not be conducive to efficient utilization of resources. Hence, it is necessary in the interest of transparency that when an exemption is issued it indicates the period of its validity with a proviso that changed circumstance may warrant a mid-term review. This would ensure a comprehensive periodic review by the Government which must record the justification for its continuance. It would also put the burden on the beneficiaries to establish the continued justification for the exemptions. This also resolves the problem of promissory estoppel and also ensure transparency and stability.

6.3 Taking into account all factors the the grant of exemptions on the central excise side needs careful consideration and justification based upon the following touchstones :

(i) **Income elasticity of the product** - an exemption is not justified on items which have high income elasticity. In other words, social equity demands that exemption should not be granted in respect of goods which are purchased or used by the high income groups and can be termed as luxury goods. This is not to justify the grant of exemption in each and every case the goods are consumed by the masses. A careful approach is required before grant of exemptions.

(ii) **Cost of compliance** is an important element which would justify the grant or otherwise of the duty exemption - in view of the vastness of the economy and that the tax administrators are spread thin it is desirable that the cost of collection should not be high. Hence, an exemption should be weighed both against the revenue mobilization as well as the cost of collection thereof. In the event, the cost of collection is significant it may be an economically viable decision to grant exemption.

(iii) **International practices** serve as an important input for grant or denial of exemption. No doubt the ground realities and compulsions of other countries may not adequately compare with the situation at home nevertheless tax treatments of goods internationally do reflect the international thinking. For instance, it is a common trait internationally that demerit goods are subject to high tax rates, and the same is done here also. Likewise exemptions to environmental friendly equipment is an international phenomenon and is equally justified at home.

(iv) Whether an exemption meets the **canon of transparency** or not is an important factor to be taken into account while examining the issue. By and large conditional exemptions run the risk of increase in cost of compliance and inefficient monitoring systems provide scope for misuse. On principle a more transparent methodology is the grant of budgetary support to the activity warranting an exemption. This would ensure accountability, reduce transaction cost, and most importantly lead to periodic monitoring on regular basis. In such scenario the unintended continuance of an exemption would also be ensured against. In other words, while granting exemptions on sound principles the scope of extending the intended benefit through budgetary support should first be examined.

6.4 Applying the aforementioned tests to the present exemptions the consensus is that a number of duty exemptions can be removed. An illustration is the duty Exemption No. 13/2000 C.E., dated 1.3.2000 issued in respect of freight element incurred by Integrated Steel Plants.

6.5 As stated, the general prescription in respect of grant of duty exemption, as indicated in the context of customs duty exemption notifications would equally apply. In other words, it is the view that sound taxation policy demands limited use of exemptions. Further, when exemptions are justified these should not be end use based conditional exemptions, which cause compliance problems and increase contact points which are best avoided. Thus, instead of exemptions we should preferably move to a budgetary mechanism for giving the same relief.

6.7 To sum up, **it is recommended that the following factors must be taken into account while considering the grant of a duty exemption :**

(d) Income elasticity of the product; cost of compliance; international best practices; and canon of transparency;

(e) Instead of duty exemption whether it is possible to extend the same benefit through a budgetary mechanism; and

(f) If an exemption is issued it should indicate the period of its validity with a proviso that changed circumstance may warrant a mid-term review.

7. Small Scale Sector duty exemption

7.1 The Small-Scale Sector Industries (SSIs) have been playing an important role in India's economic development in the form of value addition, employment generation, mobilisation of capital, entrepreneurial skills and contribution to export earnings. At present, the SSI sector with over 40 lakh units spread all over the country accounts for nearly 95 per cent of industrial units in the country and 40 per cent of value-added in the manufacturing sector. Its share is as high as 34 per cent in national export and it contributes roughly 7 per cent to the country's total GDP. Yet its contribution to excise revenue is negligible, only of the order of 3.4% of the total excise revenue.

7.2 Traditionally, the central excise duty exemption has been used to support the SSI sector. But it has been noticed that over the time the exemption is increasing and today no central excise duty need be paid by a unit whose clearances are upto Rs. 100 lakhs in a financial year. Whereas there is no doubt that the smaller units do need the central excise exemption, the flip side is that so long as such a vast sector continues to remain exempted, avoidable distortions are caused, as follows :

(i) The adverse impact on the tax to GDP ratio is an undeniable outcome of the increasing exemption limit for this sector;

(ii) Central excise being a tax at first stage of production, the exemption therefore leads to non-accountal of production which leads to non-payment of all other taxes (Income Tax, Sales tax etc.) and generation of black money;

(iii) Exemption leads to misuse of Cenvat credit by the duty paying (large) sector which procures the exempted goods from SSI sector but wrongly takes credit on basis of duty payment documents generated elsewhere;

(iv) Non-accountal of transactions encourage a cash economy with its own adverse implications;

(v) The exemption gives benefit to units upto a specified turnover after which, duty has to be discharged at the full rate. Therefore, for obvious reasons the units prefer to keep their turnover within the full exemption limit, either by unaccounted removals or by horizontal proliferation. This is not desirable from the point of view of evasion of tax. It also discourages economies of scale;

(vi) Duty exemptions for the SSI sector cause a break in the Cenvat credit chain and would adversely impact the adoption of a full fledged VAT; and

(vii) An exemption leads to loss of valuable data which proves counterproductive in respect of dissemination of information, tax planning etc.

7.3 In so far as the payment of tax in general is concerned it is important to appreciate that the SSI sector does pay its dues, the sector contributes significantly in the payment of central excise duty on the goods procured from the duty paying sector, payment of income tax, sales tax etc. However, the units do not pay central excise duty. The starkness of this simple statement is brought out when we find that a person owning a phone or residential property is on the records of the Income Tax; a person with a turnover of Rs.40 lakhs is subject to compulsory audit by Income Tax; all such persons pay sales tax and income tax etc. Yet, upto a turnover of Rs. 100 lakhs no central

excise duty need be paid and upto clearances of Rs.90 lakhs in a financial year these are not even on the records of the central excise department. The threshold limit for exemption in the developed countries does not exceed Rs.30-40 lakh. It is also the view that the ever increasing exemption limit (from Rs.25 lakhs to Rs.50 lakhs and now to Rs.100 lakhs) has been cornered by the larger of the SSI units and the smaller (tiny and family) units continue to produce at lower levels of output. In fact, being a first point tax non-payment of central excise duty leads to non-accountal of production and income which leads to non-payment of sales tax, income tax, generation of black money etc. Obviously there is something wrong somewhere.

7.4 It is the view that as a policy, SSI sector must also pay central excise duty. In fact since they already pay all other taxes there should be no hesitation in paying the central excise duty also. In any case, being an indirect tax, it gets passed on the consumer. Moreover it is the finding that the SSI sector is not averse to payment of central excise duty so long as they do not have to interact with the department. There is a logical reason for this. Since the units are mostly one-man shows dealing with the tax department would lead to loss of man-hours which they can ill afford. This is especially true of the smaller of the SSI units. The bottom line is that it is not the payment of excise duty rather method of collection of the same i.e. harassment by the department which is bothering the SSI sector. Accordingly, what is required is a moderate tax rate and a transparent mechanism to collect the due tax without interaction with the department to the extent possible. At the same time it needs to be appreciated that the present system of collection of central excise may not be administratively able to cope with over 40 lakh units. Hence, while accepting that the smaller of the SSI units need to be kept out of the tax net it is also necessary to evolve a modern system of tax collection which does not encourage interface, contact points and excessive documentation.

7.5 The matter of SSI sector duty exemption was debated at length and the view was that the exemption must be available to only the really small units with turnover of upto Rs. 50 lakhs. Other units must gradually start paying the duty. This is, however, subject to the condition that the central excise procedures improve appreciably and the procedures are ‘small scale sector friendly’. In short, the view regarding the SSI sector duty exemption is that the problem in payment of duty (by the sector) is basically that the present procedures do not encourage participation and confidence building.

Accordingly, there is a need for confidence building measures, which may take some time. In this background, **the following recommendations are made :**

(x) **The duty exemption should be extended to only small units with a turnover of Rs. 50 lakhs -** This would ensure the really small scale units being run mostly with family labour and having low capital investment get the desired support. It will exempt those units whose compliance cost will be significantly high relative to their tax obligations.

(xi) The duty exemption limit for the larger SSI units should be gradually brought down to Rs. 50 lakhs. The gradual downward revision of the limit would give the industry time to adjust. **The time frame is suggested, as follows :**

(a) Year 0 (2004-05) – From Rs.100 lakhs to Rs. 75 lakhs.

(b) Year 0 (2005-06) – From Rs.75 lakhs to Rs. 50 lakhs.

However, on reduction of the exemption limit, the unit would have the option of payment of duty at 4% (without Cenvat) on the value of clearance upto Rs. 100 Lakhs. The other option available at present of paying duty at a certain percentage of the normal rate would continue to be available.

It is important to note that the downward revision in exemption is proposed to be complemented by a transparent and hassle free tax collection mechanism, which must be in place from April 2004.

(iii) The duty exemption should be based upon total turnover - Since the exemption is for a small scale unit, the logical criteria to determine the smallness of a unit is its turnover. It can reasonably be expected that if the turnover is few hundreds of lakhs (Rupees) there is really no difference between a small scale and a large scale unit. Accordingly, at present, a unit is entitled to a small scale exemption if the value of its

clearances does not exceed Rs.300 lakhs in the previous financial year. This figure is determined after ignoring the value of clearance of exempted goods and goods exported. Thus, if a unit has clearances of Rs.10 crores or even Rs.20 crores it would still qualify for the SSI sector exemption if these are exempted goods! Surely this cannot be the intention of the duty exemption scheme. It is the view that this is a wrong methodology. The central issue is whether a unit is small or not, a factor of its turnover. **Thus**, **the duty exemption should provide for determining the turnover based on value of total clearances including exempted goods. However, in view of the special contribution of the sector towards the overall exports and to encourage exports, it is proposed that the clearances for exports may continue to be excluded for this purpose, as at present**.

(iv) **On principle duty exemption for SSI sector should not subsidise consumption of luxury items by the affluent** - Central Excise duty is an indirect tax and is paid by the consumer of the goods. In case of an exemption on the goods, the benefit actually accrues to its consumer. It is the view that consumers of luxury goods (e.g. Airconditioners) do not merit the subsidy extended indirectly to them through the SSI sector duty exemption. **Hence, it is recommended that a negative list of such items should be drawn up and the SSI sector duty exemption should be denied to a unit making these items**. One yardstick to define a luxury item may be that item which attracts over 24% duty. However, this is only a guideline.

(v) **Declaration of production activity** - At present a SSI unit is required to file a declaration with the Department when its clearances touch Rs.90 lakhs. **It is proposed that with effect from 1st April 2003 a Declaration should be filed by the unit when value of its clearances touches Rs.50 lakhs.** We can simply not have a modern tax system unless there is a data base and proper accountal of all transactions.

7.6 As regards the SSI sector duty exemption it is also observed that at present the exemption is not extended to all items. In fact, there are a large number of such items – watches, blankets of wool, copper circles, ball or roller bearings are few examples. No doubt one rationale for the denial of the duty exemption may have been that the economies of scale do not permit the manufacture of the item in the small scale sector. Another could be the possibility of misuse. Nevertheless this is an important matter and as a policy the small scale sector duty exemption should be extended to all items. **Accordingly, it is recommended that the present list of items to which the small scale sector duty exemption has not been extended should be subjected to a comprehensive review and to the extent possible the exemption should be extended. A relevant factor would also be the nature of the item and it should not be the case that grant of exemption subsidizes consumers of luxury items.**

7.7 Extension of SSI sector duty exemption to Matches

7.7.1 At present, the small scale sector duty exemption does not apply to Matches. This sector has over 18,000 tax payers, with an overwhelming majority in the cottage sector located in and around Madurai and Chennai, and only few large mechanized units. The revenue from Matches is nominal - only Rs.32 Cr. in 2001-2002. Thus, large number of small scale assessees are subject to nominal tax, which is not desirable particularly as it is in contrast to general policy to exempt from excise duty the small scale sector.

7.7.2 Rules 13 and 14 of Central Excise Rules, 2002 prescribe a special procedure for the assessment and collection of duty on Matches (CETH 36.05). This procedure continues on the statute as a unique dispensation for the Match sector. It envisages payment of central excise duty by the method of affixing to each box or booklet a central excise stamp of the value appropriate to the duty. The stamps are printed at Government Security Printing Press, Hyderabad and kept in safe custody at the District Revenue Treasuries or Sub–treasuries wherefrom these are supplied to the individual Match manufacturers. It is the finding that the special duty structure for the Match sector and the special procedure, which is an aberration in so far as the general procedures of central excise administration is not desirable. Some of the common problems which

have been noticed are :

(i) The system is inefficient – reportedly, the cost of collection of revenue ranged from 124% in 1998-99 to 68% in 2001-02 - major share being the cost of purchase and distributions of stamps.

(ii) Cost of compliance is high as a tax payer has to shuttle between the Range Office and the Treasury more than once a week to pay the duty and obtain central excise stamps before effecting clearance.

(iii) The central excise stamps are frequently not available, which dislocates the production activity besides increasing the administrative work on account of Department having to declare 'Stamp Holidays'.

(iv) The specimen of the labels (of stamps) are approved by the Department, and often it is dragged into disputes of Trade Mark. This is avoidable litigation.

(v) The Treasuries are under the control of State Government and the Security Printing Press under Department of Economic Affairs, Ministry of Finance. Thus, procedural or other delays at either end affect the collection of central excise revenue.

7.7.3 As a result of the unique tax structure and absence of duty exemption there is, reportedly, wide spread corruption and inefficiency. There can be no sound rationale why the poor unorganized sector is being deprived the advantage of the SSI sector duty exemption. In fact, if there is a case for the SSI sector duty exemption for any item it is the Match sector. Accordingly, it is necessary to clean up the central excise law and bring this sector into the main stream.

7.7.4 It is recommended that :

(i) The small scale sector duty exemption should be extended to Matches - the vast majority of the manufacturers would then be

outside the scheme of excise procedure i.e. – no registration, no records, no returns and no payment of duty. This would be source of great relief to the small and cottage sector units.

(ii) The duty structure may be made ad-valorem. Since, the duty would be paid only by the large units (semi-mechanized and mechanized) only, the Cenvat credit scheme can be extended. Such step would also clean up the Central Excise Rules as the rules 13 and 14 may be deleted. The present duties incidence various from less than 1% to about 8%. Since it is an item of necessity, a duty of 6% is recommended.

8. In the light of all the above recommendations, the suggested central excise duty structure is given in Annexure 'B'. The Annexure has attempted to cover all goods but in the event certain items may have been left out inadvertently, the duty rates on such items may be fixed in the light of the principles laid down earlier.

9. Location based exemptions

9.1 In 1999, for the first item in the history of central excise the Government issued two exemption notifications aimed at development of the North-Eastern States. While the intention was laudable it has actually translated into shifting of investment to the North-East from other parts of the country. The long terms effect of the exemption, which is valid for 10 years would be to depress the excise revenues for this long period. Another fall out, on expected lines has been the demand from other states for similar exemption. Kutch district and Jammu and Kashmir have been included under this scheme and the day is not far when other States would press for such exemption. The net result would be the creation of areas of exemption, which is most undesirable from the point of view of any tax administration. Such a move would seriously impact the tax to GDP ratio in the coming years.

9.2 It is recommended that there is a need to review the policy of granting exemption based upon location and no further exemption should be granted.

10. Relevant date of Notification

10.1 An important issue relating to exemption notifications, both customs and central excise is the relevant date from which the exemption would come into force. Over time , this has been an area of dispute with some treating the date of issue as the relevant date and others the date from which it is made known to the public. Without going into the legality of the issue, it is the finding that any good tax administration must provide some advance notice to the tax payer before a change is introduced. This has its obvious advantages. In fact, at present the system is that a notification is issued on a particular day and that same day it is placed on the C.B.E.C. web site and comes into force. This is true even if the notification is issued after office hours or late at night, which is usually the case. Reportedly, this situation results in neither the departmental officials or the trade and industry knowing about the notification. As a result, there is invariably an exercise of issue of demand notices (when duty has been increased) and filing of refund claims (when duty is reduced). Another fall out of the sudden introduction of the notification is that the automated clearances on the customs side give the wrong results, since the software modification does take time.

10.2 As stated, it is not reasonable to bring into force a notification from the date of its issue as this increases the work load and adversely affects the efficiency of the system. At the same time, it may not be appropriate to give too much time for the implementation of the notification as this may lead to speculation.

10.3 It is recommended that a notification should come into force from the day after the day of its issue. To illustrate, a notification dated (i.e. issued) 1st December would come into force from 2nd December. This would require each notification to contain a suitable clause, till such time as the law is amended.

11. Zero rating of exports

11.1 There is a misconception that exports are exempt form central excise duty. This is not so. Excisable goods meant for exports are chargeable to duty as any other excisable goods. Today, there are two schemes of giving tax credit in respect of exports, in terms of rules 18 and 19 of the Central Excise Rules, 2002. In one scheme

the goods can be cleared without payment of duty and the manufacturers can take credit of the input taxes paid which can be used for payment of duty on their domestic clearances, if any. The other scheme is that the exporters can pay excise duty on their products and subsequently claim rebate of the duty paid.

11.2 In this regard it is the view that since the central excise duty is meant to apply only to consumption of goods in India, obviously export should not be subject to any tax. This is based on the destination based principle of Trade Taxes, whereby domestic taxes are not transmitted across the borders. The international practice is also that exports are treated as zero-rated, that is, to say no VAT is charged on export of any goods and the manufacturers are given the credit of all input taxes which have gone into the manufacture of exported goods and periodically this amount is refunded to the exporters. There appears to be no reason why in our country there is a dual system of giving the export rebates, more so when there is substantial delay in many cases in granting rebates. This only adds to the cost of the exporters.

11.3 In the event exports are zero rated, that is, to say no excise duty is payable on exports, as distinct from exempt goods in respect of which no tax rebate is admissible, manufacturers will no longer have the option to pay duty on exports. Whatever duty has been paid on the tax credits would be regulated and periodically refunded to the manufacturers in case they are not in a position to utilize such credit on their domestic clearances. For this purpose, suitable mechanism will have to be evolved for quick refund of the credit in all such cases, say, at monthly intervals. There would be cases where the goods may not be exported directly from the factory, in which case Cenvat will be payable, and in such cases the Drawback scheme would apply. It is the view that this system would be far more efficient in facilitating the exporting community.

11.4 It is recommended that from 1st April 2003 exports should be zero rated.

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CHAPTER 9

VALUE ADDED TAX

1. Introduction

1.1 Value Added Tax (VAT) is unanimously acknowledged to be a major reform in the indirect taxation system for the following reasons:

(i) It eliminates the cascading effect of taxes;

(ii) It promotes competitiveness of exports;

(iii) It has a simple and transparent structure; and

(iv) It Improves compliance.

1.2 In recent time, more and more countries have been adopting VAT for taxation of commodities and services, and presently there are more than 120 countries in which VAT is in force. Only the USA and India are amongst the more populous countries that do not have a VAT. Economists have generally shared the view that VAT is best suited as a Federal or Central tax, and not at the State-level. However, states and provinces in a few large federal countries like Brazil, and, to a lesser extent, Canada, have adopted VAT, with varying degrees of success. By adopting VAT the country would soon be joining the majority of the countries and hopes to derive the advantages thereof in like measure.

1.3 Considering that the implementation of VAT is closely linked to the administration of other indirect taxes and impacts the tax to GDP ratio, it has become necessary to examine the relevant issues. In this direction the Task Force has had the benefit of meeting with the Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nationwide State-level VAT. The Empowered Committee is indeed a unique experiment in federal fiscal planning and has achieved much in terms of building a consensus on many of the critical issues relating to implementation of VAT in a relatively short spell of time. Most countries have taken several years to implement VAT. As was learnt, decisions have been taken on the important features of VAT relating to replacement of the Sales Tax levied by the States (though some other local taxes like octroi, mandi cess etc. may continue); the Revenue Neutral Rate and other rates; the tax to be a multi-point levy, with the tax paid on inputs

within the State being set off against the tax payable on the dealer's sales (subject to a threshold limit); phasing out of CST in 4 years; adoption of uniform classification, etc. Most all vital areas have been covered by the Empowered Committee and it would not be appropriate, nor is it considered necessary for this Task Force to reexamine these issues. The Task Force would like only to highlight few issues to ensure successful implementation of VAT, and its continuity and stability in a dynamic sense. These matters assume importance in view of the limited time now left for the proposed implementation of State VAT, from 1st April 2003.

2. Preparedness for State VAT

2.1 For State VAT to become a reality, a high level of commitment is required for all concerned tax administrators and businesses which include the small traders. Thus, clear andtransparent dissemination of information is going to be critical to the success of the implementation of State VAT. In this regard, it is evident that what is required is a comprehensive publicity programme across the country to apprise and educate all concerned regarding the implications of VAT. This programme should take place at National and State level and percolate down to the Districts. Naturally this requires resources. It is the view that the publicity programme must involve both Central and State Governments and the former should be prepared to extend financial support for this.

2.2 It is recommended that a publicity awareness programme should be started jointly by the Central Government and the State Governments and the former should extend financial support for this, if required. Since the State VAT is expected to be implemented from 1.4.2003 it is also necessary that the publicity awareness programme should be implemented at the earliest.

3. Uniformity of definitions

3.1 Reportedly, some of the State VAT legislations are not fully based upon the model legislation and, as a result, there is a variance in the definitions of dealers, distributors, etc. In some cases even the charging section is not uniform. Further there must also be uniformity in the procedures and documentation. In fact, common

classification of goods is critical, though there is one view that it would be difficult for the small dealers to adapt to the same. However, uniformity in all these matters is important for the creation of a truly common market. It will also take care of the apprehension that absence of uniformity may give rise to avoidable disputes.

3.2 It is recommended that an attempt should be made towards uniformity of all State legislations, procedures and documentation relating to VAT.

4. Compensation to States

4.1 One of the issues which impact the transition to VAT is the compensation to be given to the States upon the removal of Sales Tax and the introduction of State VAT, in the event the tax revenue drops due to the change over. In this regard it is observed that the experience world-wide has been that a move to VAT results in higher revenue realisation. Therefore, there is no cause for concern. Nevertheless if such eventuality arises any compensation should be through revenue mobilization (by the States) from specified services and not through Budgetary support. One avenue is to allow the States to collect and appropriate the Service Tax on identified services.

4.2 It is recommended that issue of compensation, if it arises, must be primarily tackled through mutually acceptable mechanism of additional resource mobilization through Service Tax and not through Budgetary support.

5. VAT to unify all local taxes

5.1 During the meetings that the Task Force had with several industry and trade bodies, it was represented that the switch-over to VAT must ensure that the desired benefits are achieved, especially in view of the fact that this switch-over will entail a major overhaul of systems and procedures for businesses and governments, and at substantial expenditure of money, time and effort. One of the views that was consistently expressed is that the simultaneous imposition of several taxes on goods, with VAT alone being eligible for credit and set-off, would not serve the purpose. Currently, about 16 States impose Entry Tax on goods, 12 States impose Luxury Tax on goods, in addition to which a number of States impose Mandi Cess and a number of local bodies impose

Octroi. The rates of each of these taxes vary widely between the States. It was pointed out that if VAT were to achieve its purpose including removal of the cascading effect then it must replace all these local taxes.

5.2 The Task Force is an agreement with the submission of the industry and trade. At the same time, it is a fact that local taxes such as Entry Tax, Octroi, Luxury Tax etc., in addition to Sales, Purchase and Turnover Taxes, are productive sources of revenue for many States, and that therefore, it would be difficult for the States to forego the revenue from these taxes. The proposed VAT should, therefore, meet both these concerns.

5.3 It is recommended that with the introduction of VAT, all other local taxes be discontinued, and the same should be taken into account in determining the RNR.

6. VAT and AED

6.1 The Additional Duties of Excise (Goods of Special Importance) Act, 1957 imposes Additional Duties of Excise (AED) on sugar, textiles and tobacco products. AED was introduced in lieu of sales taxes being levied at that time by the States. There is once view that the rationale for the Act is no longer valid and States should be allowed to levy sales tax on the goods. Another view is that as a policy multiplicity of levies must be reduced and in this direction AED is not required. A third view is that the goods, particularly tobacco products contribute significantly to the revenue that the matter of changing the methodology of levy and rate of tax must be handled with caution as the country can ill afford uncertainty in revenue generation. Accordingly, the matter has been examined in its entirety.

6.2 It is a fact that if AED is removed and the goods are subject to State level taxes the incidence thereon is likely to increase. Thus, the issue of removal of AED has to be examined in the context of impact of higher and also differential incidence of taxes from State to State. As regards tobacco products, it has been the experience of many countries that differential taxes on such high-excise goods particularly cigarettes, incentives large scale illegal cross-border movement resulting in huge evasion of revenue. Studies also reveal that such revenue losses, as a proportion to revenue

collected, range from 10-14% in the case of Canada to 25% in the case of Sweden. Unregulated tax rates on such high value good have also been seen to lead to displacement of domestic tax-paid cigarettes by contraband products, translating to significant losses in revenue. Further, being a final consumer product, there is very little value-addition beyond the manufacturing stage in respect of cigarettes. In our country the entire trade margin is found to average about 10%, with around 7% going to the retailers, who number about 2 million and most of whom would be below the threshold limit for VAT. Considering that the excise duty on cigarettes is as high as 100 to 130% in assessable value terms, the VAT on cigarettes would chiefly be a tax on excise. Further, cigarettes constitute one of the most important sources of excise revenue (over Rs.5000 Cr. in 2001-2002) and in addition, the AED on cigarettes, through a specific rate structure, has achieved a stable and substantial revenue stream. It has also completely eliminated the scope for cross-border arbitrage in an otherwise high evasion-prone category of goods. Thus, there is a justifiable case for keeping cigarettes outside VAT.

6.3 In so far as textiles are concerned, India is bound by the MFA and from 2005 competition would increase. Therefore, while proposing to keep the central excise duty at 12% no doubt the idea had been to allow the industry to upgrade and modernize. To further this objective it appears necessary that the tax rates on the item must not increase, a likelihood with the removal of AED and subsequent multiplicity of State level taxes. Hence, it appears that while conceptually AED must go there is sufficient merit in maintaining status quo for this item upto 2005.

6.4 It is recommended that that whereas AED may continue for textiles upto 2005, it may continue even thereafter for cigarettes which should not be subjected to VAT.

7. Credit on Inter-state transactions

7.1 An important issue is the grant of credit of the tax paid in one State by another State in the course of inter-State movement of goods. There is one view that the States into which goods are imported from other States, may find it difficult to allow credit of tax already paid on such goods. However, if the credit is not given there is apprehension of cascading effect besides placing the 'imported' goods at a competitive disadvantage vis-

à-vis the local goods with resultant effect of dividing the common market, since investment decisions will tend towards States where the market within that State is larger than that outside.

7.2 In this regard experience of other federal countries like Brazil and Canada reveals that either the inter-State transactions are zero-rated or the tax paid in the exporting State is allowed to be set off by the importing State. The same is the case between the European Union members also. It appears that in our context once the Central Sales Tax is phased out, as presently contemplated, this would cease to be an issue. However, the denial of credit in inter-State transactions appears to have legal implications, inasmuch as it could well attract the provisions of article 304(a) of the Constitution which prohibits any discrimination between local goods and imported goods in the matter of taxation.

7.3 It is recommended that the VAT scheme should provide for grant of credit of duty by the importing State for the duty paid in the exporting State, in the course of inter-State movement of goods.

8. Stability and continuity of the VAT regime

8.1 VAT is going to be a reality soon chiefly on account of the commitment of the States which have after years of painstaking deliberations built a consensus. As earlier observed, this was possible only due to the tremendous efforts of the Empowered Committee. Thus, it appears that stability and success of VAT will, equally, depend on the States' continued commitment to the interest of all stakeholders. In this regard, it appears desirable to consider having in place an arrangement which ensures stability and continuity of the VAT regime.

8.2 The creation of a truly unified domestic common market is the ultimate objective of the tax reform process. A related and equally important issue is that of a mechanism to eliminate internal barriers to trade and commerce. In this regard it is learnt that the Empowered Committee is contemplating setting up a VAT Council which could continue the work done so far by the Committee itself. In view of the fact that the Empowered Committee has achieved so much it can only be expected that the VAT Council would

further consolidate the tremendous work, especially if it also includes representation of the Central Government. An alternate view is to explore the possibility of a consensual agreement taking support of a Constitutional provision, such as Article 307. The Task Force would leave this thought with the Empowered Committee for consideration since it is the body most concerned with the long-term stability of the proposed VAT.

8.3 It is recommended that for the stability and continuity of VAT, a VAT Council or a permanent suitable alternative vested with adequate powers to take steps against discriminatory taxes and practices and eliminate barriers to free flow of trade and commerce across the country should be explored.

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CHAPTER 10

SERVICE TAX

1. Introduction

1.1 The service sector contributes roughly 48.45% of the GDP (2000-01) and, as has been the experience worldwide, its contribution to GDP is expected to grow over the time. Taxation of services in the country was started in July, 1994 in a limited way on three services i.e. stock brokers, telephone services and general insurance. Since then the scope has been considerably enhanced and at present 51 services have been notified for levy of Service Tax. Whereas Service Tax contributed revenue of Rs. 3,227 Crs. in 2001-2002, it is expected that the importance of this tax, as a source of revenue to the exchequer shall increase appreciably over the time.

1.2 Whereas the expansion of Service Tax in the coming days is not debatable certain critical issues need to be addressed at this juncture to ensure smooth administration of this tax. The matter assumes importance considering that the country is progressing towards implementation of VAT and the compensation of revenue to the States (in the case there is revenue loss in the transition period) through revenue from Service Tax is under consideration. At the same time, it is learnt that the Government has already taken a view in the matter of levy of Service Tax in the future. Accordingly, it would not be appropriate at this stage to re-open the issues on which a consensus appears to have been arrived at after much deliberation.

1.3 In the aforestated background, the Task Force has examined the critical issues which, in its opinion, would facilitate the early implementation of a modern Service Tax administration and its integration with central excise and VAT.

2. Comprehensive Service Tax

2.1 Service Tax is currently levied on 51 services. However, there are a large number of services, which are not covered, though in the organized sector. Examples of such services are transport sector, construction activity, legal and tax consultancy

services, recreation services, etc. It is of the view that in due course Service Tax should be comprehensive and there should be no selectivity of items. However, it would be in order to identify certain services, which are not to be subjected to Service Tax. Examples of these services are public utilities and social services (health, education, etc.) and activities performed by the Government such as administration, defense, etc. (if these are treated as services in the first place). Needless to state, Service Tax should be levied on services, which are received within the country. In other words, they should be no Service Tax on services, which are exported.

2.2 It is recommended that to the extent possible Service Tax should be levied in a comprehensive manner leaving out only few services by including them in a negative list.

3. Extension of duty credit scheme to service sector

3.1 A beginning has been made in extending the scheme of tax credit to service sector by allowing service providers to take credit of the tax paid on the services received. However, the input service and the output service have to be in the same category. It is necessary to expand this scheme to reduce the cascading effect of taxes. Accordingly, the scheme of tax credit should be extended to include all services. In other words, tax credit of services received should be available to a service provider even if the two are not in the same category (of service). Further, service providers procure excisable goods on payment of central excise duty for use in providing the services. It is logical and desirable that the credit of the duty paid should be allowed. In other words, the Cenvat credit scheme on goods should be amalgamated into the Service Tax legislation.

3.2 In this regard, an important matter for consideration is the proposal for the levy of Service Tax by the Union and its collection and appropriation of the proceeds by both the Union and the States in accordance with a certain laid down principles is under serious consideration. This has implications for the grant of credit of the duty paid on goods and services procured by the service provider. A situation where the credit is availed of duties paid to the Centre but the same is used to discharge duties paid to the States would lead to complexities of record keeping besides going against the principle

of equity. Accordingly, the way out is that whereas the credit of duty paid on both goods and services by a service provider would be allowed only that much credit as has been accumulated on account of central taxes (on goods and services) should be used for payment of Service Tax collected and appropriated by the Centre. Likewise, the service provider would utilize credit of the State level duty paid on goods and services to pay the Service Tax collected and appropriated by the State. In other words, they should be a one-to-one correlation between the credit availed and utilized separately for central level taxes and state level taxes.

3.3 **It is recommended that the following measures should be taken to allow the credit of duty paid by a service provider on the goods and services procured:**

(i) There should be complete integration of the Cenvat credit and Service Tax credit schemes with effect from 1.4.2003.

(iii) Credit of Central duties (on goods and services) should be utilized for payment of Service Tax collected and appropriated by the Central Government.

4. Rate of Service Tax

4.1 At present, Service Tax is levied @ 5% on the value of the service provided. This rate is common to all services. However, the service provider is presently not allowed to pay credit of the duty paid on inputs (goods in services), though a small beginning has been made in this direction by allowing a service provider to take credit of the duty paid on services procured provided both procured service and the service provided are in the same category of service. However, it is the view that a comprehensive Service Tax Law should provide the service provider the facility of taking credit of both goods and services procured for providing the said service. This would enable the service provider to utilize the credit to pay the duty on the services provided thereby reducing the cascading effect of taxes.

4.2 In this regard, it is seen that the mean Cenvat rate of duty on goods is presently 16% ad-valorem. Thus, if a service provider avails credit of 16% and is required to

discharge duty on the services provided @ 5% there would be an accumulation of credit. Accordingly, it is necessary that in an integrated scheme of credit of duty paid on goods and services the rate of Service Tax would be required to be enhanced from the present 5%. While doing so the proposed Cenvat rate of 14% should be taken into account. However. It is possible that some service providers do not avail the credit of the duty paid on their input goods and services. Accordingly, the rate structure must also take into account these service providers.

4.3 It is recommended that along with integration of the goods and services credit schemes from 1.4.2003, the rate of Service Tax should be suitably enhanced so as to achieve parity with the Cenvat rate by 2006-2007. However, there should be two rates, one for service providers who avail credit and a lower rate for those who do not.

5. Threshold limit of exemption

5.1 Historically, the Indirect Tax regime in respect of central excise duties has evolved taking into account the fact that manufacturers who have low level of activity in terms of value of output should be kept outside the tax net. This decision is influenced by the fact that the small manufacturers cannot cope up with the procedural requirements of the levy and the cost of compliance would be high. Interestingly this rational has not been applied to Service Tax right from its inception. One reason could be that being the new levy the strategy was to allow time for its acceptance and it was not been strictly administered. Furthermore, it is a fact that the selection of services so far has been such that only big providers are covered by the levy. However, as the scope of Service Tax increases and more and more services enter the net, a decision would be required to be taken as regards providing an exemption limit in like manner as is being done on the central excise side. Administrative convenience and cost of compliance would be on the determining factors. It is also to be considered that an exemption limit has a tendency of inviting pressure groups unless it is applied across the board i.e. to all services. Finally, that an exemption limit may be enhanced from time to time, which would eventually impact revenue collection and smooth administration. Therefore, a considered view has to be taken on the subject.

5.2 In this regard, one view is that all service providers who provide services upto the value of Rs. 10 Lakhs in a financial year should be excluded from payment of Service Tax. However, the proposed exemption limit is subjective, and as aforestated there would be a tendency to enhance it from time to time through use of discretion, which is avoidable. Moreover a exemption results in loss of valuable data which adversely impacts policy formulation in the long run. Hence, it is the view that on grounds of administrative convenience and cost of compliance the small service providers should be exempted from the procedural of levy but consistent with the policy so far they should also discharge their tax liability.

5.3 It is recommended that the service providers who provide services upto a value of Rs. 10 lakhs in a financial year should be subjected to a total tax of 1% on the value of the services on an annual basis on the basis of simple declaration. Such service providers would be exempt from the normal procedures of returns and documentation. This scheme does not envisage availment of the credit of the duty paid on the input goods and services.

6. Separate enactment for Service Tax

6.1 Presently Service Tax is levied through the provisions of the Finance Act, 1994 and Service Tax Rules, 1994. With the progressive expansion of the Service Tax coverage it is necessary to enact a specific legislation to administer the tax. Once this is done there would be increased legal clarity and better administration. Considering the recommendation to allow credit of duties paid on goods to service providers it is necessary to have suitable and similar provisions as are in the Cenvat Credit Rules in the Service Tax Law. This will eventually pave the way to have an integrated goods and Service Tax legislation.

6.2 It is recommended that there should be a separate legislation for levy of Service Tax, which should eventually be integrated with the central excise law.

7. Classification of services

7.1 Service Tax is presently levied on the basis of description of the service. However, as its scope becomes more comprehensive and it is integrated into the central excise and VAT there is possibility of disputes arising on the levy. The absence of scientific classification and categorization of services may also lead to lack of uniformity in its administration. It may so happen that a particular service is taxed in one part of the country and since it is known by another name elsewhere it may escape the levy. In any case it is well established that uniformity of classification ensures better administration and reduces the chances disputes. Accordingly, it is the view that there must be development of a Service Tax classification code. As seen, WTO has come up with such classification.

7.2 It is recommended that the services should be classified on the basis WTO classification, which should be made a part of the Service Tax legislation.

8. Dispute resolution

8.1 Service Tax is relatively new levy and is desirable that steps should be taken at this stage to provide that its administration should not lead to disputes and in the event a dispute arises it should be settled at the earliest. This objective is desirable in all fiscal legislations. In this regard, on the central excise side some recommendations have been made to provide for voluntary deposit of disputed duty on payment of interest and penalty, if warranted. It is the view that a similar provision is required in Service Tax Law. Further, it is the view that as a policy when department detects short levy or payment of duty it should have an open discussion with the assessee before proceeding with the issue of Show Cause Notice, if warranted. This will allow the assessee to exercise the option of voluntary payment of duty thereby saving on time and resource in adjudication proceedings.

8.2 It is recommended that as a measure of early settlement of disputes :

(i) Suitable legal provision should be provided to allow voluntary payment of Service Tax not paid when detected either suo-motto or by Department.

(v) Suitable legal provision should provide for the automatically collapse of a Show Cause Notice if the duty is voluntarily paid along with interest and 25% penalty within a period of 30 days of the issue of the notice in cases involving fraud, suppression of fact etc. In such cases the Notice should also mention in its preamble that there would also be no prosecution proceedings. The provision regarding collapse of the Show Cause Notice should apply to 'other' cases but without the requirement of payment of 25% penalty.

9. Non-recovery of Service Tax in certain situations

9.1 Service Tax is a relatively new tax and as with any new tax it's understanding and correct implementation may take time. This applies equally to the service providers and the tax administrators. Therefore, it may so happen that a practice may develop regarding either the levy or non-levy of the tax on a particular service, which may not be strictly legally correct. For instance, it may so happen that in respect of a particular service the tax may not be levied or be short levied on account of the practice. In this situation there is an apprehension that on discovery of the fact of non-payment or short payment, the service providers would be burdened with duty demands which would adversely impact them. On the other hand, Section 11 C of the Central Excise Act, 1944 takes care of similar problem in the case of central excise duty by empowering the Government to direct that in such situation the duty not paid or short paid shall not be required to be paid. It is the view that like provision in respect of Service Tax would bolster the confidence of the service providers.

9.2 It is recommended that a provision similar to that contained in Section 11C of the Central Excise Act, 1944 should be provide in respect of levy of Service Tax.

10. Service Tax as the first E-tax

10.1 In order to facilitate voluntary tax compliance, reduce cost of compliance, eliminate tax payer inconvenience, and improve administration, Service Tax should be implemented as the first electronic tax (E-tax) with self-assessment and on-line web based connectivity between the department and the tax payers. In this regard it is seen that a number of recommendations have been made regarding the need to increase automation and use of information technology in indirect tax system and procedures. These would apply equally to Service Tax Administration and Procedures.

10.2 It is recommended that there should be a time bound review of the automation needs of the service tax administration and in like manner as proposed for other indirect taxes steps should be taken to automate the processes and allow online filing of returns and payment of Service Tax.

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