VI. REFORM OF CUSTOMS DUTIES

1. Reduction of Exemptions

Though the total of 103 exemptions may not be considered a big number by itself, the number of items in each of the exemptions makes the whole system complicated. One exemption which gives the effective rates of various commodities (16\2000 cus dated 1.3.2000) has 346 entries, with 33 lists and 83 conditions. This notification runs into 81 pages. Though this is the longest, the other notifications are also quite lengthy. Together they comprise a complicated structure not only for importers, but they must also pose a serious problem for appraising officers who are entrusted to finalise the classification as quickly as possible. There are 22 export-related exemptions, 20 exemptions for licence related schemes, 9 for re-imports and so on. The huge lists take away the generic character of the tariff. To a great extent, it reflects lists supplied by different administrative ministries in their endeavour to show that they are rendering appropriate service to that segment of industry with which they are concerned.

Since there is a provision for a rate of duty which is uniform, it would be much more simple and transparent to give a general lower rate of duty to the leather industry and crude oil refining industry than to give exemptions to specified 200 to 300 machines and parts thereof. There is much scope for improvement on the above line. However the most important need in this regard is to reduce exemptions drastically. This will broaden the tax base as well while allowing the authorities to reduce the tariff rate in general.

Specific suggestions for removal of exemptions are made below.

1. 50\96 &76\96 cus dated 11.9.96 Exemption for materials for R&D for which elaborate procedure and certificatation are necessary. The industry may as well pay for this.

2. 122\93 cus dated 14.5.93 giving exemption to hotels for capital goods (as found in Table) has no justification. Five-star hotels usually use these, which should be able to bear the cost.

3. A large number of exemptions such as 29\97 dated 1.4.97 and 32\97 cus which have been given under the EPCG Scheme to capital goods are being enjoyed by different industries. Even five-star hotels have been given this. The revenue forgone is reportedly huge and enforcement of demand against defaulters is proverbially ineffective. The indigenous capital goods industry has been badly affected by lack of demand. Though these exemptions have been issued under the request of the Commerce Ministry, these should be reviewed immediately.

4. There are twenty exemptions under the Advance Licence Scheme and the Pass Book Scheme which have huge lists attached to them. During our visits to ports and offices we found that the assessing officers ask for catalogues in a large number of cases ostensibly to verify these lists. So long as these long lists are there in the exemptions, this trend will continue which makes much of computerisation ineffective. The scope of corruption also increases. These exemptions should be reviewed and restructured by combining them, making the descriptions more generic and abolishing many of the schemes, which are overlapping in their scope. The revenue foregone should be weighed against the probable gain in exports.

5. The general exemption 16\2000 cus dated 1.3.2000 which has 346 entries. It means there are 346 exemptions. A close study shows that many populist items exist which have no economic justification. They are the following (serial numbers and tariff entries in brackets) :

Cows, bulls, poultry stock etc (1, 1), frozen semen , frozen equipment etc(6,5), planting materials like oil seeds , vegetable seeds (8, 6to 12), cashew nuts (11,8) , fruits (12, chapter 8 has got so many rates like 15,25,35, 40 and 50 which can be made into one,

abolishing the exemption at 25%), chocolate preparations (35, 18.06 ---why should chocolate preparations be charged a less duty of 15 percent than the tariff rate of 35 percent?), prawn feed (48,23), dietary soya fibre (47,23), instruments for silicone breast prosthesis (317,90), spodumene ore (50,25), chemicals for the manufacture of Centchroman (64,28), iodine for manufacture of potassium iodate (65,2801), several chemicals such as Zirconium oxide, Gebberalic acid (64 to 81,-- 28 and 29, if these exemptions are removed all chemicals will attract the same rate of duty), paper for packing grapes (123, 48), machinery (178 to 290 Chapters 84 and 85—large number of exemptions and lists and conditions in this area have made classification very complicated. Only two rates 25 percent and 15 percent would be sufficient and no exemptions given. Capital goods industry has been harmed due to the 0 percent and 5 percent rates. There are also many exemptions for telecommunications, which are totally unwarranted particularly due to privatisation in this sector. These exemptions should be removed. The long lists and conditions should be shortened. Finally exemptions for leather and textile industry should be examined with circumspection. They have been enjoying exemption for long and should be eliminated.

2. Zero-rate Customs Duty

A sluggish performance of the capital goods industry has been worrying economists recently and one has to find the reason why the growth is so slow. In 1999-2000, industrial production increased by 8 percent as against 3.9 percent in the previous year, which is cause for some relief. Even the manufacturing sector grew by 9 percent in 1999-2000 compared to 4.3 percent in the previous year. But this buoyancy is because of higher growth of intermediate goods (15 percent) and consumer durables (12.2 percent) in 1999-2000. A major non-achiever is the capital goods sector, which achieved just 4.8 percent growth in 1999-2000 compared to 11.8 percent in 1998-1999 and 9.3 percent in 1996-1997. Current year figures are being reported at even lower levels.

The index of industrial production (IIP) for July 2000 indicates an overall year-on-year growth rate of 4.3 percent, down significantly from last year.

Technologically, the capital goods industry is not exactly lagging behind. It has built sophisticated manufacturing facilities and acquired comprehensive state-of-the-art technology and expertise to manufacture a complete range of equipment required for core sector industries such as power, oil, gas, refinery, transmission and infrastructure. They have made huge investments partly by borrowing funds from international organisations and partly from local resources.

The cost disadvantage of local industry is largely due to inadequate infrastructure, local taxes such as octroi and entry tax and higher cost of financing, which together amount to about 23 percent and may even go up to 32 percent in some cases. The World Bank guidelines for "preference for domestically-manufactured goods" stipulates a price preference of 15 percent or customs duty, whichever is lower.

The customs duty has been brought down to zero by the following method. Earlier, when customs notification number 84/97 dated 11/11/97 waived customs duty on all goods imported by the United Nations or an international organisation for execution of projects financed by them and approved by the Government of India, the exemption was restricted to social sectors like health, sanitation, family planning, education and similar others.

The Finance Ministry amended the above notification vide notification number 85/99 dated 6/7/99. This later notification allowed import of all goods at zero duty for execution of projects financed by the United Nations, World Bank and other such international organisations. The scope of the notification has been widened to projects under the core sector such as power, fertiliser, coal, road, port and others. Even contractors associated with infrastructure projects like road building

have been allowed to import goods at zero duty. Thus the tariff barrier, that is the protective customs duty, available to the domestic capital goods industry prior to July 6, 1999 has been removed. To site an example, hydraulic excavator, for which the normal import duty is 53.38 per cent can now be imported by contractors on the certification of the surface transport ministry at zero customs duty.

Since the rate of duty under the above notification is nil, the benefit of price preference available to the domestic manufacturers as per World Bank guidelines is being denied by project authorities like Power Grid and NTPC. The recent report of about 10 per cent price preference for indigenous companies for supply of plants equipment and commissioning of gas-based mega power plants of the NTPC is a local affair and not connected with the above issue.

The concerned customs duty rate structure is presently the following :

Items	Customs duty %
Captive power plants of 5MW or more, Power transmission projects of 66 kV and above , other industrial plants Projects including Oil and Gas.	25%+16% CV
Fertiliser, Refining of crude petroleum, Coal mining, Power generation projects including Gas turbine power projects (excluding power plants set by project engaged in activities other than power generation)	5%+ 16%
Mega power projects, all items covered under Notification numbers 84\97 and 85\99	0%+nil

The rate structure reveals that capital goods for different projects enjoy a lower rate of duty then the average tariff rate which is acceptable under a normal tariff structure. However, those

covered under the notifications enjoy zero duty which has given rise to unequal competition in an already ailing industry.

The logic forwarded in favour of continuing these exemptions is two fold. One is that the World Bank or other multilateral UN agencies would accept to bear the basic cost of the project but not the customs duty. This argument is not tenable. The World Bank may as well fund the project cost and the importer pay for the customs duty. The second argument is that if the customs duty is included, the project cost will increase. This argument is also untenable. In the name of reducing project cost, the competitiveness of domestic industry cannot be compromised.

There are several ways to rectify the situation :

a. All the different rates of customs duty may be equalised and brought to 20 per cent.

b. The basic tariff rate should be reduced from 25 percent to 20 percent. This will reduce the need for giving very large number of exemptions, which now exist in the machinery chapters in the customs tariff. These exemptions are full of long lists and longer conditions, which have made the working of the tariff extremely difficult exercises. The fact that in spite of so many exemptions, neither the power sector nor other industrial sectors have done well proves that giving exemptions is not the best way to boost them.

c. The countervailing duty (CVD) of 16 percent should be levied uniformly so that the question of refunding the terminal excise duty, (which is associated with the CVD) is eliminated. There should be no exemption from CVD either.

d. If the zero customs duty allowed under this notification 85/99 is removed, then automatically the 15 percent price preference allowed under the World Bank guideline will return.

e. The exemption from 4 percent special additional duty (SAD) should be removed, and

imports for fertiliser, coal mining, power generation projects as well as for setting up of crude petroleum industry, should be brought under the purview of SAD.

All these measures will ensure the creation of a level playing field between the indigenous capital goods industry and foreign suppliers of capital goods. At this stage, if the indigenous capital goods industry is still not able to perform then it is they who would have to accept the consequences of fair competition, in whichever direction the industry moves.

3. Export Valuation

The valuation in Central Excise in the Budget has been now made into a transaction value. It was earlier based on the concept of deemed value. FERA Section 18 and in the FEMA Section 7 use the term "full export value" which in effect is transaction value. On the import side in customs, it has been based on the concept of transaction value since 1988. But on the export side in customs it still continues to be deemed value though many officers take it to be transaction value. In the Duty Exemption Passbook Scheme, it is transaction value as per Public Notice 143\97 dated 16.10.97 issued by the Commissioner Exports, Mumbai. Since Public Notices in legal matters are issued under the instructions of the CBEC, it indicates that there is some confusion about whether the valuation in exports is on the deemed value or transaction value . It is understood from discussions with various people that there is lack of uniformity in practice followed by different officers which result in uncertainty and even harassment.

It is pertinent to note that the WTO Agreement on Customs Valuation deals with value of imported goods and is silent on export valuation. Article 1 of the WTO Agreement specifically states that "the customs value of imported goods shall be the transaction value". So we have the option to adopt the transaction value.

The suggestion is therefore that an "Explanation" should be added to Section 14(1) of the Customs Act to make it clear that it is transaction value that should be used. That will also be in consonance with the principle followed in respect of the other valuations. At the same time it is also more reasonable, given the fact that international prices vary across transaction to transaction reflecting different circumstances.

There is also a doubt whether Section 14(1) is applicable even for goods where they are non-dutiable. (Duty refers to export duty.) There is one judgement in the context of DEEC Scheme, which says that it is applicable even under those circumstances. So the uncertainty should be ended by clarifying in the form of an "Explanation" that it applies also for non-dutiable goods. If the above is done then it will not be necessary to frame rules for export valuation. This will result in less number of rules which is better.

4. Administration Issues

a. Clearance of Cargo

Delay in the clearance of imported cargo in ports and airport cargo stations is a major source of complaint by trade and industry. Delay of course increases the cost of production. The other adverse effects are congestion in the ports leading to under-utilisation of port facility as well as corruption. In fact if the ports are decongested by quick clearance of cargo, they could handle much more cargo than currently. Such improvement should reduce the need to invest enormous sums for constructing new ports.

The Group visited a major port and examined the process of computerisation of import cargo, EDI (electronic data interface), instructions on the Fast Track Clearance Scheme and, finally, the actual clearance of goods in the dockyard. In spite of the overall computerised set up and the claim made at various levels that clearance of goods was very fast, it was found that many queries were being raised in a routine manner which delay the clearance of goods. On one day alone

there were 54 queries, 42 percent of which only asked for catalogues, 25 percent asked for provisional duty bond without indication of the reason for asking such bonds and the rest for chemical tests, other documents etc. The average number of bills of entries (clearance documents) being in the region of 300 per day, the percentage of queries came to nearly 18 percent a day. Calling for catalogues is necessary partially because there are a lot of exemptions even now, but also because the assessing officers may be inclined to want to establish contact with importers for reasons which could be suspect.

In sum, the so-called Fast Track Clearance Scheme is highly restricted and has not produced the desired result. It continues with the old system of examining the goods when they are imported under the export promotion schemes. The facility of non-examination has been given to those who have an "unblemished record". However, in Central Excise self-removal and self-assessment facilities are universally applicable . But in Customs they are severely restricted. The result is that it is hardly availed of.

To make clearance speedy and to decongest the ports the following steps should be taken:

a. In Canada, Netherlands, the United Kingdom and the United States, importers self-classify, value and remove the goods. The goods are not examined except when intelligence warrants physical checking. In India too goods should not be examined at all, and only targeted goods should be checked on the basis of intelligence. This should be allowed to manufacturer-importers irrespective of previous cases against them as is the case of Central Excise. Post–auditing should be carried out based on data recorded in the computer. For this the intelligence collection machinery should be strengthened. It should be remembered that hardly any big fraud case has been detected in Customs over a period of time by examining goods at the docks. Rather, the prevailing system has become a source of delay and abuse.

b. Classification is done in the Customs House and clearance is done in the docks. There are computer terminals in the docks where the same data are available as in the Customs House. The importers have to go the Customs House for taking the bills of entry and then again to the docks for clearance. This can be simplified if the assessing officers are available in the docks and Bank transactions are made possible there. In that case the importer can come to the docks, take the bill of entry, pay the duty and clear the goods all at one place. Even now one deputy collector was found at the dock office. If necessary, one additional collector could also be placed there to sort out the day to day problems. It is a question of finding some more office space in the docks, which is not difficult. This system will definitely bring the procedure of clearance of goods nearer to the aspiration of a "single window clearance".

c. Another way to expedite the clearance of goods is to reduce exemptions. It must be admitted that even if the assessing officers are honest and diligent, they have to satisfy themselves about the correctness of classification. This becomes difficult with so many exemptions in the tariffs. Recommendations regarding reduction in exemptions have already been made above.

b. Modifications Applicable to Both Customs and Excise

(i) Advance ruling on classification

The Government has made a law for advance rulings for excise and also customs in the 1999 Finance Act according to which, a binding ruling will be given for the NRIs by an authority which will be presided over by a retired Supreme Court judge. The scheme has incorporated all sorts of judicial formalities. CRPC and CPC have been made applicable, as it will be like a court.

The proper course of action in this respect is to give up the judicial cloak and make the CBEC give the advance rulings. The CBEC has a group of technical experts who can advise it on such matters. What is important is uniformity and certainty. An excess of judicial procedures hampers economic progress, though it may benefit particular professionals such as lawyers and solicitors. Further the advance rulings should also be made available to all and not be restricted to NRIs alone.

(ii) Stop the flurry of remanding the cases

Frequent remanding of cases by some officers like the Commissioner (Appeal) and the Tribunal has become a cause for harassment to the industry. It is not objected to by the lawyers for obvious reasons and it gives easy disposal to the authority passing the order. The incidence of remand has reached such proportions that, in fifty percent of the cases, the party cannot expect a final order. Under all sorts of pretexts, the cases are being remanded to the subordinate authorities. It is not possible to get authentic data on the number of cases being remanded. But there is no doubt that the incidence of such cases is very high.

In order to stop such excessive remands, it is necessary for the CBEC to call for a monthly report from all adjudicating and appellate officers on the number of cases being remanded. The reasons should be analysed and proper instructions given not to remand cases beyond a very small number. In the case of the Tribunal, the data can be collected through the office of the Senior Departmental Officer and the matter can be brought to the notice of the Revenue Secretary.

(iii) Add appropriate explanations in exemptions

Many doubts and controversies can be avoided if Explanations are added to remove the doubts. An example will make the point clear. There was an exemption for boiler designed for agricultural and municipal waste as per notifications 121\81 C.E. and 205\88 C.E. A certificate was

also to be obtained from the Chief Inspector of Boilers. These notifications were sources of litigation on the issue as to whether the boiler was to be designed exclusively for these wastes. An easy solution to such problems would be to incorporate an Explanation in the notification that it was not to be exclusively designed, as it was later decided by the Tribunal. More use of Explanations as soon as controversies come to light or at the initial stages of drafting the notification, should reduce litigation significantly.