# CHAPTER I : CENTRAL EXCISE RECEIPTS

## 1.1 Budget estimates, revised budget estimates and actual receipts *

The budget estimates, revised budget estimates and actual receipts of central excise duties during the year 1999-2000 to 2003-04 are exhibited in the table below: -

**(Amount in crore of rupees)**

| Year | Budget estimates | Revised budget estimates | Actual receipts | Difference between actual receipts and budget estimates | Percentage variation |
|---|---|---|---|---|---|
| 1999-2000 | 63565 | 60731 | 61672 | (-) 1893 | (-) 2.98 |
| 2000-01 | 70967 | 70399 | 68282 | (-) 2685 | (-) 3.78 |
| 2001-02 | 81720 | 74520 | 72306 | (-) 9414 | (-) 11.52 |
| 2002-03 | 91141 | 86993 | 82041 | (-) 9100 | (-) 9.98 |
| 2003-04 | 96396 | 91850 | 90390 | (-) 6006 | (-) 6.23 |

* Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs).

The actual collections fell short of the budget estimates as well as the revised estimates year after year. Despite this, Government continued to make optimistic projections during presentation of the Annual Budget. The budget estimate 2003-04 was pitched at Rs.96,396 crore, an increase of 5.76 per cent over budget estimates, 10.8 per cent over revised estimate and 17.50 per cent over actuals of 2002-03. The collections fell short of the budget estimates by Rs.6,006 crore or 6.23 per cent and short of revised estimates by Rs.1,460 crore or 1.58 per cent.

## 1.2 Value of output** *vis-à-vis* central excise receipts

The value of output from the manufacturing sector vis-a-vis receipt of central excise duties through personal ledger account (cash collection) during the years 1999-2000 to 2003-04 are as follows: -

**(Amount in crore of rupees)**

| Year | Value of output | Central excise | Percentage of central excise receipts to value of production |
|---|---|---|---|
| 1999-2000 | 886244 | 61672 | 6.96 |
| 2000-01 | 991564 | 68282 | 6.89 |
| 2001-02 | 1050239 | 72306 | 6.88 |
| 2002-03 | 1158294 | 82041 | 7.08 |
| 2003-04 | 1242849 | 90390 | 7.27 |

** Includes value of all goods produced during the given period including net increase in work-in-progress and products for use on own account. Valuation is, at producers values, that is the market price at the establishment of the producers. As separate figures of value of production by Small Scale Industry Units and for export production were not available, these have not been excluded from the value of output indicated. Value of output for the year 2003-04 is based on estimates. Source : Central Statistical Organisation (Government of India).

The foregoing table reveals that value of output had increased by a factor of 1.40 during the years 1999-2000 to 2003-04 and the corresponding increase in the central excise receipts was by a factor of 1.47.

## 1.3 Central excise receipts vis-a-vis Modvat/Cenvat availed*

A comparative statement showing the details of central excise duty paid through personal ledger account (PLA) and the amount of Modvat/Cenvat availed during the years 1999-2000 to 2003-04 is given in the following table: -

**(Amount in crore of rupees)**

| Year | Central excise duty paid through PLA | | Modvat/Cenvat availed | | Percentage of Modvat/Cenvat to duty paid through PLA |
|---|---|---|---|---|---|
| | Amount | Percentage increase | Amount | Percentage increase | |
| 1999-2000 | 61672 | 16.25 | 41230 | 16.18 | 66.85 |
| 2000-01 | 68282 | 10.72 | 44986 | 9.11 | 65.88 |
| 2001-02 | 72306 | 5.89 | 47509 | 5.61 | 65.71 |
| 2002-03 | 82041 | 13.46 | 53039 | 11.64 | 64.65 |
| 2003-04 | 90390 | 10.18 | 66576 | 25.52 | 73.65 |

* Figure furnished by the Ministry of Finance (the Ministry).

The above table shows that while the central excise receipts had grown only by 47 per cent during the years 1999-2000 to 2003-04, the growth in Modvat/Cenvat availed during the relevant period was 61 per cent. The percentage of Modvat/Cenvat availed to duty paid by cash which decreased consistently from 66.85 to 64.65 till 2002-03, increased sharply to 73.65 in 2003-04. This was also reflected in the steep rise in Modvat/Cenvat credit availed during 2002-03 and 2003-04 at 11.64 and 25.52 percentage levels respectively.

## 1.4 Cost of collection **

The expenditure incurred during the year 2003-04 in collecting central excise duty alongwith the corresponding figures for the preceding four years is given below: -

**(Amount in crore of rupees)**

| Year | Receipts from excise duty | | Expenditure on collection | | Cost of collection as percentage of receipts |
|---|---|---|---|---|---|
| | Amount | Percentage increase over previous year | Amount | Percentage increase over previous year | |
| 1999-2000 | 61672 | 16.25 | 584.82 | 6.87 | 0.95 |
| 2000-01 | 68282 | 10.72 | 615.84 | 5.30 | 0.90 |
| 2001-02 | 72306 | 5.89 | 635.79 | 3.24 | 0.88 |
| 2002-03 | 82041 | 13.46 | 702.55 | 10.50 | 0.86 |
| 2003-04 | 90390 | 10.18 | 751.13 | 6.91 | 0.83 |

** Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs).

## 1.5 Outstanding demands ***

The number of cases and amount involved in demands for excise duty outstanding for adjudication/recovery as on 31 March 2003 and 31 March 2004 are as follows: -

**(Amount in crore of rupees)**

| | | As on 31 March 2003 | | | | As on 31 March 2004 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Number of cases | | Amount | | Number of cases | | Amount | |
| | | More than five years | Less than five years | More than five years | Less than five years | More than five years | Less than five years | More than five years | Less than five years |
| (a) | **Pending with** Adjudicating officers | 1205 | 23210 | 313.10 | 14718.58 | 876 | 20361 | 565.03 | 10540.64 |
| (b) | **Pending before** | | | | | | | | |
| (i) | Appellate Commissioners | 1436 | 18968 | 475.63 | 2903.29 | 816 | 9744 | 273.92 | 1646.89 |
| (ii) | Board | 15 | 0 | 0.02 | 0.00 | 4 | 1 | 0.01 | 0.39 |
| (iii) | Government | 148 | 49 | 4.16 | 10.85 | 176 | 48 | 6.00 | 5.27 |
| (iv) | Tribunals | 1958 | 6420 | 861.30 | 7678.55 | 2039 | 7920 | 765.32 | 6233.64 |
| (v) | High Courts | 785 | 1152 | 942.65 | 975.36 | 528 | 1375 | 249.43 | 714.07 |
| (vi) | Supreme Court | 154 | 271 | 128.86 | 358.69 | 128 | 344 | 155.51 | 682.07 |
| (c) | **Pending for coercive recovery measures** | 4568 | 6260 | 283.05 | 989.54 | 3802 | 6398 | 317.19 | 1120.39 |
| | **Total** | **10269** | **56330** | **3008.77** | **27634.86** | **8369** | **46191** | **2332.41** | **20943.36** |

*** Provisional figure furnished by the Ministry and relates to 92 Commissionerates.

A total of 54,560 cases involving duty of Rs.23,275.77 crore were pending finalisation as on 31 March 2004 with different authorities.

## 1.6 Fraud/presumptive fraud cases *

The position of fraud/presumptive fraud cases alongwith the action taken by the Department against the defaulting assessees during the period 2001-02 and 2003-04 is depicted in the following table :

**(Amount in crore of rupees)**

| Year | Cases detected | | Demand of duty raised | Penalty imposed | | Duty collected | Penalty collected | |
|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Amount | Number | Amount | Amount | Number | Amount |
| 2001-02 | 1555 | 949.45 | 333.45 | 341 | 62.82 | 20.98 | 103 | 1.43 |
| 2002-03 | 1766 | 1696.08 | 594.55 | 281 | 589.69 | 52.35 | 98 | 0.33 |
| 2003-04 | 2252 | 1832.24 | 1056.69 | 563 | 171.53 | 57.13 | 62 | 0.16 |
| **Total** | **5573** | **4477.77** | **1984.69** | **1185** | **824.04** | **130.46** | **263** | **1.92** |

* Provisional figure furnished by the Ministry and relates to 92 Commissionerates

The above data reveals that while a total of 5,573 cases of fraud/presumptive fraud were detected during the years 2001-04 by the Department, involving duty of Rs.4,477.77 crore,

the Department raised a demand of Rs.1,984.69 crore only and recovered Rs.130.46 crore (6.57 per cent) out of it. Similarly, out of penalty of Rs.824.04 crore imposed, the Department recovered only Rs.1.92 crore (0.23 per cent).

## 1.7 Commodities contributing major revenue *

Commodities which yielded revenue of more than Rs.1,000 crore during 2003-04 alongwith corresponding figures for 2002-03 are as follows :

**(Amount in crore of rupees)**

| Sl. No. | Commodity | 2002-03 (Actual) | 2003-04 (Actual) | Percentage variation of actual over previous year | Percentage share in total collection |
|---|---|---|---|---|---|
| 1. | Refined diesel oil | 10569.61 | 13469.72 | 27.44 | 14.90 |
| 2. | Motor spirit | 11562.82 | 12574.96 | 8.75 | 13.91 |
| 3. | Iron & steel | 5885.88 | 7330.33 | 24.54 | 8.10 |
| 4 | Cigarettes and cigarillos of tobacco or tobacco substitutes | 5139.97 | 5495.34 | 6.91 | 6.08 |
| 5. | Cess on crude oil | 4501.42 | 5134.08 | 14.05 | 5.68 |
| 6. | Cement, clinkers, cement all sorts | 3441.14 | 4219.93 | 22.63 | 4.67 |
| 7. | Other petroleum products (excluding furnace oil and diesel oil NES) | 3482.52 | 2906.09 | (-) 16.55 | 3.22 |
| 8. | Petroleum gases and other gaseous hydrocarbons | 2445.36 | 2552.10 | 4.35 | 2.82 |
| 9. | All other machinery articles and tools falling under chapter 84 | 1911.85 | 2321.21 | 21.41 | 2.57 |
| 10 | Plastics and article thereof | 1858.58 | 2151.83 | 15.78 | 2.38 |
| 11. | Motor cars and other motor vehicles for transport of persons | 2484.58 | 2141.10 | (-) 13.82 | 2.37 |
| 12. | All other vehicles etc., falling under chapter 87 | 1721.62 | 2061.52 | 19.74 | 2.28 |
| 13. | Organic chemicals | 1609.13 | 1722.34 | 7.03 | 1.90 |
| 14. | Kerosene | 1390.39 | 1700.08 | 22.27 | 1.88 |
| 15 | Pharmaceutical products | 1421 | 1434.45 | 0.95 | 1.59 |
| 16. | Paper and paper board, articles of paper pulp or paper or paper board | 1173.91 | 1350.40 | 15.03 | 1.49 |
| 17. | Cane or beet sugar and chemically pure sucrose in solid form | 1277.10 | 1340.38 | 4.95 | 1.48 |
| 18. | Public transport type passenger motor vehicles and motor vehicles for the transport of goods | 1023.77 | 1239.41 | 21.06 | 1.37 |
| 19. | Articles of iron and steel | 824.91 | 1137.39 | 37.88 | 1.26 |
| 20. | All other electricity machinery falling under chapter 85 | 998.68 | 1104.41 | 10.58 | 1.22 |
| 21. | Synthetic filament yarn and sewing thread including synthetic monofilament and waste | 1304.60 | 1071.50 | (-) 17.87 | 1.19 |

* Figure furnished by the Ministry.

The above table reveals that there was a lower collection of revenue during 2003-04 in synthetic filament yarn and sewing thread including synthetic monofilament and waste, other petroleum products (excluding furnace oil and diesel oil NES) and motor cars and other motor vehicles for transport of persons to the extent of (-) 17.87, (-) 16.55 and (-) 13.82 per cent respectively over previous year.

## 1.8 Contents

This section contains two reviews, 'Excise duty on motor vehicles for transport of persons and goods' and 'Working of excise audit-2000'. The revenue implication is Rs.644.44 crore. Besides, there are 217 paragraphs (including cases of total under assessment), featured individually or grouped together, arising from test check of records maintained in departmental offices and the premises of the manufacturers pointing out leakage of revenue aggregating Rs.1,897.94 crore. Of these, the concerned Ministries/Departments had (till January 2005) accepted audit observations in 151 paragraphs involving Rs.814.30 crore and recovered Rs.27.73 crore. Based on available information, statutory audit detected objections in 170 cases where internal audit had already been done.

# CHAPTER II : REVIEW ON EXCISE DUTY ON MOTOR VEHICLES FOR TRANSPORT OF PERSONS AND GOODS

## 2.1 HIGHLIGHTS

- **Benefit of reduction in excise duty was not fully passed on to consumers resulting in about 38 per cent of revenue foregone being retained by the manufacturers particularly in middle and luxury segments.**

**(Paragraph 2.6.1)**

- **Payment of excise duty on 'agreed price' instead of on normal transaction value by the 'related person' resulted in revenue loss of Rs.11.21 crore.**

**(Paragraph 2.7.1)**

- **Payment of duty on the amount lower than the 'transaction value' resulted in revenue loss of Rs.8.54 crore.**

**(Paragraph 2.7.3)**

- **Non-payment of excise duty on the amount representing additional consideration flowing from buyers to assessee resulted in revenue loss of Rs.9.98 crore.**

**(Paragraph 2.7.4)**

- **Irregular availment of Cenvat credit resulted in revenue loss of Rs.32.80 crore.**

**(Paragraph 2.8)**

- **Non-payment of service tax on various services rendered by the motor car/motor vehicle manufacturers resulted in revenue loss of Rs.6.21 crore**

**(Paragraph 2.9)**

- **Non-recovery of confirmed demands and non-adjudication of demands resulted in blockage of revenue of Rs.545.32 crore.**

**(Paragraphs 2.10.1 & 2.10.2)**

## 2.2 Introduction

'Motor cars and other vehicles for transport of persons and goods' have been classified under chapter 87 of the schedule to the Central Excise Tariff Act, 1985, and are among the top ten commodities, yielding major revenue to the Government.

## 2.3 Audit objectives

The records of selected manufacturing units were scrutinized in audit to evaluate the impact of changes in duty structure made in the budgets of March 2001 and March 2003 on benefits

passed on to consumers, sales growth and government revenue as also to seek assurance that: -

(i) valuation of goods was done in accordance with provisions of section 4 of the Act and Central Excise Valuation Rules (as amended from time to time);

(ii) credit of duty paid on inputs/capital goods under Modvat/Cenvat was taken correctly;

(iii) service tax on the services provided/received by the manufacturers was paid correctly; and

(iv) internal controls were effective to safeguard revenue interest.

## 2.4 Audit coverage

Motor cars and motor vehicles falling under chapter 87 of Central Excise Tariff Act, 1985 were covered in the review. For this purpose, records of 44 manufacturing units as well as related range offices in 21 out of 92 Commissionerates of Central Excise for the period 2000-01 to 2003-04 (upto 30 September 2003) were test checked.

## 2.5 Results of audit

The revenue trend in respect of 44 manufacturing test checked units in 21 Commissionerates of Central Excise was as under: -

**(Amount in crore of rupees)**

| Year | Duty paid through PLA | Duty paid through Modvat | Total duty paid |
|---|---|---|---|
| 2000-01 | 3612.16 | 3353.59 | 6965.75 |
| 2001-02 | 3212.29 | 3600.42 | 6812.71 |
| 2002-03 | 3539.08 | 3994.43 | 7533.51 |
| 2003-04 (Upto September 2003) | 1328.61 | 2654.26 | 3982.87 |

### Macro evaluation

**2.6** In the budget for 1999-2000, Government rationalized the duty structure by introducing triple rate of excise duty, at eight, 16 and 24 per cent. While presenting the Budget, the Finance Minister, on consideration of revenue in that 'difficult' year, fixed two slabs of surcharge (special duty of excise) of six per cent and 16 per cent, over the rate of 24 per cent on commodities which carried rate of duty of 30 per cent and 40 per cent respectively. This was levied on certain categories of motor vehicles with overall excise duty of 30 per cent and 40 per cent respectively remaining unchanged. In the budget for 2000-01, although the basic excise duty was decreased to 16 per cent, the Government raised the special excise duty (SED) to 24 per cent keeping the overall duty rate unchanged. In the Budget 2001-02, the SED on the motor cars/vehicles was, however, reduced from 24 per cent to 16 per cent, and in the Budget 2003-04, the SED was further reduced by eight per cent. This had the effect of reduction in the overall rate of duty from 40 to 32 per cent in the year 2001-02 and from 32 to 24 per cent in the year 2003-04.

The impact of reduction in overall rates of excise duty in terms of benefits passed on to the consumers by the manufacturers, on sales growth and in generation of Government revenue in this sector was evaluated in audit.

### *2.6.1 Significant proportion of the amount representing reduced duty retained by manufacturers*

Analysis of the price pattern revealed that in the case of three major manufacturers of motor cars viz. M/s. Maruti Udyog, M/s. Tata Motors and M/s. Honda Siel Cars (I) Limited, (which together have a market share of 65 per cent) and a manufacturer of utility vehicles viz. M/s. Mahindra and Mahindra Limited (market share of 41 per cent in the utility segment), the extent of benefit of reduction in the rate of excise duty passed on by them to the consumers had followed a pattern as shown below: -

**(Amount in crore of rupees)**

| Commiss-ionerate | Assessee | Period | Percentage of the average price representing eight per cent of the duty reduced (on assessable value) | Percen-tage of the average price reduced | Dates on which price increased | Percen-tage increase in average sale price | Percentage of the amount representing eight per cent of the duty retained by the manufacturer as on 28.02.2002 |
|---|---|---|---|---|---|---|---|
| Delhi III | M/s. Maruti Udyog | 01.03.2001 to 28.02.2002 | 5.62 | 4.69 | 06.08.2001 and 28.01.2002 | 3.59 | 4.88 |
| Pune I | M/s. Tata Motors | | 4.94 | 4.36 | 01.06.2001 | 2.90 | 3.48 |
| Noida | M/s. Honda Siel | | 5.76 | 4.35 | 07.01.2002 | 1.96 | 3.37 |
| Nasik | M/s. Mahindra and Mahindra | | 4.96 | 2.13 | 08.01.2002 | 1.65 | 4.48 |

From the above, it would be evident that while the manufacturers had reduced prices consequent upon the reduction in excise duty, such reduction was not fully proportionate to the level representing excise duty reduction. They, however, increased prices after gaps of three to 10 months resulting in further retention of the benefit of excise duty reduction.

Audit attempted to ascertain whether the increase in the sale price of motor cars/vehicles could possibly be attributable to the rise in cost of raw material. The cost price of three major raw materials which are invariably used by manufacturers was analysed as per the table given below: -

**(Amount in lakh of rupees)**

| Raw material purchased by M/s. Maruti Udyog Limited | Cost price per tonne | | | Percentage decrease in price in 2002-03 compared to 2000-01 |
|---|---|---|---|---|
| | 2000-01 | 2001-02 | 2002-03 | |
| Steel coil | 0.36 | 0.33 | 0.32 | 11.11 |
| Ferrous castings | 0.77 | 0.75 | 0.56 | 27.27 |
| Non-ferrous castings | 3.08 | 3.04 | 2.36 | 23.38 |

It was observed that there was no rise in the prices of major raw materials to warrant increase in the sale price of motor cars/vehicles. On the contrary, the prices had declined during the years 2001-02 and 2002-03.

Further scrutiny revealed that the benefit of reduction in excise duty had been retained by some manufacturers during the period from 1 March 2001 to 30 September 2003 as given below: -

**(Amount in crore of rupees)**

| **Commissione-rate** | **Assessee** | **Revenue foregone due to reduction in excise duty (from 01.03.2001 to 30.09.2003)** | **Amount on account of reduction of duty retained by assessee** | **Amount on account of reduction of duty passed on to the consumer** | **Ratio of column 4:5** |
|---|---|---|---|---|---|
| **(1)** | **(2)** | **(3)** | **(4)** | **(5)** | **(6)** |
| Mumbai V and Nasik | M/s. Mahindra and Mahindra Limited | 161.81 | 79.65 | 82.16 | 49:51 |
| Pune I and Lucknow | M/s. Tata Motors Limited | 658.03 | 268.15 | 389.88 | 41:59 |
| Aurangabad | M/s. Skoda (I) Limited | 46.22 | 38.27 | 7.95 | 83:17 |
| Noida | M/s. Honda Siel Cars India Limited | 133.93 | 57.09 | 76.84 | 43:57 |
| Delhi III | M/s. Maruti Udyog Limited | 1444.12 | 484.15 | 959.97 | 34:66 |
| | **Total** | **2444.11** | **927.31** | **1516.80** | **38:62** |

An analysis revealed the following: -

(i) M/s. Maruti Udyog, whose sales of motor cars were largely in the family segment (price upto Rs.3 lakh) retained only 34 per cent of the amount representing reduction in excise duty.

(ii) M/s. Mahindra and Mahindra Limited and M/s. Tata Motors which had retained 49 per cent and 41 per cent of the amount representing reduction in excise duty respectively were manufacturing motor cars/vehicles in the middle segment (price from Rs.3-5 lakh).

(iii) M/s. Skoda (I) Limited and M/s. Honda Siel Cars India Limited, which had retained 83 per cent and 43 per cent of the amount respectively representing reduction in excise duty were manufacturing motor cars in the luxury segment priced at more than Rs.7 lakh and Rs.10 lakh respectively.

Thus, it was evident that manufacturers of motor cars/vehicles in middle and luxury segments retained substantial amounts representing elements of reduced duty.

The reduction in the excise duty benefited the manufacturers to the detriment of the interest of consumers. The revenue foregone by the Government upto 30 September 2003 from the five manufacturers was to the extent of Rs.2,444.11 crore, of which Rs.927.31 crore was retained by them.

On this being pointed out (July 2004), the Ministry stated (November 2004) that though there was no direct linkage between duty reduction and price reduction and no legal provision to safeguard price reduction it was expected that manufacturers would have reduced prices consequent upon duty reduction.

However the expectation had been belied as substantial component of amount representing reduced duty had been retained by the manufacturers even though there was no rise in the cost of major raw material.

### *2.6.2 Sales growth could not off set the reduction in the duty rate*

Analysis of sales records of 10 major manufacturers of motor cars/vehicles revealed that the expected growth in the sales was not adequate enough to offset reduction in the duty rate from 40 per cent to 32 per cent with effect from 1 March 2001 and from 32 per cent to 24 per cent with effect from 1 March 2003 as per the details given in the table below: -

**(Amount in crore of rupees)**

| Sale from 01.03.2000 to 28.02.2001 (Number) | Duty paid through PLA (Amount) | Sale from 01.03.2001 to 28.02.2002 (Number) | Duty paid through PLA (Amount) | Sale from 01.03.2002 to 30.09.2002 (Number) | Duty paid through PLA (Amount) | Sale from 01.03.2003 to 30.09.2003 (Number) | Duty paid through PLA (Amount) |
|---|---|---|---|---|---|---|---|
| 547640 | 2257.13 | 587941 | 2162.99 | 367202 | 1400.01 | 402421 | 1026.91 |

While car sales went up 7.35 per cent during the period 1 March 2001 to 28 February 2002, net excise collection shrank by 4.17 per cent during the same period compared to previous year. A twelve per cent growth in sales would have been necessary for retention of excise revenues at the same level.

Similarly, during the period 1 March 2003 to 30 September 2003, the car sales increased by 9.59 per cent but collection of excise duty fell by 26.64 per cent compared to previous period. The percentage growth in car sales would have had to be 49.40 per cent to ensure the same level of excise revenues in the corresponding previous period.

### *2.6.3 Net excise collection vis-à-vis Modvat/Cenvat availed*

The effect of reduction in excise duty on the ratio of excise duty paid through Personal Ledger Account (net excise collection) and Cenvat credit in respect of 10 major manufacturers is indicated in the table below: -

**(Amount in crore of rupees)**

| Excise duty paid from 01.03.2000 to 28.02.2001 | | | Excise duty paid from 01.03.2001 to 28.02.2002 | | | Excise duty paid from 01.03.2002 to 30.09.2002 | | | Excise duty paid from 01.03.2003 to 30.09.2003 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Through PLA | Through Modvat/ Cenvat | Total | Through PLA | Through Modvat/ Cenvat | Total | Through PLA | Through Modvat/ Cenvat | Total | Through PLA | Through Modvat/ Cenvat | Total |
| 2257.13 | 2189.28 | 4446.41 | 2162.99 | 2012.39 | 4175.08 | 1400.01 | 1369.63 | 2769.64 | 1026.91 | 1556.61 | 2583.52 |

An analysis revealed the following: -

(i) The ratio of excise duty paid through PLA vis-à-vis Cenvat credit stood at around 52:48 during the period 1 March 2001 to 28 February 2002 compared with 51:49 in 1 March 2000 to 28 February 2001.

(ii) The ratio, however, significantly came down to 40:60 during the period from 1 March 2003 to 30 September 2003 from 51:49 during 1 March 2002 to 30 September 2002.

(iii) A large proportion of parts and components of motor cars/vehicles are manufactured by vendors and received as input by manufacturers on which they take Cenvat credit. Since

rate of duty on inputs remained unchanged, net excise collection after adjusting Cenvat credit shrank significantly when excise duty on the final product (motor vehicles) was reduced on 1 March 2001 and 1 March 2003.

**Micro issues**

## 2.7 Valuation

Section 4 of the Central Excise Act, 1944, was replaced by new section 4 with effect from 1 July 2000 bringing in the concept of "transaction value" for levy of duty. New valuation rules were also introduced vide the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 with effect from the same date.

Test check of records of selected motor cars/vehicles manufacturers revealed the following irregularities: -

### *2.7.1 Goods sold through related person*

Rule 9 of the Central Excise Valuation Rules, 2000, stipulates that where the assessee so arranges that excisable goods are not sold by the assessee except to or through a person who is related in the manner specified in section 4 of the Act, value of the goods shall be the normal transaction value at which these are sold by the related person at the time of removal to buyers (not being related), or where such goods are not sold to such buyers, to buyers (being related person) who sell such goods in retail.

(i) M/s. Maruti Udyog, Gurgaon and M/s Swaraj Mazda Limited, under Delhi III and Jalandhar Commissionerates of Central Excise respectively got spare parts and accessories manufactured through persons who were 'related persons' in terms of section 4 of the Act. Such goods were procured by the spare parts divisions of these manufacturers at an 'agreed price' and were supplied to dealers or service stations/workshops directly at higher prices. Excise duty was, however, paid on the agreed price instead of on the price at which these goods were sold by the spare parts division. This resulted in short payment of excise duty to the extent of Rs.11.21 crore for the period from April 2000 to September 2003 and notional interest thereon amounting to Rs.5.82 crore.

(ii) M/s. Tata Motor Limited in Pune-I Commissionerate of Central Excise, cleared the goods to M/s. Concorde Motors Limited (related person). The assessee availed deduction on account of dealers' mark-up and period discount in respect of clearances made to the related person. In view of the provisions contained in rule 9 of Valuation Rules, in such a case, the value would be the normal transaction value at which it was sold by the related person (M/s. Concorde Motors Limited) to the unrelated buyers. Therefore, the deductions from assessable value on account of dealers' mark-up and period discount were not admissible. Undervaluation of the goods during the period 1 July 2000 to 30 September 2003 thus resulted in short levy of duty amounting to Rs.2.43 crore and notional loss of interest of Rs.1.19 crore.

On this being pointed out (July 2004), the Ministry stated (November 2004) that they did not have direct or indirect interest in the business of each other

The reply of the Ministry is not tenable as M/s. Maruti Udyog in its balance sheet had declared these persons as 'related person'.

### *2.7.2 Undervaluation of goods consumed captively*

The Board vide circular dated 1 July 2002 clarified that valuation of goods in case of captive consumption, samples, free gifts etc. be done according to rule 11 read with rule 8 of the Central Excise Valuation Rules, 2000. Rule 8 of the Rules ibid stipulated that where excisable goods were not sold by the assessee but were used for consumption by him or on his behalf in the production or manufacture of other articles, the value would be 115 per cent of the cost of production or manufacture of such goods (110 per cent with effect from 5 August 2003).

Test check of records revealed that nine motor cars/vehicles manufacturers in eight Commissionerates of Central Excise, cleared motor cars/vehicles/parts of motor vehicles for captive consumption on payment of duty on the basis of 'transaction value' or the value wrongly calculated on cost of production instead of on the value calculated at 115 per cent of the cost of production. This resulted in short payment of duty of Rs.3.12 crore and interest of Rs.1.52 crore on clearances during different periods between July 2000 and September 2003.

### *2.7.3 Goods manufactured through job worker under valued*

As per rule 11 of the Valuation Rules, where the value of any excisable goods cannot be determined under the said rules, it is to be determined using reasonable means consistent with the principles and general provisions of these rules and sub section (1)(a) of section 4 of the Act ibid.

(i) M/s. Eicher Motors Limited in Indore Commissionerate of Central Excise, cleared chassis fitted with engine on payment of duty to job workers for fabrication of the body of buses, tankers, ambulances. The completed vehicles thus manufactured by the job workers were returned to the assessee after payment of duty on job charges only. The assessee ultimately sold these built-up vehicles to the dealers/buyers directly and through depots situated in various parts of the country on separate commercial invoices at a value much higher than the value on which duty was paid by the manufacturers and job workers. Sale of vehicle/chassis thus did not take place till the goods were received back from the job worker and sold by M/s. Eicher Limited to the buyers/dealers. The price charged by M/s. Eicher Limited would, therefore, be transaction value in terms of section 4(1)(a) of the Act and Valuation Rules made thereunder. Undervaluation of the goods for the period from 1 July 2000 to 30 November 2003 resulted in short payment of duty of Rs.5.36 crore and notional loss of interest of Rs.2.61 crore.

(ii) M/s. Swaraj Mazda Limited in Jalandhar Commissionerate of Central Excise, transferred chassis on payment of duty to M/s. JCB Limited in Chandigarh Commissionerate of Central Excise, for fabrication of buses on them. The buses so manufactured were transferred back to the special assignment cell (SAC), a branch of M/s. Swaraj Mazda Limited, which was engaged in marketing and selling of the vehicles on their behalf. SAC ultimately sold the buses to independent buyers at a value much higher than the value on which duty was paid. Actual sale of vehicles, thus did not take place till the goods were received back by M/s. Swaraj Mazda Limited in their marketing and selling divisions and cleared to the independent buyers. The price charged by M/s. Swaraj Mazda Limited from the buyers would, therefore, be the transaction value in terms of section 4(1)(a) of the Act. Undervaluation of the goods during the period from 11 January 2001 to 30 September 2003 resulted in short payment of duty of Rs.3.18 crore and notional loss of interest of Rs.1.24 crore.

On this being pointed out (August 2004), the Ministry stated (November 2004) that the sale of the body built vehicles, though by the assessees themselves would be a trading activity.

The reply of the Ministry is not tenable as the assessee sent the chassis to job worker for undertaking body building and sold them on their return as built up vehicles. The price charged by the assessee would, therefore, be transaction value in terms of section 4(1)(a) of the Act on which appropriate duty was required to be paid.

### *2.7.4 Other charges over and above transaction value*

Under rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, where excisable goods are sold in the circumstances specified in clause (a) of sub section (1) of section 4 of the Act except the circumstances where price is not the sole consideration for sale, value of such goods shall be deemed to be aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from buyer to the assessee.

(i) As per agreement executed between transporters and M/s. Maruti Udyog Limited in Delhi III Commissionerate of Central Excise, transport of vehicles from the factory gate to dealer's premises was arranged by M/s. Maruti Udyog Limited on behalf of the dealers. To meet the cost of repairs of vehicles damaged during transit, they recovered 'service charges' (varying from model to model) from the dealers over and above the declared transaction value.

Scrutiny of the records of M/s. Maruti Udyog revealed that during the period 1 July 2000 to March 2003 a sum of Rs.21.70 crore was shown as net recovery in the balance sheet from dealers after meeting the cost of repair of damaged vehicles. This amount was an additional consideration flowing back to M/s. Maruti Udyog Limited, Gurgaon on which excise duty amounting to Rs.7.37 crore, cess amounting to Rs.3 lakh and interest amounting to Rs.3.61 crore was payable.

(ii) M/s. Hyundai Motors (I) Limited in Chennai IV Commissionerate of Central Excise, received commission for sale of audio systems and other optional fittings, which were components of cars manufactured by the assessee. As commission received from the producers of optional fittings was in connection with sale of cars, it was includible in the assessable value of cars. Non-inclusion thereof resulted in short payment of Rs.96 lakh and notional interest loss of Rs.12 lakh.

On this being pointed out (August 2003), the Department issued demand notice (December 2003).

(iii) M/s. Mahindra and Mahindra Limited, M/s. Fiat India Limited and M/s. Skoda Private Limited in Mumbai V, Nasik, Mumbai II and Aurangabad Commissionerates of Central Excise, sold motor vehicles, which were registered as "taxi" after clearance. Since they were exempt from SED vide Notification dated 1 March 2002, the assessees received refund of SED paid on these goods. While the assessees had also recovered sales tax on SED from the buyers (which was also exempt), they returned to the buyers only the sum representing SED, and thus retained the amount representing sales tax on SED which was an additional consideration flowing from the buyers to the assessees. This resulted in short levy of duty to the tune of Rs.1.62 crore and notional interest thereon of Rs.84 lakh for the period from April 2000 to September 2003.

### *2.7.5 Price of the goods cleared to related person less than the cost adopted for captive consumption*

As per rule 11 of the Central Excise Valuation Rules, 2000, where the assessable value could not be determined by any other rule of the Valuation Rules, it could be determined using reasonable means consistent with the principles and general provisions of these rules and sub section (1) of section 4 of the Act.

M/s. Ashok Leyland Limited in Chennai I Commissionerate of Central Excise, cleared melting scrap generated in the course of manufacturing process to its sister unit M/s. Ennore Foundry, adopting assessable value at Rs.5.50 per kilogram. During audit of the assessee's branch factory, in Chennai III Commissionerate, it was noticed that the assessable value of melting scrap, captively consumed, was Rs.9.40 per kilogram. Both scraps were of the same melting grade and used for production of castings of motor vehicles chassis which were marketed under the same brand name. Undervaluation of scrap cleared to branch factory for the period from 2002-03 to 2003-04 resulted in short payment of duty of Rs.92 lakh.

On this being pointed out (December 2003), the Department stated that the buyer of the scrap and assessee company were not related persons (December 2003). Reply of the Department was not tenable, as the assessee had exhibited the transactions between the assessee and the branch factory under related party transactions in the balance sheet.

## 2.8 Cenvat credit

Under Modvat/Cenvat scheme, credit is allowed for duty paid on 'specified inputs' and 'specified capital goods' used in manufacture of finished goods. The credit can be utilised towards payment of duty on finished goods subject to the fulfilment of certain conditions. A few cases of incorrect availment of Modvat/Cenvat credit, noticed in test audit are elucidated in the following paragraphs :-

### *2.8.1 Credit availed on capital goods not received*

According to rule 3 of the Cenvat Rules, 2001/2002, a manufacturer is allowed to take credit of specified duty paid on capital goods received in the factory for use in or in relation to the manufacture of final products.

M/s. Fiat India Private Limited in Mumbai II Commissionerate of Central Excise, availed Cenvat credit on capital goods, which were actually not received in the factory. This resulted in irregular availment of Cenvat credit of Rs.6.53 crore and interest thereon amounting to Rs.2.54 crore for the period from 1 January 2001 to 31 December 2001.

### *2.8.2 Cenvat credit not reversed on inputs/capital goods destroyed in flood/found short/written off*

Board vide their instructions dated 22 February 1995 and 16 July 2002 clarified that no Cenvat credit was permissible on inputs/capital goods destroyed/found short/written off, before actually being used in the manufacture of final products.

Eight assessees in Mumbai II, Pune I, Aurangabad, Bangalore III, Delhi III, Indore and Baroda II Commissionerates of Central Excise, did not reverse Cenvat credit availed on the inputs/capital goods, which were either destroyed in flood, found short during annual stock-taking or written off from the stock-account. This resulted in irregular availment of Cenvat credit of Rs.5.23 crore and notional loss of interest of Rs.2.03 crore.

### *2.8.3 Incorrect availing of Cenvat credit on capital goods acquired on lease*

According to rule 57R(3) of the Central Excise Rules, 1944 (operative upto 31 March 2000), a manufacturer was allowed to take credit of specified duty paid on capital goods purchased on lease only if he had paid the duty amount to the financing company before paying the first instalment of lease rental. He was also required to produce a certificate from the financing company to that effect.

M/s. Fiat India Limited in Mumbai II Commissionerate of Central Excise, acquired capital goods on lease from M/s. Turin Auto (P) Limited, which were received in the factory during the years 1998-99 and 1999-2000. The assessee availed of credit of Rs.8.94 crore during April 2000 and June 2000. On verification of the lease records, it was observed that whereas the first rental was paid in August 2000, the amount of duty was paid subsequently in March 2001. Availing and utilizing credit without having paid duty was incorrect.

### *2.8.4 Refund of duty in cash when duty paid from Cenvat account*

According to notification dated 1 March 2002, motor vehicles falling under sub heading 8703.90, which after clearance have been registered for use solely as taxi, were exempt from payment of SED subject to fulfilment of relevant conditions laid down therein.

Refund of SED paid on such motor vehicles was admissible in terms of sub section 2(c) of section 11B of the Central Excise Act, 1944. In terms of notification ibid read with clarifications issued by Board dated 3 January 2003, refund of credit would, however, be allowed to be paid in cash only when the inputs were used in the manufacture of final products, which were cleared for export.

Scrutiny of records revealed that the Department had irregularly refunded in cash a sum of Rs.4.58 crore representing SED during April 2002 to March 2003 which was initially paid by the manufacturer M/s. Hindustan Motors Limited in Kolkata III Commissionerate of Central Excise from Cenvat account. This resulted in the assessee earning a cash flow of Rs.4.58 crore in the transactions irregularly.

### *2.8.5 Irregular Cenvat credit taken on capital goods on taking over of business*

Rule 57AF of the Central Excise Rules, 1944 (prior to 1 July 2001) stipulates that, if a manufacturer of final products shifts his factory to another site or the factory is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the factory to a joint venture with specific provision for transfer of liabilities of such factory, then he shall be allowed to transfer Cenvat credit lying unutilized in his account to such transferred, sold, merged, leased or amalgamated factory.

M/s. Premier Automobiles Limited (PAL) in Mumbai II Commissionerate of Central Excise, was taken over by M/s. Fiat India Private Limited in March 1998. On taking over the business, the assessee M/s. Fiat India Private Limited did not discharge the liability of confirmed demand against M/s. PAL, contending that it had taken over only a part of the liabilities. But M/s. Fiat India Private Limited availed of Modvat credit of Rs.2.81 crore which was lying unutilized in the account of M/s. PAL. Since provisions did not allow transfer of credit on transfer of part of liability, the availment of Modvat/Cenvat credit of Rs.2.81 crore by assessee was irregular and required to be reversed alongwith interest due thereon.

### *2.8.6 Incorrect availment of Cenvat credit on unspecified capital goods*

According to rule 57Q of the Central Excise Rules, 1944 as it existed prior to 1 April 2000 and rule 3 of the Cenvat Credit Rules, 2001/2002, a manufacturer or producer of final product could be allowed to take credit of specified duties paid on capital goods received in the factory for use in or in relation to the manufacture of final product. Capital goods eligible for Cenvat were specified in rule 57Q of old rules and rule 2 of Cenvat Credit Rules, 2001/2002.

M/s. Fiat India Private Limited, M/s. Tata Motor Limited, M/s. Bajaj Auto Limited, M/s. Bajaj Tempo Limited and M/s Hyundai Motor in Mumbai II, Pune I, Aurangabad, Pune I and Chennai IV Commissionerates of Central Excise, respectively availed of Cenvat credit of Rs.1.60 crore on unspecified capital goods received during the period 1998-99, 1999-2000 and December 2002 to June 2003, which were ineligible for Cenvat credit (when received in the factory). They were also liable to pay interest of Rs.1.24 crore.

### *2.8.7 Incorrect availment of Cenvat credit on inputs not received back*

According to rule 2(g) of the Cenvat Credit Rules, 2002, "input" meant all goods except light diesel oil, high speed diesel oil, which were used in or in relation to the manufacture of final products whether directly or indirectly and whether contained in the finished product or not.

M/s. Hyundai Motor (I) Limited in Chennai IV Commissionerate of Central Excise, availed Cenvat credit on the basis of supplementary invoice issued by a vendor for differential duty in respect of scrap generated during the production of various components out of the raw materials supplied by the assessee during February 2002 to November 2002. The vendor sold waste and scrap referred to in the supplementary invoice to a third party on payment of duty. Since scrap was not received by the assessee and did not constitute an input, availment of Cenvat credit to the extent of Rs.1.14 crore on this account was irregular.

On this being pointed out (April 2003), the Department reported issue of demand notice (February 2004).

### *2.8.8 Irregular availment of Cenvat credit on invalid certificate*

Under rule 57 G(3)(L) (applicable upto 31 March 2000), the certificate issued by superintendent of excise or customs was considered a valid document for availment of Modvat/Cenvat. But, according to rule 57 AE of the Central Excise Rules, 1944, effective from 1 April 2000, Cenvat credit could not be availed of on its basis.

M/s. Maruti Udyog Limited, Gurgaon, in Delhi III Commissionerate of Central Excise, imported machinery and spare parts under Export Promotion Capital Goods Scheme. As the assessee did not fulfil export obligations under the scheme, Commissioner Customs, Kandla raised a demand on 16 July 1998 for payment of differential duty on account of custom duty, countervailing duty (CVD) and interest, which were paid by the assessee on 17 July 1998. They availed Cenvat credit of Rs.1.29 crore during March 2003 on account of differential duty of CVD on the basis of certificate issued on 19 March 2001 by the superintendent of customs, Kandla. Since such a certificate was not valid under the new rule 57AE, the availment of Cenvat credit of Rs.1.29 crore was irregular.

### *2.8.9 Other cases*

Six other cases of irregular availment of Cenvat credit amounting to Rs.67.46 lakh were noticed during the review and are given in the table as follows: -

**(Amount in lakh of rupees)**

| Sl. No. | Commissi-onerate | Name of assessee | Nature of incorrect credit taken | Period | Amount | Remarks |
|---|---|---|---|---|---|---|
| 1. | Chennai IV | M/s. Hyundai Motors | Interest on the amount wrongly availed not levied | 01.04.2000 to 31.01.2002 | 32.00 | Demand confirmed |
| 2. | Chennai III | M/s. Tatra Udyog Limited, Hosur | Incorrect adoption of assessable value of inputs sold | 01.04.2000 to 31.03.2002 | 22.00 | Demand notice not issued even after confirmation of facts by department to Audit |
| 3. | Mumbai II | M/s. Fiat India Limited | Input not received back from job worker | 01.11.2002 to 28.08.2002 | 08.00 | Rs.04 lakh recovered |
| 4. | Pune I | M/s. Tata Motors Limited | Duty not paid on the value of capital goods | August 2002 | 04.00 | -- |
| 5. | Pune I | M/s. Bajaj Tempo | Input not received back from job worker | 01.09.2002 to 31.03.2003 | 01.00 | -- |
| 6. | Bangalore I | M/s. Volvo India Private Limited | Irregular availment of Cenvat credit | 01.02.2002 to 31.10.2002 | 0.46 | -- |
| **Total** | | | | | **67.46** | |

## 2.9 Service tax

Scrutiny revealed that some motor car/motor vehicle manufacturers had also provided services to clients on which service tax was payable.

A few illustrative cases are given below: -

### *2.9.1 Consulting engineer's service*

According to section 65(1) read with section 66 of Chapter V of Finance Act, 1997 with effect from 7 July 1997, the value of services of transfer of technical know-how and technical assistance of any manner to a client in one or more disciplines of engineering was liable for service tax under the category of consulting engineers. Under Rule 2(1)d(iv) of the Service Tax Rules, 1994 as amended person receiving taxable service would have to pay service tax, if the service provider was non-resident or was outside India and did not have any office in India.

M/s. Ford (I) Limited and M/s. Hyundai Motor in Chennai III and Chennai IV Commissionerates of Central Excise, respectively paid royalty of Rs.35.32 crore and Rs.81.86 crore to their parent companies during the period 2000-01 to 2003-04 for use of licensed information. Service tax to the extent of Rs.1.77 crore by M/s. Ford (I) Limited and Rs.1.84 crore by M/s. Hyundai (I) Limited remained unpaid.

### *2.9.2 Clearing and forwarding agent*

Service tax at the rate of five per cent was levied on services provided by clearing and forwarding agents with effect from 16 July 1997. CEGAT in the case of Prabhat Zarda

factory (India) Limited Vs. Commissioner of Central Excise, Patna {2002 (145) ELT 222 (Tri.-Kolkata)} held that the scope of services provided by clearing and forwarding agent was very wide and that apart from the actual dealings with goods, even services rendered indirectly which were connected with the clearing and forwarding operations in any manner of other persons, would be covered under the definition of clearing and forwarding agency.

It was noticed that M/s. Tata International Limited in Mumbai I Commissionerate of Central Excise, received a commission of Rs.20.11 crore during the period April 1999 to March 2003 from M/s. Tata Motors Limited for services of procuring orders and exporting goods on their behalf. The assessee, however, did not pay service tax of Rs.1.01 crore leviable thereon. Similarly, M/s. Mahindra and Mahindra Limited in Mumbai V Commissionerate of Central Excise, availed services of foreign persons for procuring orders and paid commission of Rs.15.30 crore for the financial year 2002-03. According to service tax rules as amended with effect from 16 August 2002, if the service provider happened to be a foreign person and did not have office in India, the service tax was to be paid by the service receiver. The assessee was, therefore, required to pay service tax of Rs.77 lakh according to amended rule. This resulted in non-payment of service tax on clearing and forwarding agent amounting to Rs.1.78 crore by these two companies.

### *2.9.3 Banking and other financial services*

Service tax at the rate of five per cent was levied on 'banking and other financial services' with effect from 16 July 2001 including financial leasing service, equipment leasing and hire-purchase.

M/s. Tata Motors Limited, M/s. Turin Auto Private Limited and M/s. Eicher Motors Limited, Pithampur in Mumbai II, Pune I and Indore Commissionerates of Central Excise respectively, provided equipment leasing and financial services, and collected Rs.10.72 crore for the period from 16 July 2001 to 31 March 2003. Service tax on this account amounting to Rs.58.00 lakh was, however, not paid.

### *2.9.4 Other cases of non-payment of service tax*

Scrutiny of records of motor cars/vehicles manufacturers revealed that service tax was not paid by them as shown in the table below: -

**(Amount in lakh of rupees)**

| **Sl. No.** | **Commissio-nerate** | **Name of assessee** | **Service provided** | **Tax leviable with effect from** | **Period** | **Amount of service tax not paid** |
|---|---|---|---|---|---|---|
| 1. | Pune III | M/s. Piaggio Vehicles | Market research agency | 16.10.1998 | 01.03.2003 to 19.11.2003 | 03.00 |
| 2. | Mumbai II | M/s. Fiat India Private Limited | Goods transport operators | 16.11.1997 | April 1998 to May 1998 | 05.00 |
| 3. | Vadodara II | M/s. General Motors India | Goods transport operators | 16.11.1997 | 16.11.1997 to 02.06.1998 | 05.48 |
| 4. | Chennai III | M/s. Tatra Udyog Limited | Annual maintenance services | 20.06.2003 | 01.07.2003 to 31.10.2003 | 10.40 |
| **Total** | | | | | | **23.88** |

## 2.10 Internal controls

Under rule 6 of the Central Excise Rules, 2002 the assessee is required to follow self assessment procedure. Departmental officers are, inter-alia, responsible for strengthening all assessments made for verification of correctness; issuing show cause notice (SCN) in the event of non-payment, short payment or erroneous refund; adjudicating SCN within the prescribed time limit; and enforcing recovery in case of confirmed demands.

Some illustrative cases of ineffective internal control mechanism noticed during the course of review are narrated below: -

### *2.10.1 Confirmed demands not recovered*

The Department was required to enforce recovery under section 11 of the Central Excise Act, 1944, in case assessees failed to make payment of confirmed demands for duty not levied or paid or erroneously refunded.

During the course of review it was observed that the Department did not initiate action for recovery of the confirmed demands as per the details given in the table below :-

**(Amount in crore of rupees)**

| Name of assessee | Commissionerate | Amount not recovered | Remarks |
|---|---|---|---|
| M/s. Premier Automobiles Limited (Now M/s. Fiat India Limited) | Mumbai II | 52.81 | While Department continued to sanction refund to the company, no action for recovery of confirmed demand was initiated against it. |
| M/s. Maruti Udyog, Gurgaon | Delhi III | 12.42 | The Department took no action for recovery of confirmed demand for more than one and half years till audit pointed it out in February 2004. |
| **Total** | | **65.23** | |

### *2.10.2 Cases pending adjudication*

According to provisions of section 11A of the Act, where SCNs had been issued, central excise officer was required to adjudicate the cases within six months in normal cases and within one year, in cases of non-levy/short levy due to fraud, collusions etc., where it was possible to do so.

Test check revealed that in 12 Commissionerates of Central Excise adjudication of 155 SCNs issued to motor cars/vehicles manufacturers involving a revenue of Rs.198.96 crore were pending. Age-wise pendency is given below: -

**(Amount in crore of rupees)**

| Sl. No. | Commissionerate | More than 5 years old | | More than 1 year old | | Less than 1 year old | | Total pendency | |
|---|---|---|---|---|---|---|---|---|---|
| | | No. | Amt. | No. | Amt. | No. | Amt. | No. | Amt. |
| 1. | Chennai IV | -- | -- | 2 | 7.26 | 3 | 4.59 | 5 | 11.85 |
| 2. | Bangalore I | -- | -- | 2 | 7.65 | 1 | 0.03 | 3 | 7.68 |
| 3. | Bangalore III | -- | -- | 6 | 6.54 | 1 | 0.02 | 7 | 6.56 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 4. | Delhi III | 1 | 0.29 | 6 | 74.83 | -- | -- | 7 | 75.12 |
| 5. | Mumbai V | -- | -- | 2 | 1.13 | -- | -- | 2 | 1.13 |
| 6. | Nasik | -- | -- | 5 | 15.63 | -- | -- | 5 | 15.63 |
| 7. | Pune I | 26 | 23.27 | 14 | 1.48 | 4 | 0.48 | 44 | 25.23 |
| 8. | Jamshedpur | -- | -- | 3 | 7.08 | -- | -- | 3 | 7.08 |
| 9. | Noida | -- | -- | -- | -- | 2 | 8.39 | 2 | 8.39 |
| 10. | Lucknow | 1 | 1.32 | 2 | 5.86 | -- | -- | 3 | 7.18 |
| 11. | Indore | 35 | 29.01 | 9 | 2.58 | 6 | 0.77 | 50 | 32.36 |
| 12. | Kolkata IV | 22 | 0.74 | 2 | 0.01 | -- | -- | 24 | 0.75 |
| **Total** | | **85** | **54.63** | **53** | **130.05** | **17** | **14.28** | **155** | **198.96** |

Eighty nine per cent of the cases constituting 93 per cent of the total revenue involved were more than a year old. Around 55 per cent of number of cases involving 27.5 per cent of the value of pendency, were pending adjudication for more than five years.

Further, scrutiny of the records of Nasik Commissionerate revealed that demands for Rs.281.13 crore against M/s. Mahindra and Mahindra, Nasik were transferred to call book due to Board's instructions. The issue was kept pending for more than 5 years for want of a decision by the Board.

Despite the amendments brought in section 11A of the Act of fixing time-limit for adjudication of demand notices, albeit, with qualification 'where it was possible to do so', the pace of finalisation was very slow. Such pendency was indicative of the need to monitor disposal of adjudication cases more effectively.

### *2.10.3 Interest on delayed payment not recovered*

According to provisions of rule 8(3) of the Central Excise Rules, 2002, (earlier rule 9 read with rules 49 and 173G), if the assessee failed to pay amount of duty by due date (fortnightly upto 28 February 2003 and monthly from 1 March 2003 onwards) he was liable to pay the outstanding amount alongwith interest at the rate of 24 per cent (15 per cent with effect from 13 May 2002). Further, in terms of section 11AB of the Act if the assessee had paid duty under sub section 2B of section 11A, he was liable to pay interest at the rate of 24 per cent (15 per cent with effect from 13 May 2002).

Scrutiny of the records of some range offices revealed that in cases as indicated in the following table, the Department had failed to demand interest due from the assessees on account of delayed payment of duty.

**(Amount in lakh of rupees)**

| Sl. No. | Name of the assessee | Commiss-ionerate | Amount of interest payable | Remarks |
|---|---|---|---|---|
| 1. | M/s. Fiat India (P) Limited | Mumbai II | 2.14 | Under rule 8(3) |
| 2. | M/s. Diamler Chrysler India Private Limited | Pune I | 16.48 | Under rule 8(3) |
| 3. | M/s. Mahindra and Mahindra Limited, Nasik | Nasik | 4.35 | Under section 11AB |
| 4. | M/s. Mahindra and Mahindra Limited, Kandivili | Mumbai V | 7.79 | Under rule 8(3) |
| **Total** | | | **30.76** | |

### *2.10.4 Proof of export not watched*

Under rule 19 of the Central Excise Rules, 2002, excisable goods could be exported without payment of duty. However, proof of export was required to be submitted to the Department within six months from the date of clearance of goods. In the course of scrutiny of the monthly return submitted by the assessee the range superintendent was required to watch submission of proof of export. In the event of failure of the assessee to do so within the stipulated period, the Department was required to initiate action for recovery of duty alongwith interest.

Cases were noticed where no action was taken for recovery of duty even though assessees failed to submit proof of export within the time limit. Duty payable for 17 vehicles exported by M/s. Eicher Motors and M/s. Tata Motors in Indore and Pune I Commissionerate of Central Excise respectively amounted to Rs.12 lakh apart from interest leviable.

### *2.10.5 Ineffective internal audit*

It was noticed that internal audit had conducted the audit of 35 out of 44 units selected for statutory audit scrutiny but had failed to detect the irregularities brought out in the review which was indicative of its ineffectiveness.

## 2.11 Miscellaneous irregularities

Other cases of irregularities noticed in the course of review are given in the table below: -

**(Amount in lakh of rupees)**

| Name of assessee | Commissionerate | Nature of irregularity | Period | Amount not paid |
|---|---|---|---|---|
| M/s. Tatra Udyog Limited | Chennai II | Non-levy of cess on chassis consumed captively | 01.04.2001 to 01.09.2003 | 12.00 |
| M/s. Automotive Coaches and Components | Chennai II | Non-payment of cess on fully built vehicles | 2002-03 to 2003-04 | 11.00 |
| M/s. Fiat India | Mumbai II | Duty collected but not remitted to government | 2000-01 and 2001-02 | 09.00 |
| M/s. Skoda Auto India | Aurangabad | Short payment of duty on goods | 2002-03 | 03.00 |
| **Total** | | | | **35.00** |

In two other cases of undervaluation in Chennai I and Indore Commissionerates of Central Excise, duty of Rs.39 lakh had been recovered by the Department at the instance of audit.

## 2.12 Conclusion

**Review has revealed that reduction in excise duties had a negative effect on net excise collection. Growth in sales did not match such reduction either. Benefits of reduced duty were not adequately passed on to consumers, with luxury segment manufacturers retaining large proportion of the duty cuts. Cases of incorrect valuation and availing of Modvat/Cenvat credit were also noticed. Internal controls through timely issue of SCN, adjudication and enforcement of recovery in cases of confirmed demands seemed weak.**

# CHAPTER III : REVIEW ON THE WORKING OF EXCISE AUDIT – 2000

## 3.1 HIGHLIGHTS

- **Creation of database of assessee's profile was completed only in 34 per cent of the total units in 40 Commissionerates of Central Excise. In five Commissionerates, the work was not taken up at all.**

**(Paragraph 3.6.1)**

- **Non-mandatory units were taken up for audit at the cost of mandatory units. Absence of proper risk analysis led to lopsided selection of units resulting in ineffective audit results.**

**(Paragraphs 3.7.1 & 3.7.2)**

- **Audit of multi-locational units in a coordinated manner as envisaged in the scheme was not achieved and 82 per cent of the multi locational units in 21 Commissionerates of Central Excise remained unaudited under EA-2000.**

**(Paragraph 3.7.3)**

- **In 31.2 per cent of the units audited under EA-2000 in 17 Commissionerates of Central Excise 'nil' reports were issued. The number of 'nil' report increased alarmingly during the year 2002-03 compared to 2001-02.**

**(Paragraph 3.8.1)**

- **The revenue yield as a result of audit under EA-2000 witnessed consistent decline from 2000-01 to 2002-03.**

**(Paragraph 3.8.2)**

- **Thirty four per cent of objections issued under EA-2000 involving revenue of Rs.853.61 crore were pending in 44 Commissionerates of Central Excise as on 30 September 2003.**

**(Paragraph 3.11)**

## 3.2 Introduction

As part of initiatives to encourage voluntary tax compliance by assessees, the Department introduced the system of self-assessment in 1996 and its role focused on compliance verification. To have a more scientific and effective audit system by professionally trained officers, an initiative called 'Capacity development of central excise administration' was taken by the Board under which Excise Audit-2000 (EA-2000) was introduced in December 1999. Audit management involving planning, organising, directing and controlling of the audit process was entrusted at two levels – apex and local. Directorate General of Audit as

nodal agency, was to provide direction, evolve and improve audit techniques and suggest measures to improve tax compliance. The Director General was, thus entrusted with the twin functions of (i) aiding and advising the Board in policy formulation; and (ii) guiding and providing functional direction to the Commissionerates for audit management at the local level for compliance verification. At the local level, the audit section in the Commissionerate handled audit management.

Salient features of EA-2000 were: -

(i) creation of database of assessee's profile;

(ii) selection of units based on risk assessment;

(iii) an entire new audit approach based on new manuals, audit programme and working papers;

(iv) preliminary desk review prior to commencement of audit;

(v) involvement of senior officers; and

(vi) specialised training to concerned officers and deployment of trained staff.

## 3.3 Audit objectives

The new approach through EA-2000 could be construed as a mechanism of internal control defined as an integral process of the entity's management, designed to provide reasonable assurance that its general objectives such as fulfilling accountability obligations, compliance with applicable laws and regulations and executing orderly, efficient, and effective operations were being met.

In view of the fact that the new audit system would have a significant impact on the internal control mechanism in the Department, a review was undertaken to seek assurance that: -

(i) the system had been implemented in accordance with instructions and guidelines issued by the Board at apex as well as Commissionerate levels;

(ii) audit had been effective in aiding and advising the Board in policy formulation;

(iii) the new system was more efficient and effective in checking self-assessment by assessees; and

(iv) how the new system had impacted on revenue collection.

## 3.4 Scope of audit

For this purpose, records of 44 out of 92 Central Excise Commissionerates were checked. The period covered was from 2000-01 to 2002-03. Audit findings are contained in the succeeding paragraphs.

## 3.5 Control environment

'Tone at the top' would set the foundation for all other components of internal control providing discipline and structure. This 'tone' under EA-2000 was envisaged as being

completely involved and supportive of the initiative. Analysis showed that in several cases apart from routine measures, proactive interaction at Chief Commissionerate level was absent. In Bhopal, Chennai, Coimbatore, Hyderabad, Kolkata, Patna and Vadodara zones no periodic meetings with Commissioners had been held. In Jaipur I & II Commissionerates no audit protocol was entered into and no units audited under them. No records had been maintained to indicate field supervisions by Deputy Commissioners/Assistant Commissioners either.

## 3.6 Risk assessment

Risk assessment is the process of identifying and analyzing relevant risks. Hence risk assessment needs to be an ongoing iterative process. Only then could the Department develop appropriate responses to them i.e. transfer, tolerate or terminate the risks.

### *3.6.1 Creation of database and assessee profile incomplete*

As a pre requisite to the process of selection of units as well as for undertaking preliminary desk review, the standard audit programme envisaged creation of database for ascertaining critical ratios. Assessee master file in respect of units to be audited was to be prepared. The planning cell of the audit branch of the Commissionerate of Central Excise was entrusted with the task of data management, updation and upkeep of the assessee master file.

The position in respect of completion of assessee's files in test checked Commissionerates of Central Excise is given in the table below: -

**(Position as on 31 March 2003)**

| No. of Commissionerates | Year | No. of registered assessable units | Assessee master file | | |
|---|---|---|---|---|---|
| | | | Completed | Under progress | Not taken up |
| 40 | 2002-03 | 36789 | 12563 | 7312 | 16914 |

- Assessee profile had been completed in respect of only 34 per cent of the total units.
- In Bhubaneswar I, Chandigarh, Delhi II, Ghaziabad and Thiruvananthapuram Commissionerates of Central Excise the work of creation of assessee's profile was not taken up at all.
- In Ahmedabad I and Jaipur I Commissionerates, 96 per cent and 94 per cent respectively of the assessee's profiles were yet to be created.

## 3.7 Control activities

Control activities are the policies and procedures established to address risks. To be effective they must be appropriate and function consistently according to plan throughout the period. They include a range of functions such as verification, reconciliation and review of operations.

### *3.7.1 Operating performance*

#### (i) Coverage of mandatory units under EA-2000 inadequate

The use of audit in achieving improved tax payer compliance is possible by ensuring that resources are targeted at areas most at risk of non-compliance with tax laws. Vide Board's

instruction dated 27 September 2000 all units paying over Rs.5 crore through PLA in a year (category 'A') which had already been audited by normal audit system were also to be covered by EA-2000 in 2000-01.

Details of the units covered under EA-2000 and Non-EA-2000 in some of the test checked Commissionerates are given below: -

| **No. of Commissionerates** | **Period** | **No. of units in existence** | | | **Audited under EA-2000** | | **Audited under Non-EA-2000** |
|---|---|---|---|---|---|---|---|
| | | **A** | **B** | **C+D+E** | **A** | **B** | **B+C+D+E** |
| 29 | 2000-01 | 613 | 1563 | 34184 | 371 | 268 | 12804 |

***Note:*** ***A*** ***Units paying duty of Rs.5 crore and above through PLA in a year***
***B*** ***Units paying duty between Rs.1 crore and Rs.5 crore through PLA in a year***
***C*** ***Units paying duty between Rs.50 lakh and Rs.1 crore through PLA in a year***
***D*** ***Units paying duty between Rs.10 lakh and Rs.50 lakh through PLA in a year***
***E*** ***Units paying duty below Rs.10 lakh through PLA in a year***

It was observed that contrary to the instructions of the Board, 39 per cent of category 'A' units were left unaudited. While in Delhi I, only one out of 12 category 'A' units were audited under EA-2000, in Shillong Commissionerate, not a single unit of category 'A' was covered.

In Bhubaneswar I, Bhubaneswar II, Meerut I and Vishakapatnam Commissionerates of Central Excise, the coverage of category 'A' units ranged from 17 to 30 per cent.

In Cochin, Coimbatore, Nagpur and Shillong Commissionerates, the emphasis was on coverage of category 'E' units at the cost of other categories.

**(ii) Shortfall in coverage**

The Board vide letter dated 29 June 2001 directed coverage of all units paying duty Rs.1 crore or above through PLA in a financial year under EA-2000. In order to meet this target, the Board asked the Commissionerates of Central Excise to take, inter-alia, the following steps: -

(i) to reduce frequency of audit of non-mandatory units by system of selection based on risk factors;

(ii) re-deployment of staff to strengthen internal audit wing;

(iii) improvement in audit planning; and

(iv) to take up audit of non-mandatory units only after covering mandatory ones.

Performance in terms of coverage of mandatory units (duty of over Rs.1 crore) was analysed in audit and the position emerged as follows: -

| **No. of Commissionerates** | **Period** | **No. of units in existence** | | **Audited under EA-2000** | | **Audited under Non-EA-2000** |
|---|---|---|---|---|---|---|
| | | **A+B** | **C+ D+E** | **A+B** | **C+D+E** | **C+D+E** |
| 31 | 2001-02 | 2316 | 37291 | 1747 | 538 | 9930 |

- Shortfall in achieving target was to the extent of 25 per cent. Redeployment of staff towards coverage of mandatory units was not sufficiently made resulting in coverage of 27 per cent of non-mandatory units at the expense of stipulated units.
- In Bhubaneswar II, Calicut, Coimbatore, Delhi I, Indore, Jaipur I, Jaipur II and Shillong Commissionerates of Central Excise, 130 units paying duty of more than Rs.1 crore were audited under conventional method instead of under EA-2000.
- In Chandigarh Commissionerate of Central Excise, 11 units of category 'B' were audited twice in a financial year after gap of one to ten months as against requirement of one year. Audit results in these units could not be evaluated as the relevant audit reports were not forthcoming.
- Auditing of non-mandatory units without completely covering mandatory ones indicated that the Department's efforts were misplaced.

### *3.7.2 Extension of EA-2000 to all the units - lopsided coverage of units*

Risk assessment was to provide the basis for identification of priorities and help allocation of available resources. The Board vide letter dated 9 November 2001 phased out conventional method of audit by issuing orders for coverage of all units under EA-2000 with effect from 1 January 2002. Further, it issued guidelines on the methodology to be adopted for selection of units in June 2002. Guidelines and instructions contained in central excise audit manual stipulated: -

(i) that selection of non-mandatory units be made taking into account available audit man-hours after conducting of mandatory audit;

(ii) selection of unit on risk assessment using $R_2$ value* and local risk parameters;

(iii) revision of lists by rearranging of units in descending order of $R_2$ value;

(iv) preparation of final annual lists of units selected for audits by applying local risk factor;

(v) auditing of units paying Rs.0 to Rs.10 lakh at least once in five years; and

(vi) auditing of units paying Rs.10 lakh but less than Rs.1 crore at least once in two years.

Analysis of the extent of coverage under EA-2000, in 38 Commissionerates of Central Excise, during the period 2002-03 indicated the position as given below: -

| **No. of Commissionerates** | **Period** | **No. of units in existence** | | **Audited under EA-2000** | | **Audited under Non-EA-2000** |
|---|---|---|---|---|---|---|
| | | **A+B** | **C+ D+E** | **A+B** | **C+D+E** | **C+D+E** |
| 38 | 2002-03 | 2413 | 31808 | 2150 | 3550 | 2420 |

- Contrary to the instructions of the Board, 2,420 category 'C', 'D' and 'E' units were audited under the conventional method of auditing.
- Only 89 per cent of the mandatory units ('A' and 'B') were covered under EA-2000.
- Selection of units for audit was critical for achieving effective audit results. It was, however, noticed that selection was not made in accordance with guidelines and after proper risk analysis.

* $R_2$ Value stands for rupee risk value

A few cases of skewed selection of units indicative of absence of risk analysis as envisaged in the scheme are given below: -

- In Mysore Commissionerate of Central Excise, all the units of category 'E' were audited against the cap of 25 per cent of total units. In Bangalore II Commissionerate, the coverage of category 'E' units was 30 per cent.
- In Jalandhar Commissionerate, 26 units paying duty between Rs.0 and Rs.10 lakh (PLA) ('E' category) were audited repeatedly after a gap of one/two years against requirement of once in five years. Audit objections involving amount of Rs.0.33 lakh only were raised in two units and in the remaining 24 units reports were 'nil'.
- In Delhi I Commissionerate of Central Excise, 33 units of category 'C', 'D' and 'E' were audited consecutively for two years violating the prescribed frequency. Also 57 closed manufacturing units/dealers were shown audited. In all the cases, audit parties furnished 'nil' reports.
- In Bhopal and Delhi I Commissionerates, audit of 260 dealers was conducted between 1999-2000 and 2001-02 in violation of 'standard audit programme' of EA-2000. Two hundred and sixty four mandays were thus misutilised.

### *3.7.3 Management at apex level*

**Role of Additional Director General (Audit)**

EA-2000 scheme envisaged audit of multi-locational units in a co-ordinated manner. Additional Director General (Audit) under whose jurisdiction the unit paying the highest revenue was located was entrusted with the job of planning and co-ordination as also for scheduling and co-ordination of the audit. Position of coverage of multi-locational units under EA-2000 is given in the table below: -

| No. of Commissionerates | Period | No. of units in existence | No. of units audited |
|---|---|---|---|
| 21 | 2000-01 to 2002-03 | 2374 | 437 |

- Only 18 per cent of multi-locational units were audited under EA-2000.
- In Bhopal, Nagpur and Panchkula Commissionerates of Central Excise, no multi-locational unit was audited.
- In Kolkata I and Kolkata II Commissionerates, only one and four out of 180 and 216 such units respectively were audited under EA-2000.

### *3.7.4 Management at commissionerate level*

**Excess party days utilised**

Completion of approved audit programme and audit tasks within the approved time frame is an essential requirement for improving efficiency of audit. The Board vide instructions dated 13 November 1996 prescribed party days to be utilized depending upon revenue of the units. Statutory audit in the course of review noticed deviations in excess of the prescribed norms as follows: -

| No. of Commissionerates | Period | No. of party days | | | No. of units to be audited once in a year | No. of units audited |
|---|---|---|---|---|---|---|
| | | Allowable | Allowed | Excess | | |
| 6 | 2002-03 | 3356 | 4568 | 1212 | 467 | 298 |

- Utilisation of excess party days resulted in coverage of fewer units in audit, besides impacting on the cycle time of audit.

### *3.7.5 Involvement of Assistant Director (Cost)[*] under EA-2000*

According to the Board's instruction dated 16 February 2000, for all Rs.5 crore and above units, AD (Cost)'s involvement was considered necessary. Audit scrutiny, however, revealed that AD (Cost) was involved only in 17 per cent of the total number of category 'A' units audited from 2000-01 to 2002-03. In 16 Commissionerates, he was not involved at all in 1,126 category 'A' units audited in these Commissionerates during this period.

### *3.7.6 Audit in special situations*

#### (i) Audit of 100 per cent export oriented units (EOUs)

According to guidelines contained in central excise audit manual, audit of 100 per cent EOUs was to be conducted once a year.

Position with regard to coverage of such units under EA-2000 is given in the table below: -

| No. of Commissionerates | Period | No. of units in existence | No. of units audited | Percentage of coverage |
|---|---|---|---|---|
| 19 | 2000-01 to 2002-03 | 696 | 173 | 25 per cent |

- While in Bhopal, Kolkata II, Mumbai II, Ahmedabad I, Vadodara I and Panchkula all EOUs were left unaudited, in Visakhapatnam I Commissionerate of Central Excise, only one unit out of 30 such units was covered in audit.

#### (ii) Special audit

EA-2000 scheme envisages conducting of special audit based on certain information and parameters. In the course of test check it was observed that special audit was undertaken in only two out of 44 test checked Commissionerates. The details of such special audit are given below in the table as below: -

**(Amount in crore of rupees)**

| Commissi-onerate | No. of units audited | No. of units where objection raised | | | No. of units where there were nil reports | Remarks |
|---|---|---|---|---|---|---|
| | | No. | Amt. | Recovery | | |
| Ahmedabad | 23 | 11 | 27.82 | 18.01 | 12 | |
| Delhi | 2 | -- | -- | -- | -- | Reports yet to be issued although audit was conducted in 2000-01 |

[*] AD (Cost) is an expert in auditing cost and other commercial records

- Despite special audits being conducted in Ahmedabad more than 50 percent were 'nil' reports.
- In Delhi Commissionerate of Central Excise, the matter was reported to be under examination and audit reports not yet issued even after a lapse of more than four years.

## 3.8 Review of operating performance

### *3.8.1 Performance of EA-2000 vis-à-vis Non-EA-2000 audit in terms of 'nil' reports*

Personnel entrusted with EA-2000 are to maintain a level of competence that allows them to understand the importance of internal audit in compliance verification to accomplish the general objectives of internal control. Overall resources utilised for the internal audit function should reflect an appropriate mix of knowledge and skills relevant both to the context of the assessees' organisation and the Department's objective of ensuring tax compliance.

Performance of EA-2000 in terms of generation of 'nil' reports was compared with Non-EA-2000 audit for the period from 2000-01 to 2002-03. The details of 'nil' reports are indicated in the table below: -

| No. of Commiss-ionerates | Period | No. of units audited under EA-2000 | No. of nil reports | Percen-tage of nil reports | No. of units audited under Non-EA-2000 | No. of nil reports | Percen-tage of nil reports | Total No. of nil reports |
|---|---|---|---|---|---|---|---|---|
| 11 | 2000-01 | 214 | 57 | 26.6 | 5118 | 1598 | 31.2 | 1655 |
| 14 | 2001-02 | 1053 | 107 | 10.2 | 4105 | 1201 | 29.2 | 1308 |
| 17 | 2002-03 | 2443 | 761 | 31.2 | 419 | 177 | 42.2 | 938 |

- The percentage of 'nil' reports under EA-2000 had increased in 2002-03 compared to previous years despite a system of selection through scientific procedures being in place. The high overall percentage of 'nil' reports could be attributed to: -

(a) auditing of non-mandatory units at the cost of mandatory units; and

(b) selection of units without proper risk analysis as enshrined in EA-2000 and improper audit planning by planning cells brought out in subsequent paras in this review.

### *3.8.2 Impact of EA-2000 on revenue*

Quality of output and measurement of cost effectiveness of audit are key indicators that serve as tools to enable the Department to improve. With the adoption of new audit systems based on scientific methods of auditing, it was expected that better results would ensue in safeguard/generation of revenue. In the absence of fixation of targets in terms of revenue realisation, a comparative analysis of the performance for three years since inception of EA-2000 audit was made as per the following table: -

**(Amount in lakh of rupees)**

| No. of Commissionerates | Period | No. of units audited under EA-2000 | Objections in terms of revenue (per unit) | Revenue yield in terms of (recovery per unit) |
|---|---|---|---|---|
| 36 | 2000-01 | 1145 | 96.49 | 2.14 |
| | 2001-02 | 2694 | 22.63 | 2.85 |
| | 2002-03 | 4737 | 14.03 | 0.72 |

- The average yield per unit in terms of total amount of objection declined consistently during the three years.
- Recovery registered a sharp drop during 2002-03.

### *3.8.3 Performance of EA-2000 vis-à-vis statutory audit*

Comparison of performance of EA-2000 with that of statutory audit in respect of units audited by both was analysed in some of the Commissionerates of Central Excise. Details of objections raised by statutory audit which could not be detected by EA-2000, are mentioned in the table below: -

**(Amount in crore of rupees)**

| No. of Commissionerates | Period | No. of units visited by both EA-2000 parties and CERA parties | Points raised by CERA party | | Points admitted by Department | |
|---|---|---|---|---|---|---|
| | | | No. | Amt. | No. | Amt. |
| 33 | 2000-01 to 2002-03 | 151 | 215 | 367.52 | 74 | 36.95 |

## 3.9 Review of operations, processes and activities

### *3.9.1 Creation of cells*

EA-2000 envisaged creation of various cells/committees in Central Excise Commissionerates, which were assigned specific responsibilities for its proper management. Position with regard to their creation in test checked Commissionerates as on 31 March 2003 highlighted as follows: -

| No. of commissionerates | No. of commissionerates where | | | |
|---|---|---|---|---|
| | Planning cell created | Scoring committees created | Monitoring cells created | Quality assurance programme cells created |
| 37 | 28 | 26 | 32 | 11 |

- Planning cell, which was required to formulate audit plans, was not created in 9 Commissionerates.
- Scoring committee, which had to evaluate and score the working papers was not created in 11 of them.
- Monitoring cells, which were entrusted with examination of audit reports were not created in five of the test checked Commissionerates.

- Position was worst in respect of quarterly assurance programme cells which were not found created in 26 of 37 test checked Commissionerates.

### *3.9.2 Review of audit reports by monitoring cell*

In terms of Board's instructions dated 28 October 1999 and 16 February 2000, the audit reports were required to be examined by monitoring cells for sustainability of each audit point and spelling out future action points through circulated minutes. Performance of monitoring cells with reference to the number of audit reports reviewed and meetings held was analysed in audit and the position emerged as under: -

**Table I**

| No. of Commissionerates | Period | No. of audit reports issued | No. of audit reports reviewed |
|---|---|---|---|
| 28 | 2000-01 | 1358 | 123 |
| | 2001-02 | 1629 | 654 |
| | 2002-03 | 2766 | 1261 |
| | Total | 5753 | 2038 |

**Table II**

| No. of Commissionerates | No. of meetings due | No. of meetings held |
|---|---|---|
| 35 | 1090 | 212 |

- Percentage of shortfall in reviewing audit reports during the three years was 91,60 and 54 per cent respectively.
- In Bangalore I, Bangalore II, Delhi I, Delhi II and Mangalore Commissionerates, no review was undertaken by monitoring cells.
- There was shortfall of 81 per cent in holding of meetings, which largely contributed to 64 per cent of audit reports being issued without review by monitoring committee.

## 3.10 Information and communication

Information systems produce reports that contain operational, financial and compliance related information that makes it possible to run and control the operation.

In several cases, delays in issue of inspection reports were noted. In Bhopal Commissionerate delays ranged from five to 144 days; in Indore from one to seven months. In Patna Commissionerate the audit reports register was not maintained in the prescribed form. Delays in submission of inspection reports ranged from 74 to 115 days in six cases (as against 20-25 days permissible) but there was no mention of when they were issued.

## 3.11 Ineffective pursuance of objections leading to delays/non-raising of demands

### *3.11.1 Pendency position*

The objective of an internal audit mechanism can be achieved only if the objections are raised timely and pursued to their logical end. Details of pending objections raised under EA-2000 (position as on 30 September 2003) in 44 Commissionerates of Central Excise, is given in the table below: -

**(Amount in crore of rupees)**

| No. of Commis-sionerates | Period | Reports issued | Objections raised | | Objections dropped | | Recovered | | Pendency | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | No. | Amt. | No. | Amt. | No. | Amt. | No. | Amt. |
| 44 | 1999-2000 to 2002-03 | 9037 | 19153 | 1609.06 | 7318 | 614.83 | 5356 | 140.62 | 6479 | 853.61 |

- Thirty four per cent of objections issued under EA-2000 were pending as on 30 September 2003, involving revenue of Rs.853.61 crore, which constituted 53 per cent of the total revenue involved in these objections.
- Recovery was only to the extent of nine per cent of the total amount involved in the objections raised under EA-2000.

### *3.11.2 Time barred demands*

- In Mumbai II and Pune I, Commissionerates of Central Excise, demands for Rs.4.17 crore and Rs.4.35 crore, respectively became time barred due to non-issue of SCNs.
- In Jalandhar Commissionerate, 54 objections involving Rs.3.71 crore were not shown as outstanding in the monthly technical report as on 30 September 2002, indicating unreliable recording and monitoring.
- In the same Commissionerate, audit of a unit was conducted in May 2002, but the audit report had not yet been submitted/approved till the date of audit (January 2004).

Some individual cases of demands becoming time barred due to non-issue of SCN are illustrated below: -

- In Pune III Commissionerate, no SCN on an objection involving revenue of Rs.3.17 crore raised against M/s. Indian Seamless Steel and Alloys Limited in April 2000, under EA-2000 covering the period from September 1997 to February 2000 had been issued till the date of audit (April 2004).
- In another case, the objection covered the period from 1997 to October 2000 but no SCN has been issued. In both cases substantial part of the amount involved pertained to more than five years.

## 3.12 Supervision – training activity

In order to make EA-2000 effective, the scheme envisaged deployment of professionally trained officers. The Board vide their instructions dated 28 October 1999 emphasized the need for deployment of trained personnel for undertaking such audit.

### *3.12.1 Inadequate training*

In Bhopal Commissionerate, three Superintendents and 17 inspectors working in EA-2000 were untrained. In Delhi I Commissionerate no training for EA-2000 system had been organized till 2002-03. In 2003-04, only a weeks training was organised. In Kolkata II, no training was organised at all. In Chennai II, 25 personnel were not trained. Similarly, in Mumbai II, Pune I and III atleast 20 inspectors and seven superintendents remained untrained till 2002-03. In Cochin eight and in Calicut five out of nine officers deployed in EA-2000 were untrained.

### *3.12.2 Trained staff not adequately deployed*

The extent of deployment of trained staff was evaluated in audit and the position is indicated below in the table: -

| No. of Commissionerates | Period | No. of trained personnel available | No. of trained personnel posted | Percentage of untrained staff in EA-2000 |
|---|---|---|---|---|
| 27 | 2001-02 | 473 | 355 | 25 |
| | 2002-03 | 561 | 393 | 29 |

- In Jamshedpur Commissionerate of Central Excise, only eight trained personnel were posted in the parties consisting of 86 members, during 2002-03, although they had been given specialised training.
- In Cochin Commissionerate, only 10 trained persons were posted in parties consisting of 30 members.

## 3.13 Monitoring

Monitoring is accomplished through routine activities or through separate evaluations or combinations of both. The Board in their 2 June 1998 instructions had directed that Additional/Deputy Commissioners by name would be responsible for verification of correctness of scrutiny of returns once in six months and that the Commissioners would monitor this work personally. This was not done in Bhubaneswar I and II Commissionerates. No such verification was found done in Faridabad, Ghaziabad, Jaipur, Panchkula and Ranchi Commissionerates either. In Bangalore I no records of monthly meetings at Commissionerate level were kept. In Bangalore I and Belgaum, as against stipulation for Divisional Officers to supply basic data for preliminary desk review, most material was found collected directly by audit parties. The same shortcoming prevailed in Chandigarh and Jalandhar Commissionerates.

## 3.14 Conclusion

**The new audit system operative from 1 December 1999 has not proved to be fully effective. Goals and objectives of the system were not achieved due to various reasons ranging from inadequate and skewed coverage of units, lack of proper selection, lapses in implementation at Commissionerate levels and a deficient control environment.**

**Resultantly, while on the one hand voluntary compliance on the part of assessee is in place, on the other the necessary audit controls are absent.**

**Statutory audit, therefore, recommends that the Department review the shortcomings in the implementation and either reintroduce some of the erstwhile mandatory checks or put in concerted efforts at all levels to ensure the success of EA-2000.**

The above observations were communicated in October 2004. The Ministry, while in broad agreement with the need for concerted efforts stated (November 2004) that there had been some problems in the nascent years, coupled with reorganisation of the Department during 2002-03. However, since then several steps like strengthening of Directorate General of Audit's set up, creation of zonal units, system of quarterly grading of excise commissionerates on basis of audit results etc. had been introduced by it.

# CHAPTER IV : TOPICS OF SPECIAL IMPORTANCE

## 4.1 Duty short paid by adopting lower mutually agreed price of petroleum products

Under section 4 of Central Excise Act, 1944, as effective from 1 July 2000, duty of excise is chargeable on excisable goods with reference to their transaction value. Sub section (3)(d) of section 4 defines transaction value to mean the price actually paid or payable for the goods when sold.

Test check of records of twelve terminals and two refineries of M/s. HPCL, M/s. IOCL, M/s. BPCL and M/s. IBPL, in twelve Commissionerates of Central Excise revealed that petroleum products viz., motor spirit, diesel, high speed diesel, aviation turbine fuel were sold to depots and sales units belonging to them at mutually agreed prices. Those products were further sold by depots/sales units to individual customers at fixed prices determined by zonal offices of the said oil companies which were much higher than the prices at which duty was paid. It was further revealed that the said four oil companies entered into agreement on production sharing assistance with each other and accordingly agreed prices were fixed for inter-company sale of above products which were much lower than the transaction value fixed by the zonal offices of the companies for their own depots/dealers. This resulted in undervaluation of goods and consequential short payment of duty of Rs.206.75 crore between April 2002 and July 2004.

On this being pointed out (between February and July 2004), the Ministry of Finance (the Ministry) stated (December 2004) that there was no extra consideration beyond the agreed upon price.

Such a price cannot be considered the transaction value for section 4 since this price was adopted for oil exchange transactions alone and the product sharing agreement to sell products at lower prices for the benefit of each other clearly establishes mutuality of interest among oil companies.

## 4.2 Incorrect availment and utilisation of Cenvat credit of additional excise duty for other duties

Prior to March 2003, utilization of Cenvat credit of Additional Duties of Excise (Goods of Special Importance) Act, 1957 {AED (GSI)} was restricted to payment of AED (GSI) only. Rule 3(6)(b) of Cenvat Credit Rules, 2002, was amended from 1 March 2003 to allow credit of AED (GSI) for payment of duty of excise leviable under the first schedule or the second schedule of the Central Excise Tariff Act, 1985 (BED and SED respectively).

Further, rules 12 and 13 of Cenvat Credit Rules, 2002, provide that where Cenvat credit has been taken or utilized wrongly, the same along with interest shall be recovered from the manufacturer and provisions of sections 11A and 11AB of Central Excise Act, 1944, shall apply mutatis mutandis for effecting such recoveries. The manufacturer shall also be liable to pay penalty not exceeding the amount of duty or ten thousand rupees whichever is greater.

Test check of records of thirty two assessees in fourteen Commissionerates of Central Excise, revealed that they availed of the credit of AED (GSI) of Rs.196.71 crore and utilised the same for payment of duty (other than AED). The credit so availed related to inputs procured between April 1995 and February 2003. The availment of credit and its utilization was not correct as amendment in Cenvat Credit Rules was not made retrospectively and the input goods were not in stock on the date of availing of the credit. The amount of credit so availed was recoverable with interest of Rs.17.60 crore (till March 2004) and penalty of Rs.196.71 crore under rule 12 and 13 of Cenvat Credit Rules, ibid.

On this being pointed out (between April 2003 and March 2004), the Ministry partly admitted the objection and stated (between August and December 2004) that the utilisation of the credit on inputs procured on or after 1 April 2000 had been made admissible by Finance Act 2004. Report on recovery of duty with interest and penalty for the period prior to April 2000 had not been received.

## 4.3 Concession meant for small scale industries availed of by large scale manufacturers

Notifications dated 1 March 2000/2001/2002, interalia, stipulated that manufacturers whose aggregate value of clearances for home consumption in the preceding financial year did not exceed Rs.3 crore were eligible for concessional rate of duty/full exemption from duty. Value of clearances relating to (i) branded goods manufactured and cleared on behalf of another person on payment of normal rate of duty, (ii) excisable goods which were either exempt or chargeable to nil rate of duty and (iii) excisable goods exported to countries except Nepal and Bhutan, were to be excluded.

The Union Budget 2003-04, had recognized that while Small Scale Exemption Scheme aimed at providing a distinctive advantage to labour – intensive units, there was possibility of misuse of this facility in certain sectors. Consequently the eligibility limit of Rs.3 crore under general small scale industries scheme was rationalised and the clause relating to exclusion of exempted goods for purpose of computation of total clearances was deleted. Value of clearances pertaining to exempted goods or goods cleared with nil rate of duty was therefore includible for purpose of determining eligibility criterion of Rs.3 crore with effect from 1 April 2003. However, the relevant clauses which provided for exclusion of clearances pertaining to branded and export goods were not deleted and consequently value of those clearances continued to be excluded for purpose of reckoning the eligibility limit of Rs.3 crore even after 1 April 2003.

It was however, seen that in the case of M/s. Food Specialities Limited Vs. Government of India, the Supreme Court ruled that where goods are produced with customer's brand name under his quality control, it does not mean that the customer is the manufacturer {1985 (22) ELT 324}. Despite judicial pronouncements providing enough justification and ground for inclusion of value of clearance pertaining to branded goods under the over all ceiling of Rs.3 crore, Government has not so far made suitable amendment in the SSI notifications.

Audit check of 278 manufacturers in 58 Commissionerates of Central Excise availing the benefits of the notification ibid revealed (between January 2003 and March 2004) that the total value of excisable goods cleared ranged between Rs.3 crore and Rs.86 crore. The continued retention of exclusion clause relating to branded and export goods thus enabled

these large manufacturers to derive unintended benefit of duty exemption/concession which amounted to Rs.40.41 crore during the financial years from 1999-00 to 2003-04.

The Ministry stated (December 2004) that the exclusion of the export and branded goods from the purview of aggregate clearances of Rs.3 crore was a deliberate policy decision of the Government.

The fact remains that this ran contrary to the declared intentions of the Government through Budget, which enabled the large scale manufacturers to derive undue benefit of duty concession.

## 4.4 Loss of revenue due to delay in withdrawal of circular

The Tribunal in the case of Jyoti Engineering Corporation held (October 1987) that process of drawing of wires from wire rods would not amount to manufacture, hence was not excisable. The Department's appeal filed against the Tribunal judgement was dismissed by the Supreme Court on 15 February 1989 upholding the order of the Tribunal {1990 (48) ELT A24}. The matter regarding levying of duty on wire drawn from wire rods came up for consideration again in the case of M/s. Vishwaman Industries and the Tribunal decided (20 October 2000) that process of drawing wire of lesser gauge from wire rods did not amount to manufacture even if wire and wire rods fell under different sub headings in the Tariff. Government's appeal against this decision was dismissed by the Supreme Court on 19 March 2001.

However, the Board in its circular dated 16 February 2001 clarified that the drawing of wire from wire rods would amount to manufacture. The Board withdrew its circular only on 29 May 2003.

Test check of records of twenty assessees in Aurangabad, Thane II, Ludhiana and Nasik Commissionerates of Central Excise, revealed that assessees engaged in the activity of drawing wires from wire rods, availed Cenvat credit amounting to Rs.38.12 crore on wire rods during April 2000 to March 2003. As per Supreme Court's decision dated 15 February 1989 ibid, the process of drawing wires did not amount to manufacture, consequently neither was duty leviable nor was Cenvat credit admissible on wires. Payment of duty on wires and passing on credit to buyers of wires was incorrect.

On this being pointed out (January and February 2004), the Ministry stated (December 2004) that if duty paid on finished goods was more than the credit availed, the credit was deemed to have been recovered and hence revenue loss was notional.

Reply of the Ministry is not tenable as issue of Board's circular of February 2001 contrary to the Supreme Court decision enabled the asssessees to avail credit on wire rods and to pass it further on clearance of wire which was not other wise available.

## 4.5 Incorrect transfer of deemed credit balance to Cenvat credit account

The deemed credit scheme on specified inputs applicable to manufacturers of textile and textile articles had been withdrawn with effect from 1 April 2003 and replaced by Cenvat Credit Rules with effect from 1 April 2003. Rule 9A inserted on 1 April 2003 in the said rules stipulates that a manufacturer of fabrics falling under chapters 50 to 55 and 59 or 60 of the

Central Excise Tariff shall be entitled to avail credit equal to the duty paid on inputs of such finished product, lying in stock or in process or contained in finished product lying in stock as on 31 March 2003 in the manner specified therein. It therefore follows that such manufacturers would not be eligible to carry forward the deemed credit remaining unutilized as on 31 March 2003 to their Cenvat credit account in April 2003.

Test check revealed that nine assessees in six Commissionerates of Central Excise, engaged in manufacturing/processing of cotton and man made fabrics, carried over the unutilized balance of deemed credit of Rs.5.75 crore lying in their account as on 31 March 2003 to the Cenvat credit account in April 2003.

On this being pointed out (between May 2003 and July 2004), the Ministry stated (November and December 2004) that the facts of the objection were correct and show cause notices were issued but mentioned that the matter was under further examination with the Ministry of Law.

## 4.6 Absence of appropriate provisions in the rules enabled assessees to get unintended benefit

As per rule 6(3) of Cenvat Credit Rules, 2002, with effect from 1 March 2002, manufacturers of goods falling under heading 22.04 (ethyl alcohol) of Central Excise Tariff opting not to maintain separate account for molasses used in the manufacture of rectified spirit (non-dutiable) and denatured ethyl alcohol (dutiable) are to pay amount equivalent to the Cenvat credit attributable to the input used in or in relation to the manufacture of such non-dutiable product at the time of its clearance from the factory. Rule 9 (2) of Cenvat Credit Rules, 2002 which is applicable to SSI units require a manufacturer opting out of Modvat/Cenvat scheme to pay an amount equal to the credit on inputs available in stock or in process or contained in final product lying in stock on the date when such option is exercised. After deducting the said amount, balance, if any, still remaining would lapse and not be allowed to be utilised for payment of duty on any excisable goods whether cleared for home consumption or for export. However, there are no similar provisions in rule 6(3) either to restrict the credit of duty on the date of option to the extent of (i) inputs lying in stock; (ii) inputs contained in dutiable and non-dutiable products in process; and (iii) inputs contained in dutiable and non-dutiable final products lying in stock or to expunge the surplus balances in excess of the credit attributable to items (i)(ii) and (iii) above.

Seven assessees in five Commissionerates of Central Excise, engaged in manufacture of sugar, molasses, rectified spirit and denatured ethyl alcohol used molasses (produced in their factory) for manufacture of ethyl alcohol (dutiable) and rectified spirit (non-dutiable). They paid duty on molasses and availed credit thereof in their Cenvat account. The credit so availed was utilised by them towards payment of duty on ethyl alcohol and also for debiting eight per cent on the value of clearances of rectified spirit cleared at 'nil' rate of duty. Consequent on the amendments introduced in Cenvat Credit Rules, 2002, bringing ethyl alcohol under the ambit of rule 6(3) with effect from 1 March 2002, these assessees had opted not to maintain separate account with effect from 1 March 2002/1 April 2002 for the common input (molasses) used in the manufacture of both dutiable and non-dutiable products falling under heading 22.04. As on the date of option, the assessees had an accumulated credit balance of Rs.5.73 crore in their duty paid molasses account in addition to the credit attributable to molasses lying in stock or in process or contained in dutiable and non-dutiable

products lying in stock. The excess credit to the above extent did not lapse but was carried forward for utilization towards payment of duty on their final products.

Absence of appropriate provisions similar to those contained in rule 9(2) of Cenvat Credit Rules, providing for lapsing of surplus credit balances pertaining to molasses led to unintended benefit to the assessees to the extent of Rs.5.73 crore.

On this being pointed out (June and July 2004), the Ministry stated (November 2004) that the goods falling under heading 22.04 were brought under rule 6 (3) by the Government in its wisdom and the two situations were not comparable.

Reply of the Ministry is not tenable as the surplus credit accumulated because of credit on molasses (input) exceeded the amount of duty payable on final products under rule 6 (3). Therefore necessary provision to take care of the situation was required in rule 6 (3) while amending it on 1 March 2002 as was done in rule 9 (2).

# CHAPTER V: NON-LEVY OF INTEREST AND PENALTY

Section 11AA of the Central Excise Act, 1944, prescribes that where a person chargeable with duty determined under sub section (2) of section 11A, fails to pay such duty within three months from the date of such determination, he shall pay in addition to duty, interest at the rate of 20 per cent per annum (24 per cent with effect from 12 May 2000 and 15 per cent with effect from 13 May 2002) on such duty from the date immediately after the expiry of the said period of three months till the date of payment. Some illustrative cases of interest and penalty not levied or realised are mentioned below:

## 5.1 Interest not levied

**5.1.1** The Supreme Court in the case of M/s. Oswal Agro Furane {1996 (85) ELT 3 (SC)} laid down that in the event of non-payment of duty, or part payment of duty, interest should be charged from the assessee in respect of entire period during which the Government dues remained with the assessee.

M/s. GTC Industries Limited, in Mumbai V Commissionerate of Central Excise, engaged in manufacture of branded cigarettes mis-declared the sale prices of deceptively similar versions of their regular brands of cigarettes resulting in short payment of duty from April 1983 to January 1986. After issue of necessary show cause notices in March 1988, demands for payment of arrears of duty, aggregating to Rs.73.57 crore were confirmed by the Commissioner of Central Excise, New Delhi in July 1992. In adjudicating this case, in the absence of statutory provisions no order as to recovery of interest was passed. The assessee appealed against the order in various judicial fora and the Supreme Court finally dismissed his special leave petition in September 1997. The assessee paid an amount of Rs.29.90 crore till June 2004, and was given the benefit of payment of arrears of Rs.43.67 crore by BIFR in instalments from April 2005.

Duty becomes payable from the date of clearance of excisable goods. In case of short payment of such duty, it is evident that Government dues remain in the hands of the assessee. Following the principles enunciated by the Supreme Court in the M/s. Oswal Agro Furane case, interest at normal bank rate on the amount of short payment should be charged. Since the adjudicating orders were silent about recovery of interest, a very large amount of money recoverable as interest would remain unrealised by default unless appropriate steps were taken. On the basis of the demands, the notional simple interest at the rate of 18 per cent per annum for the period April 1983 to August 1995 worked out to Rs.144.70 crore and interest for the period under section 11AA from September 1995 to June 2004 worked out to Rs.90.52 crore.

On this being pointed out (July 2004), the Ministry of Finance (the Ministry) admitted the objection (November 2004).

**5.1.2** M/s. National Fertilisers Limited, in Ludhiana Commissionerate of Central Excise, incorrectly claimed exemption on furnace oil/high petroleum stock used as fuel for generation of steam and not as a feed stock in the manufacture of fertilisers. The demands raised by the Department on this account since October 1990 were finally upheld by the Supreme Court in February 2001. Consequently, during 2001-02, the assessee deposited duty amounting to

Rs.10.48 crore upto March 2001. However, interest amounting to Rs.2.25 crore for delayed payment of duty was not recovered.

On this being pointed out (December 2002), the Ministry stated (September 2004) that interest was not leviable as the goods were cleared to the buyer who was not a manufacturer under chapter X procedure of the Central Excise Rules and therefore failure to fulfil obligations under chapter X by the buyer of goods did not attract interest under section 11AA.

Reply of the Ministry is not tenable as rules 192 and 196 under chapter X procedure explicitly stipulate duty liability on the recipient of the goods, besides obtaining of excise registration certificate and submission of bond. Therefore the provisions relating to interest on delayed payment of duty under section 11AA were attracted, buyer of the goods being central excise licencee and liable to discharge duty liability.

**5.1.3** Rule 7 of the Central Excise Rules, 2002, stipulates that where differential duty is payable consequent to finalisation of provisional assessment, interest thereon is also payable at the prescribed rates from the first day of the month succeeding the month for which such amount is determined till the date of payment thereof.

M/s. HTL Limited, Chennai, in Chennai IV Commissionerate of Central Excise, interalia manufactured telecommunication equipment and their entire sales were made to Government corporations on the basis of purchase orders where the sale price was initially provisional and assessment too was provisional. Final prices were subsequently fixed on approval by Government and differential duty due was paid between April 2002 and May 2003. Interest of Rs.52.92 lakh (approximately) under rule cited supra had not been paid. Interest leviable in respect of differential duty paid through other 16 invoices between May 2002 and September 2002 could not be quantified for want of date of removal of goods.

On this being pointed out (July 2003), the Ministry stated (October 2004) that the interest would become payable on finalisation of the provisional assessments.

The reply is not tenable as the assessee had paid differential duty on the basis of final prices fixed by Government corporations and therefore, provisional assessment would not come in the way of collecting interest.

**5.1.4** M/s. Shree Synthetics Limited, Ujjain, in Indore Commissionerate of Central Excise, engaged in manufacture of nylon filament/textured/crimp yarn paid Rs.72.78 lakh in cash between June 2002 and August 2002 on account of excess utilisation of Cenvat credit in payment of duty on fortnightly basis for the months of May to July 2001. However, interest amounting to Rs.17.39 lakh leviable on delayed payment was not demanded.

On this being pointed out (April 2003), the Ministry stated (September 2004) that a show cause notice for Rs.1.72 crore had been confirmed (April 2004) together with interest and penalty imposed for Rs.50,000.

**5.1.5** M/s. Bihar Sponge Iron Limited, in Jamshedpur Commissionerate of Central Excise, engaged in manufacture of DRI lump, fine, etc. cleared excisable goods between July and October 2002 without payment of duty of Rs.2.44 crore on different due dates during 2002. Duty was paid between March 2003 and July 2003 and the assessee was liable to pay interest amounting to Rs.26.94 lakh.

On this being pointed out (June 2003 and January 2004), the Ministry stated (August 2004) that interest of Rs.26.99 lakh and penalty of Rs.0.05 lakh had been deposited by the assessee.

**5.1.6** M/s. Jindal Praxair Oxygen Company Private Limited, in Belgaum Commissionerate of Central Excise, engaged in manufacture of industrial gases and liquids received additional consideration in the shape of surcharge and differential value of power actually consumed during the period April 2001 to March 2003 from M/s. Jindal Vijaynagar Steel Limited. Assessee paid differential duty on additional considerations with delay ranging from one to eleven months between April 2002 and January 2004. However, the interest of Rs.12.38 lakh leviable for delayed payment was not demanded.

On this being pointed out (January 2004), the Ministry admitted the objection (December 2004).

**5.1.7** M/s. ONGC Limited, Sivasagar, in Dibrugarh Commissionerate of Central Excise, paid cess of Rs.66.52 crore on clearance of crude oil for the months of April, May and June 2003 with delay of four, five and three days, respectively. Interest of Rs.12.80 lakh leviable on delayed payment was not demanded.

On this being pointed out (September 2003), the Ministry admitted the objection (September 2004).

## 5.2 Failure to demand duty resulted in loss of interest

Section 11AA of the Central Excise Act, 1944, provides that where a person chargeable with duty fails to pay such duty within three months from the date of determination of such duty, he shall pay, in addition to the duty, interest on such duty from the date immediately after the expiry of such period of three months till the date of payment of such duty.

**5.2.1** M/s. Indian Oil Corporation, Bhatinda, in Ludhiana Commissionerate of Central Excise, paid duty on motor spirit at 20 per cent ad valorem prior to 3 June 1998. The product was cleared for sale after 3 June 1998 and duty collected at 32 per cent ad valorem. Differential duty amounting to Rs.98.08 lakh collected from the customers was remitted on 19 July 2001 by the assessee on his own. Failure of the Department to demand duty on its becoming due resulted in loss of interest of Rs.58.93 lakh for the period upto 18 July 2001.

On this being pointed out (July 2002), the Ministry stated (September 2004) that the assessee had paid differential duty under section 11D of the Act, there being no provision for charging interest on delayed payments under section ibid.

The reply of the Ministry is not tenable as section 11D relates to deposit of duty collected in excess of payable duty whereas in the present case, inaction on the part of the Department had resulted in delayed remittance of duty.

**5.2.2** Scrutiny of records of M/s. Indian Oil Corporation, Betkuchi, in Shillong Commissionerate of Central Excise, revealed that the prices of motor spirit, high speed diesel, superior kerosene were enhanced on 23 July 1996 and 2 September 1997. Rate of excise duty was also increased on 23 July 1996. While duty on the products was collected at the increased rate and at the enhanced prices at the time of clearance of goods for sale during the period from 1 April 1996 to 31 March 2000, duty on them was paid to Government on pre increased rate/prices. The differential duty amounting to Rs.1.50 crore collected from the customers was remitted to Government after delays ranging from 242 to 1,525 days. Failure of the Department to demand duty on its becoming due resulted in non-recovery of interest of Rs.29.08 lakh.

On this being pointed out (July 2002), the Ministry admitted the objection (October 2004).

**5.2.3** M/s. Silver Oak Laboratories (Private) Limited, in Noida Commissionerate of Central Excise, engaged in the manufacture of cosmetic preparations, was issued show cause notice by the Department on 7 August 1998 for Rs.203.46 lakh demanding duty for the period December 1996 to June 1997 because goods were to be assessed on resale price of main unit as the assessee was only a dummy. The assessee deposited Rs.172.00 lakh in August 1997 before issue of show cause notice and balance amount of Rs.31.46 lakh was deposited in October 2000 after admission order of Settlement Commission, who had observed that no interest had been demanded therein. Thus, failure on the part of the Department to demand interest resulted in its loss to the tune of Rs.25.19 lakh for the period from July 1997 to September 2000.

On this being pointed out (December 2001), the Ministry stated (November 2004) that the Settlement Commission had refrained from passing orders regarding interest liability as it had not been demanded in the show cause notice.

The fact remains that absence of specific mention of interest in SCN resulted in its loss.

## 5.3 Non-levy of penalty

As per rule 49(1)(e) of erstwhile Central Excise Rules, 1944, as it was in force upto 30 June 2001, where an assessee failed to pay fortnightly instalment of duty beyond 30 days from the due date on one occasion or failed to adhere to the due dates and paid duty with delays ranging upto 30 days on any three occasions in a financial year whether in succession or otherwise, the facility of fortnightly payment of duty was to be forfeited for a period of two months. In such a case assessee could discharge his duty liability only through personal ledger account (PLA) on consignment basis. Utilisation of Cenvat credit during the period of forfeiture towards payment of duty attracts levy of penalty not exceeding duty leviable on the goods cleared or ten thousand rupees whichever is greater.

Similar provisions have been incorporated in rule 8 of the Central Excise Rules, 2001 effective from 1 July 2001 and in rule 8 of Central Excise Rules, 2002, effective from 1 March 2002.

Rule 8 of the Central Excise Rules, 2002, as amended on 1 March 2003 provides that till such time the amount of duty is outstanding and interest payable thereon is not paid, it shall be deemed that goods in respect of which the duty and interest are outstanding have been cleared without payment of duty, and where such duty and interest are not paid within a period of one month from the due date, the consequences and penalties as provided in these rules would follow.

Rule 25 of the Central Excise Rules, 2001/2002 stipulates that if any manufacturer removes any excisable goods in contravention of any provisions of these rules, all such goods are liable to confiscation and the manufacturer is liable to pay penalty not exceeding the duty on the excisable goods or rupees ten thousand whichever is greater.

**5.3.1** M/s. Oil and Natural Gas Corporation Limited, Sivasagar, in Dibrugarh Commissionerate of Central Excise, defaulted in payment of cess by due dates on 20 occasions between April 2002 and March 2003. No action was taken by the Department to issue orders of forfeiture as per rules ibid. Penalty for their contravention amounting to

Rs.231.85 crore i.e. equal to cess and interest of Rs.18.85 lakh for delayed payments was leviable.

On this being pointed out (September 2003), the Ministry admitted the objection and stated (October 2004) that the demand of interest of Rs.18.85 lakh had been confirmed and penalty of Rs. five thousand imposed under rule 27 of the Central Excise Rules, 2002.

The facts remain that the assessee failed to pay duty on due dates on 20 occasions and provision of rule 8 was violated. Penalty under rule 25 of the Central Excise Rules, 2000, was therefore, imposable and not under residuary rule 27.

**5.3.2** M/s. Hindustan Paper Corporation Limited in Shillong Commissionerate of Central Excise, manufacturing paper revealed that the due date of payment of instalment had been violated for the third time during the financial year 2002-03 in as much as the assessee had delayed payment for the months of June, October and November 2002 by one day. The Department did not issue an order for forfeiture of facility to pay dues in instalments and to pay duty from cash for each consignment for December 2002 and January 2003. The assessee paid duty of Rs.6.91 crore in instalments and also utilised Cenvat credit of Rs.64.35 lakh for payment of duty. Penalty equivalent to the duty of Rs.6.91 crore was leviable which was not levied.

On this being pointed out (August 2003), the Ministry stated (October 2004) that action was initiated to forfeit the facility in January 2003 but assessee continued to pay duty from Cenvat credit account till 3 March 2003. Ministry further stated that SCNs demanding duty of Rs.43.56 lakh had been issued in December 2003.

The fact remain that notices were issued only after being pointed out in audit and the reply was silent about penalty leviable for violation of rule 8 ibid.

**5.3.3** M/s. Prism Cement Limited, Satna, in Bhopal Commissionerate of Central Excise, cleared cement and clinker between 16 and 31 March 2003 without payment of duty of Rs.3.02 crore payable by 31 March 2003. The assessee paid duty of Rs.3.02 crore and interest of Rs.1.41 lakh during different dates between April and December 2003. Since the duty and interest were not paid within a period of one month from the due date, assessee was liable to pay penalty of Rs.3.02 crore. No action was taken by the Department to recover this amount.

On this being pointed out (February 2004), the Ministry stated (November 2004) that interest was paid in two instalments in April 2003 and December 2003 because of revision of interest rate in April 2003.

Reply of the Ministry is not tenable as rule 8 clearly stipulates that when duty and interest are not paid within a period of one month from due date, the consequences and penalties as provided in the rules would follow.

**5.3.4** Test check of records of M/s. Simplex Castings Limited, in Raipur Commissionerate of Central Excise, revealed that the assessee had defaulted in payment of duty on three occasions i.e. August 2002, December 2002 and January 2003 during the financial year 2002-03. The assessee continued to pay duty through Cenvat accounts even after the third default though he was not eligible to utilise Cenvat credit account. Duty of Rs.45.95 lakh paid during February and March 2003 from Cenvat credit account was in contravention of the rule. The assessee was liable to pay duty in cash and penalty of Rs.45.95 lakh was also leviable.

On this being pointed out (November 2003), the Ministry admitted the objection (September 2004).

**5.3.5** M/s. Asian Peroxides Limited, in Guntur Commissionerate of Central Excise, engaged in the manufacture of inorganic chemicals was served with an order of forfeiture of fortnightly payment facility during December 2000 for failure to pay duty on due dates on three occasions in 2000-01 consequent to which the assessee switched over to payment of duty on consignment basis during January and February 2001. It was noticed (November 2003) that during the two relevant months, the assessee utilised Cenvat credit to the extent of Rs.20.76 lakh towards payment of duty instead of paying the entire duty in cash. Department did not initiate action to levy penalty of Rs.20.76 lakh as required under the provisions.

On this being pointed out (February 2004), the Ministry while admitting the objection stated (September 2004) that the assessee had paid duty of Rs.20.76 lakh in June 2004 and interest of Rs.12.70 lakh in July 2004. SCN for penalty was under issue.

**5.3.6** Rule 8 of the Central Excise Rules, 2002, stipulates that in case of goods removed during the second fortnight of the month of March, the duty shall be paid by 31$^{st}$ day of March.

The Board in its circular dated 19 March 2002 clarified that assessee should ensure that duty for the second fortnight of March 2002 was paid by 31 March 2002 failing which the clearances would be treated as non-duty paid. It, therefore, follows that in case duty for second fortnight of March 2002 was not paid by 31 March 2002, there would be contravention of rule 8 ibid and provisions of rule 25 would get attracted.

M/s. Agrawal Overseas, Khandwa, in Indore Commissionerate of Central Excise, engaged in the manufacture of man made yarn, cleared the goods between 16 and 23 March 2002. Excise duty of Rs.18.94 lakh payable by 31 March 2002 was paid on 3 April 2002. Since duty was not paid by 31 March 2002, the clearances of goods between 16 March and 23 March 2002 were to be treated as clearances without payment of duty and hence penalty of Rs.18.94 lakh was leviable under rule 25. The Department did not take any action for recovery of penalty.

On this being pointed out (December 2003), the Ministry stated (October 2004) that since the non-payment of instalment for March 2002 was made good three days after due date, the assessee was required to pay only interest on the outstanding amount.

The reply of the Ministry is not tenable as there was contravention of rule 8 and hence penal provisions under rule 25 were attracted. Reply is also not in consonance with the Board's clarification ibid.

**5.3.7** M/s. K.K. Kohli & Brothers Private Limited, in Faridabad Commissionerate of Central Excise, engaged in processing of cotton/man made fabrics defaulted thrice in payment of duty on due dates during 2001-02. The Department directed (January 2002) the assessee to pay duty on consignment basis during the months of February and March 2002 and do so from personal ledger account. The assessee, however, continued to avail deemed credit and paid duty of Rs.19.46 lakh from Cenvat account during these months which was in contravention of the rules. Duty liability of Rs.19.46 lakh besides penalty of equal amount alongwith interest of Rs.6.16 lakh was therefore due.

On this being pointed out (January 2003), the Ministry admitted the objection and stated (September 2004) that SCN issued in March 2003 was pending adjudication.

**5.3.8** M/s. Tirupati Fibres and Industries Limited, in Jaipur II Commissionerate of Central Excise, did not deposit duty payable for the months of September and October 2003 amounting to Rs.17.01 lakh. No action was taken to realise this amount alongwith interest and penalty of an equal amount.

On this being pointed out (December 2003), the Department stated (April 2004) that the assessee had deposited duty of Rs.17.01 lakh and interest of Rs.1.45 lakh between November 2003 and February 2004 respectively. Report on recovery of penalty had not been received.

The Ministry admitted the objection and stated (November 2004) that SCN invoking penal provisions under rule 25 had been issued in September 2004.

**5.3.9** According to sub rule 3 of 96 ZO of the Central Excise Rules, 1944, a manufacturer having a total furnace capacity of 3 tonne could opt to pay duty at rupees five lakh per month in two equal instalments, the first instalment being payable by 15$^{th}$ day of the month and second instalment by the last day of each month. Failure to do so would attract interest at the rate of eighteen per cent per annum and penalty equal to such outstanding amount of duty or five thousand rupees whichever was greater.

M/s. Satyam Steels and Alloys Private Limited, Byrnihat, in Shillong Commissionerate of Central Excise, engaged in the manufacture of MS ingots opted to pay duty on lump sum basis under the terms of the rule ibid. The assessee did not pay duty from 1 April 1999 to 7 July 1999 whereupon Department directed (April 2000) for payment of duty of Rs.16.15 lakh with an equal amount of penalty together with interest. The duty of Rs.16.15 lakh and interest of Rs.2 lakh was adjusted by the Department in twelve equal monthly instalments against the refund claims of the assessee during January 2001 to February 2002. No action was taken by the Department to recover the balance amount of interest of Rs.5.67 lakh and penalty of Rs.16.15 lakh.

On this being pointed out (July 2002), the Ministry stated (September 2004) that the assessee had filed a writ petition before the Guwahati High Court which had directed (23 May 2003) that status quo ante be maintained.

## 5.4 Other cases

In 36 other cases of non-levy of interest/penalty, the Ministry/the Department had accepted objections involving duty of Rs.59.62 lakh and reported recovery thereof till January 2005.

# CHAPTER VI : GRANT OF MODVAT/CENVAT CREDIT

Under Modvat/Cenvat scheme, credit is allowed for duty paid on 'specified inputs' and 'specified capital goods' used in manufacture of finished goods. The credit can be utilised towards payment of duty on finished goods subject to the fulfilment of certain conditions. Some cases of incorrect availment of Modvat/Cenvat credit, noticed in test audit are elucidated in the following paragraphs :-

## 6.1 Modvat/Cenvat credit availed but amount not paid on final goods

Rule 57CC of the Central Excise Rules, 1944 (corresponding to rule 6(3)(b) of Cenvat Credit Rules, 2001 and 2002) envisages that where a manufacturer is engaged in the manufacture of any final product which is chargeable to duty as well as any other final product which is exempt or is chargeable to nil rate of duty and the manufacturer takes credit of specified duty on any input used in relation to the manufacture of both the categories of final products whether contained in the said final product or not, and opts not to maintain separate accounts of common inputs, he shall pay an amount equal to eight per cent of the price of second category of final products charged by the manufacturer for sale of such goods at the time of clearance from the factory.

**6.1.1** M/s. Hind Lever Chemicals, in Haldia Commissionerate of Central Excise, manufacturing both dutiable (sodium tripoly phosphate) and exempted goods (di-ammonium phosphate and single super phosphate) was allowed to avail of Cenvat credit on some common inputs. Detailed examination of manufacturing process revealed that during the manufacture of sodium tripoly phosphate, a product named neutral filter cake (NFC) emerged which was used in the manufacture of di ammonium phosphate and complex fertilizers. In the course of manufacturing such NFC (classified by the assessee under sub heading 3103.00) Cenvatable inputs like sodium bi-carbonate and sodium hydroxide were used. Similarly the assessee used linear alkyl benzene (LAB) being a common Cenvatable input in the manufacture of single super phosphate (SSP). Despite using common inputs on which Cenvat credit was availed, the assessee had not maintained separate accounts of inputs for exempted and dutiable category of excisable goods. The Cenvat credit on inputs so availed was utilised towards payments in respect of dutiable products. So an amount equivalent to eight per cent of the value of such exempted final products was required to be paid. This resulted in non-payment of Rs.90.69 crore during the period from March 2002 to July 2003.

On this being pointed out (September 2003), the Ministry of Finance (the Ministry) admitted the objection (November 2004).

**6.1.2** M/s. Grasim Industries Limited, Nagda, in Indore Commissionerate of Central Excise, engaged in the manufacture of viscose staple fibre, sodium sulphate, sulphuric acid and carbon disulphide also produced electricity which was partly sold outside the factory including residential colony of the staff. Modvat/Cenvat credit availed on inputs such as furnace oil, low sulphur heavy stock etc, for generation of electricity, was utilised for payment of duty on final products. No separate accounts of inputs used for production of electricity cleared for sale were maintained. The cost of electricity sold amounted to Rs.375.58 crore on which an amount of Rs.30.04 crore was recoverable during the period

September 1996 to December 2003. No action was taken by the Department to recover the amount.

On this being pointed out (February 2004), the Ministry stated (November 2004) that electricity being non-excisable goods, credit of duty paid on inputs used for generation of electricity sold outside factory would not be available and reversal of the proportionate credit would be reasonable.

Reply of the Ministry is not tenable as Cenvat Credit Rules do not provide proportionate reversal of credit after opting of the facility of non-maintenance of separate inventory of common inputs to be used in both dutiable and non-dutiable output goods. This has been done for LSHS from 1 March 2002. Therefore eight per cent of the price of electricity sold was recoverable.

**6.1.3** M/s. Kochi Refineries Limited, in Cochin Commissionerate of Central Excise, engaged in the manufacture and clearance of petroleum and petrochemical products availing Cenvat credit facility on inputs and capital goods, cleared refined diesel oil and low sulphur high flash high speed diesel (LSHFHSD) to an oil company under bond from where it was supplied to the Indian Navy availing exemption under a notification dated 16 March 1995. Even though the assessee had not maintained separate accounts of inputs, it did not pay eight per cent of the value of the exempted goods on clearance. This resulted in non-payment of Rs.11.53 crore during December 1997 to March 2002.

On this being pointed out (May 2002), the Ministry stated (October 2003 and December 2004) that LSHFHSD was a straight run product manufactured from low sulphur crude and no Cenvat credit availed inputs were used in the manufacture of the same. It was further stated that there was no direct clearance of exempted LSHFHSD from the assessee's premises since the ultimate clearance to Indian Navy was from the oil distribution company who received the product under bond from the assessee's premises.

The reply of the Ministry is not tenable as several common inputs like ferric chloride, hydrogen peroxide, indfloc, synthetic gum, polymer etc. were used in its manufacture. The Department however had issued two SCNs (October 2002 and January 2003) for Rs.11.53 crore for the period from December 1997 to March 2002, adjudication of which was awaited.

**6.1.4** M/s. IVP Limited, in Mumbai I Commissionerate of Central Excise, availed Cenvat credit on inputs used in the manufacture of dutiable as well as exempted final products. The assessee had neither maintained separate inventory nor paid an amount equal to eight per cent of the price of the final products cleared without payment of the duty during January 2003 to April 2003. This resulted in non-payment of Rs.4.96 crore.

On this being pointed out (November 2003) the Ministry admitted the objection and reported (October 2004) issue of SCN for the amount.

**6.1.5** Test check of records of nine assessees in eight Commissionerates of Central Excise, revealed that they manufactured both dutiable and exempted products using various common inputs. They availed Modvat/Cenvat credit of duty paid on inputs but had not maintained separate accounts of inputs used in exempted goods. Therefore they were liable to pay eight per cent of the price of exempted goods cleared. This resulted in non-payment of Rs.3 crore between April 1999 and March 2004.

On this being pointed out (between June 2001 and April 2004), the Ministry admitted (between September and December 2004) the objection in eight cases and reported recovery of Rs.0.29 crore for the period from October 2000 to March 2003 from two assessees. In the ninth, it stated (November 2004) that the assessee had neither maintained separate accounts nor paid eight per cent of exempted final goods and therefore, the only course of action open to revenue was to recover the amount equal to Cenvat credit. Report on recovery of credit with interest and penalty had not been received.

## 6.2 Removal of inputs or capital goods without payment of duty

Rule 57AB(1C) of the Central Excise Rules, 1944, {rule 3(4) of the Cenvat Credit Rules, 2002, as was in force till 28 February 2003} clearly provides that when inputs and capital goods, on which Cenvat credit has been taken are removed from the factory, the manufacturer of the final products shall pay an amount equal to the duty of excise leviable thereon.

**6.2.1** M/s. Reliance Industries Limited, in Raigad Commissionerate of Central Excise, cleared inputs/capital goods, on which credit was availed, to their power plant without payment of duty. The assessee claimed and was allowed exemption on income derived from the new industrial undertaking under section 801A/801B of the Income Tax Act, 1961, treating the power plant as a separate industrial undertaking and a separate entity. Since this was so, removal of inputs/capital goods without payment of duty to power plant was incorrect.

On this being pointed out (May 2002), the Ministry admitted the objection and intimated (November 2004) that SCNs for duty of Rs.74.68 crore had been issued to the assessee in September 2003 and April 2004.

**6.2.2** M/s. Ranbaxy Laboratories Limited, in Indore Commissionerate of Central Excise, engaged in the manufacture of bulk drugs and medicaments removed inputs valued at Rs.56.02 crore between April 2002 and March 2004. Duty amounting to Rs.8.74 crore was not paid on the date of removal of inputs but was paid on 15$^{th}$ day or the last day of the month. This was in contravention of rule 3(4) ibid and tantamounts to removal of inputs without payment of duty. The assessee was, therefore, liable to pay interest of Rs.6.90 lakh and penalty of Rs.8.74 crore under rules 12 and 13 of rules ibid.

On this being pointed out (April 2004), the Department stated (May 2004) that an offence case was being booked against the party.

However, there was nothing on record to indicate that this had been done till date of audit although the irregularity persisted since April 2002.

The Ministry confirmed the facts (December 2004).

**6.2.3** M/s. Denso Faridabad Private Limited, in Faridabad Commissionerate of Central Excise, procured capital goods like moulds, jigs and dies etc., and availed Cenvat credit of the duty paid thereon. The assessee sold these capital goods as such on 1 November 2001 for Rs.454.55 lakh without payment of excise duty of Rs.72.73 lakh leviable thereon.

On this being pointed out (September 2003) the Ministry stated (September 2004) that duty was not paid because capital goods were not removed physically from the factory.

Reply of the Ministry is not tenable as sale of capital goods on commercial invoice No.C/001/01-02 dated 1 November 2001 and realisation of sale value provide sufficient proof for removal of capital goods for effecting recovery of duty.

## 6.3 Incorrect grant of deemed credit

Under rule 57A(2) {from 23 July 1996 and 57A(5) from 1 March 1997} Government may declare input on which duties of excise or additional duty paid should be deemed to have been paid at such rate or equivalent to such amount as may be specified in the notification and allow Cenvat credit of such declared duty deemed to have been paid. It is therefore clear that duty on the input should have been paid to make them eligible for deemed credit. The Tribunal in the case of M/s. Machine Builders {1996 (83) ELT 576} held that the intention of the provisions was not to deem that inputs which did not suffer duty were inputs which suffered duty.

By notifications dated 1 March 2001 (as amended on 29 June 2001) and 1 March 2002, the Government allowed deemed credit ranging from 20 per cent to 66.66 per cent of the aggregate of the duty of excise leviable under the Central Excise Act, 1944, and the Additional Duty of Excise (Goods of Special Importance) Act, 1957 on the final product declared therein. Grey fabrics had not been declared as inputs.

**6.3.1** Test check of records of 21 assessees, in Jaipur II, Ghaziabad II and Surat I Commissionerates of Central Excise, engaged in the manufacture of processed fabrics out of grey fabrics of cotton and man made fibre, availed and utilised deemed credit of Rs.16.88 crore during the period between March 2001 to March 2003, even though grey fabrics were not leviable to basic duty and additional duty {under Additional Duty of Excise (Goods of Special Importance) Act, 1957} and were not declared as an eligible input. Allowance of deemed credit was not correct.

On this being pointed out (between April 2002 and February 2004), the Ministry stated (between October and December 2004) that deemed credit scheme was introduced to complete the Modvat chain and in no way provided credit where no duty incidence had been suffered on the inputs. It was further stated that this issue had recently been taken up in litigation and the CEGAT, New Delhi had held (November 2002) that the assessee was entitled to deemed credit.

Reply of the Ministry does not address the points raised in audit.

**6.3.2** Test check of records of 15 assessees in Jaipur II Commissionerate of Central Excise, engaged in production of processed fabrics, revealed that credit of additional duty of Rs.3.99 crore had been availed between March 2001 and March 2003. The credit so availed was utilized for payment of additional duty on final products though no additional duty was paid on inputs used in their manufacture. Inclusion of additional duty payable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957, in the said notification, for grant of deemed credit, was not correct as this duty was not leviable on the declared inputs (viz. yarn). Additional duty was also exempt on the intermediate product – grey fabrics. Therefore, as no additional duty was payable on the inputs, the grant of credit of the same was incorrect in the light of the restrictions in the Cenvat Credit Rules.

On this being pointed out (February 2004), the Ministry stated (September 2004) that deemed credit scheme was introduced to complete the Modvat chain and in no way provided credit where no duty incidence had been suffered on the inputs. It was further stated that this issue had recently been taken up in litigation and the CEGAT, New Delhi had held (November 2002) that the assessee was entitled to deemed credit.

Reply of the Ministry is not tenable as, in fact, no additional duty was leviable on input goods (yarn). The CEGAT's decision quoted also is not relevant as audit has questioned the validity of notification providing deemed credit of additional duties of excise and not the assessee's entitlement to deemed credit.

**6.3.3** Mention was made in para 10.2 of Audit Report for the year ended March 2002, that M/s. SKM Fabrics Limited, Dewas, in Indore Commissionerate of Central Excise, engaged in the processing of textile fabrics, exclusively with the aid of hot air stentor, did not pay duty on the dates stipulated during November 2001 to March 2002 and the Department did not levy mandatory penalty of Rs.2.04 crore. The Ministry had stated (December 2002) that the party's option for grant of permission to avail compounded levy scheme had been rejected on the ground that the condition prescribed regarding value of plant and machinery was not fulfilled.

Subsequent audit of the records of the assessee revealed that while rejecting permission the Department instead of recovering differential duty of Rs.2.62 crore (i.e difference between duty payable and duty paid under compounded levy scheme) incorrectly allowed (December 2002) deemed Cenvat credit of Rs.3.52 crore in respect of goods manufactured during May 2001 to March 2002 under notification dated 1 March 2001 and refunded Rs.6.54 lakh paid in excess on goods exported during May 2001 to May 2002. Grant of deemed Cenvat credit and refund of duty was incorrect as the application dated 10 May 2001 for availing special procedure under rule 96ZNC was rejected by the Department on account of value of plant and machinery misdeclared as less than Rs.3 crore though it exceeded Rs.3 crore. Since there had been suppression of facts, deemed Cenvat credit was not admissible in terms of clause 6 of notification dated 1 March 2001 which specifically denies grant of deemed credit in such cases. Refund of duty was also not admissible as application for refund of duty was submitted on 3 December 2002 and hence time barred.

On this being pointed out (April 2004), the Ministry stated (December 2004) that the Commissioner, while rejecting the application, had not questioned the bonafide of the assessee which was essential to disentitle the assessee from availing the benefit of deemed credit.

The fact remains that by not probing the misdeclaration further revenue of Rs.6.20 crore was lost.

**6.3.4** Under rule 9A(1) (inserted on 25 March 2003) manufacturers of processed fabrics were allowed credit of duty paid on inputs of processed fabrics lying in stock or in process or contained in finished products lying in stock as on 31 March 2003 subject to availability of the documents evidencing actual payment of duty thereon. In case where a manufacturer was unable to produce the documents evidencing actual payment of duty he was allowed to take such credit on deemed basis {as per sub rules (2) and (3) of rule 9(A)} at the rates as were notified by the Central Government.

M/s. Anant Syntex Limited and M/s. Ranjan Processor Limited, in Jaipur II Commissionerate of Central Excise, engaged in the manufacture of processed fabrics from duty free

unprocessed fabrics availed deemed credit of Rs.57.35 lakh on the inputs (unprocessed fabrics) lying in stock or in process or contained in finished goods. Since duty was not leviable on unprocessed fabrics lying in stock or in process or contained in finished goods, grant of deemed credit of Rs.57.35 lakh was incorrect.

On this being pointed out (January 2004), the Ministry stated (September 2004) that rule 9(A) was a transitional provision introduced in March 2003.

Reply of the Ministry is not tenable as grant of deemed credit on inputs which did not suffer duty caused loss of revenue to Government.

## 6.4 Simultaneous availment of credit under Cenvat scheme and depreciation under Income Tax Act

As per rule 57R (8) of the Central Excise Rules, 1944 (at present rule 4(4) of the Cenvat Credit Rules, 2002), no credit of specified duty paid on capital goods shall be allowed, if the manufacturer claims depreciation under section 32 of the Income Tax Act, 1961, in respect of that part of the value of the capital goods which represents the amount of specified duty on such capital goods.

**6.4.1** M/s. Ispat Industries Limited, in Raigad Commissionerate of Central Excise, procured capital goods viz., structural steel and availed Cenvat credit of specified duty paid. The Department disputed the availment of credit on the ground that the goods were not eligible capital goods. The dispute was settled under Kar Vivad Samadhan Scheme, 1998 and the assessee was allowed to retain the Cenvat credit. The assessee utilised the credit so availed. Audit noticed that the assessee in addition to retaining and utilizing the credit, also added the amount of credit availed, in the fixed assets register and claimed depreciation under section 32 of the Income Tax Act, 1961 in 2000-01 on that part of the value which represented the amount of duty. Availing of credit was, therefore, incorrect and resulted in double benefit.

On this being pointed out (October 2002), the Ministry admitted the objection and intimated (December 2004) issue of SCN disallowing credit of Rs.9.91 crore.

**6.4.2** Four assessees in four Commissionerates of Central Excise, procured certain capital goods and availed Modvat credit of Rs.1.31 crore thereon between 1996-97 and 2002-03. It was noticed that the assessee had also claimed depreciation under section 32 of Income Tax Act on full value of the capital goods including duty. Availment of credit was therefore, incorrect and resulted in double benefit.

On this being pointed out (between February 1999 and December 2003), the Ministry admitted the objection in three cases (September and December 2004) and intimated issue of SCN for Rs.1.47 crore to two assessees. In the fourth, it stated (September 2004) that the assessee had filed revised income tax return (February 2004) and paid differential income tax.

This however cannot be construed as a corrective measure as the Modvat/Cenvat Credit Rules stipulate disallowance of credit in such situation and do not provide for filing of revised income tax return under Income Tax Act.

## 6.5 Excess availment of Cenvat credit on capital goods

Rule 57AC of the Central Excise Rules, 1944, and rule 4(2) of the Cenvat Credit Rules, 2001, stipulate that Cenvat credit in respect of capital goods received in a factory at any point of

time in a given financial year shall be taken only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year, and balance fifty per cent in the subsequent financial year.

The Board clarified on 29 August 2000 that credit of duty paid on capital goods received prior to 1 April 2000 could be taken on or after the said date provided the credit was earned by the manufacturer prior to 1 April 2000 and credit was not taken due to some reasons.

**6.5.1** M/s. Ispat Metallics India Limited, in Raigad Commissionerate of Central Excise, availed credit of Rs.17.20 crore between April and December 2000 in respect of capital goods received before 1 April 2000. The credit so availed was 100 per cent of the duty paid on those capital goods as against the permissible 50 per cent. This resulted in excess availment of credit of Rs.8.60 crore.

On this being pointed out (October 2002), the Ministry stated (December 2004) that the goods were installed prior to 1 April 2000 and hence credit availed was correct.

Reply of the Ministry is not tenable as the assessee's statutory records indicate that the machinery had been put to use for commencement of production only from 11 May 2000.

**6.5.2** M/s. Cement Corporation of India, in Shillong Commissionerate of Central Excise, engaged in the manufacture of cement, availed full credit of the excise duty of Rs.1.64 crore paid on capital goods between April 2000 and July 2002 instead of availing fifty per cent of the duty paid in the first financial year. The assessee also utilised the credit for payment of duty on final products between May 2000 and September 2002 to the extent of Rs.88.59 lakh. This resulted in availment of Cenvat credit in excess of Rs.81.84 lakh which was recoverable alongwith interest of Rs.5.25 lakh and penalty under rule 13 of the Cenvat Credit Rules.

On this being pointed out (December 2002), the Ministry admitted the objection and stated (September 2004) that SCN had been issued to the assessee.

**6.5.3** M/s. Precision Fasteners Limited, in Belapur Commissionerate of Central Excise, imported capital goods in 1996 under Export Promotion Capital Goods (EPCG) Scheme without payment of customs duty subject to fulfilment of export obligation (EO). When EO was not fulfilled, the additional duty (CVD) under section 3 of the Customs Tariff Act, 1975, on such capital goods was recovered from the assessee in August 2002. The assessee availed credit at 50 per cent of CVD in August 2002 and balance 50 per cent in April 2003. As the capital goods received did not suffer duty prior to 1 April 2000, no credit was earned by the assessee as per the above quoted Board's circular resulting in wrong availment of credit of Rs.34.18 lakh.

On this being pointed out (March 2003), the Ministry stated (August 2004) that though the capital goods were received in 1996, duty was levied due to non-fulfilment of the EO and thus the assessee was deemed to have earned credit in 1996 by virtue of duty leviability.

The Ministry's contention runs contrary to the instructions issued by the Board in August 2000.

In a similar case the Ministry had admitted the objection in October 2003.

**6.5.4** Rule 57Q of the Central Excise Rules, 1944, as was in force from March 1997 to February 2000, stipulated that credit on additional duty paid on project imports classifiable

under heading 98.01 of the Customs Tariff was admissible to the extent of 75 per cent of the duty paid. According to the Tribunal judgment in the case of Commissioner of Central Excise, Coimbatore Vs. Sengunthar Spinning Mills {1998 (99) ELT 409 (T)} the law in force at the time of receipt of project imports was applicable and the eligibility for credit was determined at the time of receipt of capital goods into the factory.

M/s. Kochi Refineries Limited, Ambalamugal in Cochin Commissionerate of Central Excise, commissioned a diesel hydro de-sulphurisation plant in March 2000 on turnkey basis and availed full Cenvat credit during 2000-01 and 2001-02 of countervailing duty amounting to Rs.4.73 crore paid on capital goods imported for the plant under project imports during the period prior to March 2000. As the imports were made prior to 1 March 2000 the credit should have been restricted to 75 per cent of countervailing duty paid as admissible at the time of receipt of project imports. The excess inadmissible credit worked out to Rs.1.18 crore.

On this being pointed out (May 2002), the Ministry stated (December 2004) that restriction of credit of 75 per cent was withdrawn on 1 March 2000 and since the project was commissioned on 23 March 2000, full credit was admissible in terms of Tribunal's judgement in case of M/s. Strodyne Packaging Private Limited.

Reply of the Ministry is not relevant as the project imports were received prior to March 2000. The case law quoted is not relevant as it relates to input goods whereas Tribunal decision in Sengunthar Spinning Mills relates to capital goods. The Ministry had intimated recovery of excess credit in a similar case featured in Audit Report 2001-02.

## 6.6 Incorrect utilisation of basic excise duty credits for payment of additional duty

As per rule 57AB(2)(b) of the Central Excise Rules, 1944, credits in respect of (i) additional duty of excise under section 3 of the Additional Duties of Excise (Textile and Textiles Articles) Act, 1978; and (ii) additional duty of excise under section 3 of the Additional Duties of Excise (Goods of Special Importance ) Act, 1957 {(AED (GSI)}, shall be utilized only towards payment of duty of excise leviable under the said Acts on any final products manufactured by the manufacturer.

M/s. Auro Textiles Baddi, in Chandigarh I, M/s. Divya Dying and Exports Private Limited and M/s. Vaibhav Laxmi Processors Limited in Belapur Commissionerate of Central Excise, engaged in the manufacture/process of cotton fabrics, man made fabrics etc., availed and utilised Cenvat credit of basic excise duty incorrectly towards payment of additional duty leviable under Additional Duties of Excise (Goods of Special Importance ) Act, 1957. This resulted in incorrect utilization of credits amounting to Rs.8.56 crore between March 2001 and March 2004.

On this being pointed (March 2002 and July 2004), the Ministry stated (August and November 2004) that the rule did not contain any prohibition for utilisation of credit of basic excise duty for payment of AED (GSI).

Reply of the Ministry is not tenable as rule 57AB(2)(b) specifically debars utilisation of credit of AED (GSI) for payment of other duties.

## 6.7 Incorrect availment of credit of inputs used in exempted final products

As per rule 6(1) of Cenvat Credit Rules, 2002, (erstwhile rule 57C and 57AD (1) of the Central Excise Rules, 1944), no credit of specified duty shall be allowed on such quantity of inputs used in the manufacture of final products, which are exempt from the whole of the duty of excise leviable thereon or are chargeable to nil rate of duty.

**6.7.1** M/s. Dynamix Dairy Industries Limited, in Pune II Commissionerate of Central Excise, manufactured both dutiable and non-dutiable final products. The dutiable final products constituted about 2 to 10 per cent of total value of clearances during 2000-01 to 2002-03. However, the assessee availed and utilised Cenvat credit on entire quantity of furnace oil used in the manufacture of both kind of products. Cenvat credit recoverable on the furnace oil used in the manufacture of exempted final products for the period 2000-01 to 2002-03 worked out to Rs.3.75 crore.

On this being pointed out (August 2000), the Ministry admitted the objection (December 2004).

**6.7.2** M/s. Bilag Industrial Private Limited, in Daman Commissionerate of Central Excise availed cenvat credit on light diesel oil used for generation of steam. The assessee did not reverse the credit attributable to the quantity of light diesel oil used as inputs in the manufacture of steam cleared outside the factory of production during April 2000 to March 2003. This resulted in incorrect availment of Cenvat credit of Rs.50.79 lakh.

On this being pointed out (August 2003), the Ministry admitted (July 2004) the objection and intimated recovery of the amount.

**6.7.3** The Board, in consultation with the Ministry of Law clarified on 4 January 1991 that in the event of a manufacturer availing Modvat/Cenvat credit and paying duty on exempted final products on his own volition, the payments would not be in nature of duty and were to be treated as deposits and hence credit of duty paid on inputs was not permissible.

M/s. VFC Industries Private Limited, in Vadodara II Commissionerate of Central Excise, availed Modvat/Cenvat credit of duty paid on inputs and utilised it for payment of duty on shrink sleeves of plastic. As shrink sleeves attracted nil rate of duty under sub heading 4901.90, the duty paid thereon was to be treated as deposits. Therefore, the assessee was not entitled to utilise the credit of payment of duty on shrink sleeves. The utilisation of Modvat credit of Rs.42.32 lakh for the period from April 2002 to March 2003 by the assessee and availing of credit subsequently by the recipient was incorrect.

On this being pointed out (January 2004), the Ministry stated (October 2004) that shrink sleeves were classifiable under sub heading 3926.90 attracting appropriate rate of duty and hence utilisation of credit by the assessee and availing of credit subsequently by the recipient was correct.

Reply of the Ministry is contradictory to its earlier reply on a similar issue where it admitted the objection in October 2002 and also intimated (March 2004) confirmation of demand of Rs.3.08 crore and imposition of penalty of Rs.2.16 crore.

## 6.8 Modvat credit not recovered on material written off or found short

As per rules 57A/57T/57AB of erstwhile Central Excise Rules, 1944/rule 3 of Cenvat Credit Rules, a manufacturer of dutiable final products shall be allowed to take credit of duty paid

on inputs or capital goods and spares thereof received in his factory for use in or in relation to the manufacture of such final products. The Board clarified in February 1995 that where Modvat credit was availed on inputs but subsequently such inputs were not used in the manufacture and their value was written off from stock account for any reason, Modvat credit should be reversed. The Board further clarified on 3 January 1996 that credit can be taken only after the goods are installed or used by the manufacturer.

**6.8.1** Scrutiny of annual accounts for the years 1997-98 to 2001-02 revealed that M/s. Ingersoll Rand (India) Limited, in Ahmedabad II Commissionerate of Central Excise had written off inputs worth Rs.13.96 crore on account of obsolescence and scrap without paying back Modvat/Cenvat credit availed on them. It was noticed that annual accounts and amount written off were combined for both Ahmedabad and Bangalore plants and the assessee had not furnished separate figures for both the plants to audit. The Department was asked to take action to recover duty.

On this being pointed out (December 2001), the Ministry admitted the objection and stated (September 2004) that SCN for Rs.2.76 crore for the period from April 1997 to March 2003 was issued of which demand for Rs.0.88 crore for the period from April1997 to March 1999 had been confirmed. It was further stated that SCN for Rs.6.65 lakh in respect of Bangalore plant was under issue.

**6.8.2** M/s. National Aluminium Company Limited, Angul (smelter plant), engaged in manufacture of aluminium in Bhubaneswar I Commissionerate of Central Excise, had written off Rs.14.90 crore in its annual accounts (profit and loss account) for the period from 1999-2000 to 2002-03 towards 95 per cent of the value of stores and spares not utilised for production of finished goods for more than five years and in view of the aging and reduction of balance useful life of such stores and spares. The corresponding Modvat/Cenvat credit availed on such capital goods was however not reversed, notwithstanding the fact that the items became unfit for use for the specified purposes. This resulted in incorrect grant of availment of Modvat/Cenvat credit of Rs.2.38 crore.

On this being pointed out (November 2001), the Ministry stated (October 2004) that the inputs were physically available for use, as such, the assessee was eligible to claim Modvat/Cenvat credit on them.

Reply of the Ministry is not tenable as the assessee themselves stated (November 2001) that due to aging and reduction of expected balance useful life, the value of such spares had been reduced by 95 per cent after lapse of six to nine years. As such these non-moving spares cannot be treated as fit for use.

**6.8.3** M/s. Hindustan Zinc Limited, in Visakhapatnam I Commissionerate of Central Excise, engaged in the manufacture of zinc ingots procured duty paid inputs like zinc concentrate, zinc dust, calcine etc. besides spare parts of machinery and availed Modvat/Cenvat credit on such materials. Verification of the assessee's records revealed that (i) during the year 1999-2000 inputs and spares valuing Rs.58.61 lakh which did not move from stores stock and were not fit for use were charged off to profit and loss account as loss and (ii) zinc dust and calcine valuing Rs.132.29 lakh and Rs.131.55 lakh respectively which were found short on physical verification conducted during June 2002 were charged to consumption of chemicals/decrement in stock accounts in the annual accounts for the year 2002-03. The Modvat/Cenvat credit amounting to Rs.51.60 lakh related to the above write off/shortages was not reversed by the assessee.

On this being pointed out (March 2001 and December 2003), the Ministry admitted the objection and stated (October 2004) that the adjudication orders confirming the demand in respect of Modvat credit on written off material had been stayed by the Tribunal and that the assessee's appeal against confirmation of demand of Modvat credit on inputs found short had been allowed by the Tribunal which was under review.

## 6.9 Irregular re-credit taken of the reversed Cenvat credit

Under rule 6(1) of the Cenvat Credit Rules, 2001 (previously rule 57C of the Central Excise Rules, 1944), credit is not to be allowed on such quantity of inputs which is used in the manufacture of exempted products.

M/s. Burn Standard Company Limited, in Salem Commissionerate of Central Excise, engaged in manufacture of ramming mass, calcined magnesite etc. removed calcined magnesite without payment of duty. The Modvat/Cenvat credit availed on furnace oil used in the manufacture of calcined magnesite was periodically debited (under protest) in the Modvat/Cenvat credit account. However, the assessee took re-credit of Rs.2.10 crore so reversed (during the period from March 1997 to December 2002) in the Cenvat account in January 2003 which was incorrect and in contravention of the rules ibid.

On this being pointed out (June 2003), the Ministry admitted the objection in principle (November 2004).

## 6.10 Incorrect availment of Cenvat credit on unspecified goods

As per rule 57A of the Central Excise Rules, 1944, introduced with effect from 1 April 2000 (now rule 3 of Cenvat Credit Rules, 2002), Cenvat credit on specified capital goods used in the manufacture of final products shall be allowed to be availed of and be utilised towards the payment of duty on final products.

The Tribunal in the case of M/s. Vivek Alloys Limited Vs. Commissioner of Central Excise {1998 (98) ELT 156} held that construction materials like tor, steel, MS angles, MS rounds etc., are not eligible for Modvat credit as capital goods. Similar views have also been expressed by the Tribunal in the case of M/s. Indo Rama Synthetics (India) Limited {1996 (86) ELT 277} and M/s. Malvika Steels Limited {1998 (97) ELT 530}.

**6.10.1** M/s. MCC PTA India Limited, in Haldia Commissionerate of Central Excise manufacturing purified terepthalic acid availed Cenvat credit on various construction materials i.e. part of expansion joint, electric construction materials and other parts of construction materials. As per rule 57A read with various judgements cited supra, such materials did not qualify for Cenvat credit, and availment of Cenvat credit of Rs.1.20 crore during the period from May 2000 to April 2001 was therefore incorrect.

On this being pointed out (February 2002), the Ministry stated (September 2003 and December 2004) that all goods imported by the assessee were in the nature of capital goods and/or components and spare parts falling under chapters 82, 84, 85 and 90 of the Central Excise Tariff. These were eligible capital goods for the purpose of availment of Cenvat credit.

The Ministry's reply is not tenable since the bills of entry establish that the assessee imported part of construction material which was classified by the Customs Department under sub heading 7307.99 of the Customs Tariff and countervailing duty was also collected under this heading. As chapter 73 has not been included in the rule as capital goods, Cenvat credit on these items was not admissible and requires recovery with interest.

**6.10.2** M/s. Durgapur Steel Plant and M/s. Chennai Petroleum Corporation Limited, in Bolpur and Chennai I Commissionerates of Central Excise, availed Cenvat credit of Rs.76.58 lakh between April 2001 and October 2002 on rails/rail clips (chapter 73) and imported crane (heading 87.05). Since these goods were not covered by the definition of 'capital goods', credit of Rs.76.58 lakh incorrectly availed by the assessees was required to be recovered.

On this being pointed out (February 2003), the Ministry while admitting the objection in both the cases stated (September and October 2004) that SCN for Rs.89.57 lakh had been issued to an assessee in May 2003.

## 6.11 Incorrect availment of Cenvat credit on capital goods used in mines

Rule 2 of Cenvat Credit Rules defines capital goods as those which are used in the factory of the manufacturer of final products. The Tribunal in the case of M/s. Madras Cements Limited Vs. Commissioner of Central Excise, Hyderabad {1998 (99) ELT 395 (T)} held that mining is not an integral part in the manufacture of cement, and excavators used in mines are not eligible goods for credit. Rule 12 of the Cenvat Credit Rules, 2001, provides for recovery of Cenvat credit taken or utilised wrongly alongwith interest under section 11AB of the Central Excise Act, 1944.

M/s. Madras Cements Limited, Perambalur, in Tiruchirapalli Commissionerate of Central Excise, manufacturing cement availed Cenvat credit of Rs.1.36 crore on capital goods viz surface miner excavator in September 2001 and April 2002. The excavator was used exclusively in the mines located outside the factory and was not involved in the actual manufacture of cement in the factory. Further, limestone was an exempted product. Credit availed was incorrect and recoverable alongwith interest.

On this being pointed out (January 2002 and March 2004), the Ministry while admitting the objection stated (September 2004) that demand for Rs.1.36 crore had been confirmed but assessee had filed appeal before CESTAT which was pending decision.

## 6.12 Incorrect availment of Cenvat credit on imported inputs

**6.12.1** The Board clarified in February 1999 that countervailing duty, paid only in cash, on imported goods is admissible for credit but not when it is debited through duty entitlement pass book (DEPB).

M/s. IVP Limited, in Mumbai I Commissionerate of Central Excise, availed credit of additional duty paid on imported goods which was debited through DEPB during the period from August 2003 to November 2003. This resulted in incorrect availment of Cenvat credit of Rs.75.29 lakh.

On this being pointed out (November 2003), the Ministry admitted the objection and intimated (December 2004) issue of SCN in September 2004.

**6.12.2** Under rule 57AB (2) of the Central Excise Rules, 1944, (rule 3 of Cenvat Credit Rules, 2001 as it stood prior to 1 March 2002), Cenvat credit in respect of inputs or capital goods produced in a 100 per cent Export Oriented Unit (EOU) and used in the manufacture of final product in any place in India, would be restricted to the extent of additional duty leivable on like goods under section 3 of the Customs Tariff Act, 1975, paid on such inputs or capital goods. While interpreting the above provisions, the CEGAT – larger bench, in the case of Vikram Ispat {2000 (120) ELT 800 Trib-LB}, in its order dated 9 August 2000, held that the duty levied on 100 per cent EOUs for clearance to domestic tariff area (DTA) was duty of excise and hence manufacturer in India was eligible for credit equivalent to additional customs duty leviable on such goods. The Government brought amendment from 1 March 2002 so as to allow credit of additional customs duty actually paid by 100 per cent EOU.

M/s. Turbo Energy Limited, M/s. India Japan Lighting Private Limited and M/s. Bridgestone India Private Limited in Chennai III, IV and Indore Commissionerates of Central Excise, respectively, were receiving certain inputs from 100 per cent EOUs. They availed credit to the extent of additional duty of Rs.158.50 lakh payable on such goods based on CEGAT decision cited though the additional duty of customs actually paid was only Rs.79.25 lakh between April 2001 and February 2002. This resulted in loss of revenue of Rs.79.25 lakh.

On this being pointed out (September and December 2003), the Ministry admitted the objection in principle (October and November 2004).

## 6.13 Excess availment of credit on scrap due to irregular transfer of credit by dealer

Rule 7(2) of the Cenvat Credit Rules, 2002 stipulates that the manufacturer or producer taking Cenvat credit on inputs or capital goods should take all reasonable steps to ensure that the inputs or capital goods in respect of which he had taken the Cenvat credit are goods on which the appropriate duty of excise as indicated in the accompanying documents was paid . Sub rule 3 further provides that Cenvat credit in respect of inputs or capital goods purchased from a first or second stage dealer shall be allowed only if such goods were supplied from the stock on which duty was paid by the producer of such inputs or capital goods, and only an amount of such duty on pro rata basis had been indicated in the invoice issued by him.

M/s. Indian Seamless Steels and Alloys Limited, in Pune III Commissionerate of Central Excise, received steel scrap from dealers registered under central excise in Mumbai and Pune. On verification of dealer's invoices it was seen that in a large number of cases, the selling price of the dealer was less than the dealer's purchase price. The dealer's invoice was not correlated with the duty paid scrap purchased by them as required under provisions of rule 7(3). During the period from January 2002 to December 2002, assessee availed credit amounting to Rs.3.22 crore on dealers invoice whereas the purchase price of this scrap during this period was Rs.16.83 crore (excluding excise duty). Amount of credit that was required to be passed on was Rs.2.69 crore (16 per cent duty on such value). Hence the amount of Cenvat credit irregularly passed on worked out to Rs.52.26 lakh.

On this being pointed out (January 2003), the Ministry stated (November 2004) that the Directorate General of Central Excise Intelligence had initiated investigation in the matter in August 2002.

The fact remains that the revenue still remains unprotected even after lapse of more than two years.

## 6.14 Credit taken unauthorisedly without refund order

Section 11B of the Central Excise Act, 1944, envisages that any person claiming refund of any duty of excise may make an application to the jurisdictional Assistant/Deputy Commissioner of Central Excise before the expiry of six months from the date of payment of duty. In the case of M/s. Indian Oil Corporation Limited Vs. Commissioner of Central Excise, New Delhi, the Tribunal while interpreting the provisions of section 11B, ruled that since there was no other provision under the Act authorizing assessees to take credit on their own of the duty paid by mistake, the only course open to them was to file a refund claim with the proper authority within the time limit specified. The Tribunal further held that credit wrongly taken by the assessees in their PLA without a refund order was liable to be debited {2003 (153) ELT 355}.

M/s. Bharat Petroleum Corporation Limited, in Hyderabad III Commissionerate of Central Excise, erroneously paid central excise duty of Rs.42.29 lakh on clearances of customs duty paid stocks during May 1997, June and August 1998. On the basis of representations made by the assessee, the range officer permitted (June 1998/April 1999) the assessee to take back the credit in his PLA. As the requirements of section 11B were not complied with by the assessee in obtaining a refund order from the jurisdictional divisional officer, authorisation of credit by range officer was incorrect.

On this being pointed out (January 2001), the Ministry admitted the objection in principle (November 2004).

## 6.15 Incorrect transfer of Cenvat credit

Where the factory of a manufacturer is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer to a joint venture with a specific provision for transfer of liabilities, rules 57AF(1) and (2) of erstwhile Central Excise rules, 1944, provide for transfer of Cenvat credit lying unutilised in the account of such manufacturer to be transferred, sold, merged, leased or amalgamated factory subject to the condition that the stock of inputs as such or in process are also transferred alongwith the factory and the inputs on which credit was availed of are duly accounted for by the transferee.

M/s Essar Steels Limited, in Visakhapatnam I Commissionerate of Central Excise, engaged in the manufacture of iron ore concentrate was taken over by M/s Hygrade Pellets Limited, with effect from 8 June 2000 with a specific condition for transfer of assets and liabilities. Credit balance of Rs.39.94 lakh lying unutilised as on 7 June 2000 was allowed to be transferred to the input credit account of M/s Hygrade Pellets Limited. Verification of details pertaining to input stocks available on the date of transfer however, revealed (September 2002) that only inputs corresponding to a credit of Rs.5.88 lakh were physically available for transfer to the new management. Transfer of balance credit of Rs.34.06 lakh permitted by the Department was not correct.

On this being pointed out (July 2003), the Ministry stated (August 2004) that the rule did not restrict or limit the quantum of credit to the extent of inputs in stock or inputs in process available on the date of transfer.

Reply of the Ministry is not tenable since the relevant provisions, inter-alia, imposed a specific condition in regard to accountal of inputs/capital goods on which credit was availed of by the transferee. Transfer of balances was therefore, required to be restricted only to the extent of inputs in stock/in process actually available on the date of transfer of management and which were eventually accounted for by the transferee.

## 6.16 Credit availed on goods brought for remaking but duty equal to Cenvat credit taken not paid on clearance

As per rule 16(1) of the Central Excise Rules, 2001/2002, where any goods on which duty is paid at the time of removal thereof are brought to any factory for being remade, refined, reconditioned or for any other reason, the assessee shall state particulars of such receipt in his records and shall be entitled to take Cenvat credit. Sub rule 2 of rule ibid provides that if the process to which the goods are subjected before being removed does not amount to manufacture, the manufacturer shall pay an amount equal to the Cenvat credit taken under sub rule(1).

M/s. Indian Aluminium Company Limited, in Belapur Commissionerate of Central Excise, availed credit on rejected final products (printed aluminium foil rolls) received in the factory under the provisions of rule 16 ibid. The assessee scrapped more than 80 per cent of the rejected final products without subjecting them to any process and duty was paid on the scrap value. The duty paid was less than the Cenvat credit taken. As the scrapping of goods by cutting/slitting did not amount to manufacture, the assessee was required to clear the scrap by payment of amount equal to Cenvat credit taken. The short payment worked out to Rs.30.10 lakh for the period from 1 July 2000 to 31 October 2003.

On this being pointed out (November 2003), the Ministry admitted the objection (November 2004).

## 6.17 Other cases

In 480 other cases of grant of Modvat/Cenvat credit, the Ministry/the Department had accepted objections involving duty of Rs.13.37 crore and reported recovery of Rs.8.56 crore in 455 cases till January 2005.

# CHAPTER VII : DEMANDS NOT RAISED OR DELAYED

Short payment or non-payment of duty on any excisable goods is to be recovered by issuing a show cause notice (SCN) under section 11A to be followed up with its adjudication and recovery proceedings. The period of limitation for issue of SCN is one year (six months upto 11 May 2000) in normal cases of non-levy/short levy of duty. In case of short levy/non-levy due to fraud, collusion etc. the limitation period stands extended to five years. Some illustrative cases of demands raised with delay or not raised are given in the following paragraphs: -

## 7.1 Non-raising of demands

The Supreme Court in the case of M/s. Madhumilan Syntax Private Limited {1988 (35) ELT 349 (SC)} held that unless SCN was issued under section 11A of the Central Excise Act, 1944, the Department was not entitled to recover the dues.

(a) M/s. Punjab Communication Limited, Mohali, in Chandigarh Commissionerate of Central Excise, entered into a contract with Bharat Sanchar Nigam Limited and Railways in November 2001 and June 2002 respectively for supply of telephone exchange MAX-L/XL exchange and MUX (STM-S) exchange in complete package form comprising equipment, MDF, SMPS, VRLA batteries etc., alongwith other necessary equipment. Exchanges which were being manufactured by the assessee were cleared on payment of duty, whereas the other integral parts of the package i.e. VRLA batteries, SMPS module and 1600 PRMDF etc., were purchased from outside and supplied alongwith the exchange without payment of duty. As the bought out items were essential/integral constituents of a complete package form of an exchange demanded by the customer, their cost was required to be added to the transaction value of exchanges. The internal audit of the Department had also suggested (December 2001) inclusion of cost of bought out items. However no action was taken to safeguard Government revenue of Rs.6.76 crore for the period from 1 July 2000 to 31 March 2003 by issue of show cause notice.

On this being pointed out (June 2003), the Ministry of Finance (the Ministry) stated (November 2004) that the bought out items did not form part of the exchanges and the assessee had not undertaken their installation.

Reply of the Ministry was not tenable as BSNL order dated 29 November 2001 clearly mentions supply of exchanges in a complete package form comprising exchange equipment, IOP, MDF, spares, SMPS power plant, VRLA batteries alongwith all other associated equipment, accessories, installation etc. The reply of the Ministry that the assessee had not undertaken their installation was also not tenable as the contract provided for all technical assistance for installation, commissioning and monitoring of equipment by the assessee at no extra cost.

(b) Indore Commissionerate of Central Excise issued SCN to M/s. SKM Dewas for not fully valuing grey fabrics (inputs) for arriving at the assessable value of processed fabrics (output goods) in line with the Supreme Court decision in the Ujagar Prints case. This was adjudicated on 30 October 2001 confirming duty of Rs.6.38 crore with penalty of Rs.50 lakh for the period from April 1993 to February 2000 against which assessee had appealed. Audit

noticed that the assessee did not revise the assessable value of grey fabrics/processed fabrics for the period from March 2000 onwards and short levy persisted. The Department too did not take any action to protect revenue by issuing SCN. This resulted in duty of Rs.92.49 lakh for the period from May 2001 to January 2004 remaining unprotected. Duty for the period from March 2000 to April 2001 was not ascertained as assessee did not produce the records. Therefore the Department was asked to workout the short levy and raise demands.

On this being pointed out (April 2004), the Ministry stated (December 2004) that no show cause notice was issued since the assessee started clearances on ad valorem basis after February 2001 and valuation of the goods was done on the basis of CAS-4 standard.

Reply of the Ministry is not tenable as CAS-4 standard was made applicable from 13 February 2003 and hence valuation of goods in the instant case was to be done in line with Supreme Court decision ibid.

## 7.2 Delay in raising demands

Commissionerate of Central Excise, Indore issued two SCNs in February 1998 demanding duty of Rs.1.97 crore and Rs.0.89 crore from M/s. Century Denim Khargone and M/s. Maral Overseas Limited Khargone respectively for incorrect availment of benefit under notifications dated 1 March 1997 in respect of goods cleared between April 1997 and January 1998 and between March 1997 and January 1998, respectively. However, it was noticed that in final adjudication in January 2002, the demand for Rs.0.78 crore and Rs.0.22 crore for the period from April to June 1997 and from March to June 1997 (respectively) had been dropped on the grounds of limitation of time. Thus, inability to raise demand within the prescribed time period resulted in loss of revenue of Rs. one crore.

On this being pointed out (January and February 2004), the Ministry stated (December 2004) that the order of dropping demand had not been accepted and a further appeal had been filed before the High Court of Madhya Pradesh.

## 7.3 Non-realisation of confirmed demand

Section 11 of the Central Excise Act stipulates that the officer empowered by the Board may recover duty and any other sums of any kind payable to the Central Government under Central Excise Act or Rules by deducting the amount payable to the assessee by the Government or by attachment and sale of excisable goods belonging to person from whom sums are recoverable. In case amount payable is not so recovered, certificate action may be taken through Collector of the District for recovery as arrears of land revenue.

**7.3.1** Bolpur Commissionerate of Central Excise, confirmed a demand for Rs.3.23 crore in February 1994 against M/s. Durgapur Steel Plant for short payment of duty due to non-inclusion of 'steel development charges' in the assessable value. Apex Court granted stay order on an appeal filed against the demand in March 1998 and further decided the case alongwith similar cases on 24 October 2002 in favour of revenue. Even after the final decision, the Department did not initiate any action to recover the duty. This resulted in duty of Rs.3.12 crore and interest of Rs.5.64 crore (till June 2004) remaining unrealised.

On this being pointed out (March 2004), the Ministry admitted the objection and intimated (November 2004) recovery of Rs.5.04 crore from the total demand of Rs.5.74 crore due for

the period from 1 March 1992 to 11 September 1994. Action was also initiated to quantify the interest recoverable.

**7.3.2** In Chennai Commissionerate of Central Excise, a demand of Rs.12.54 lakh against the Central Yard Works Department, Corporation of Chennai was confirmed in February 1993 due to clearance of reinforced cement concrete articles without payment of duty during August 1987 to July 1992 and manufacture of goods without registration with central excise authorities. Recovery of duty had not been made so far. Interest of Rs.19.93 lakh for the period from September 1995 to November 2003 leviable for such non-payment was also pending recovery. Further scrutiny revealed that no SCN was issued for the subsequent period from August 1992 to March 1995 resulting in Government revenue of Rs.30.08 lakh remaining unprotected. Thus, revenue of Rs.32.47 lakh including interest remained unrealised.

On this being pointed out (August 2002), the Ministry admitted the objection (November 2004).

**7.3.3** In Jaipur Commissionerate of Central Excise, a demand of Rs.28.03 lakh was confirmed against M/s. United Felt Corporate, Jhotwara, in November 1985 on account of misclassifcation of goods. Of this, a sum of Rs.12 lakh was deposited by the assessee in compliance of CEGAT's order as a precondition for granting stay. The CEGAT, in their final order dated 6 January 1995 dismissed the appeal. Thus, balance amount of Rs.16.03 lakh was recoverable. However, the Department did not take any action to recover this amount even after lapse of eight years of CEGAT's decision. The inaction of the Department resulted in duty of Rs.16.03 lakh and interest of Rs.24.93 lakh (due till March 2003) remaining unrealised.

On this being pointed out (April 2003), the Ministry while admitting the objection intimated (August 2004) that the assessee had deposited Rs.4.03 lakh in June 2003 and for the remaining amount action had been initiated.

## 7.4 Delay in adjudication of demands

**7.4.1** Delay in adjudication of demand had been adversely commented upon by the Public Accounts Committee as early as in 1981-82 (in its 84$^{th}$ Report) followed by Board's instructions of January 1983 for expeditious adjudication.

Audit scrutiny revealed that Tirunelveli Commissionerate of Central Excise, issued seven SCNs to M/s. Sterlite Industries (India) Limited, Tuticorin, between May 1997 and January 2000 for short payment of duty of Rs.113.43 crore due to undervaluation of copper cathode cleared to sister unit during the period from September 1996 to October 1999. These were not however, adjudicated timely, with delay in adjudication ranging from six months to twenty six months. This resulted in postponement of realisation of revenue of Rs.113.43 crore and also caused notional loss of interest of Rs.25.73 crore till August 2000.

On this being pointed out (September 2000), the Department stated (September 2003) that all SCNs had been confirmed and revenue safeguarded.

The Ministry stated (November 2004) that the clearances were made by the assessee to their sister units only and the services of Assistant Director (Cost) were taken to arrive at cost of the product which necessitated further correspondences and investigations, and thus needed time.

Ministry's reply is silent about recovery of duty.

**7.4.2** Sections 35A(3) and 35C(I) of the Central Excise Act, provide that Commissioner (Appeal)/CEGAT, as the case may be, may refer a case back to the original adjudicating authority with such direction as may be thought fit for fresh adjudication or decision. The Board in their circular dated 17 January 1983 instructed that remand cases be decided within a period of six months from the date of issue of show cause notice.

Test check of records of Bhubaneswar I Commissionerate of Central Excise, revealed that five show cause cum demand notices involving duty of Rs.5.86 crore, were issued against M/s. Titagarh Paper Mills Limited, Chowdwar towards valuation, classification, duty on wrapper and caustic soda for the period from January 1979 to January 1989 and the same were confirmed between December 1985 and June 1992 by the adjudicating authorities. These were subsequently remanded to the jurisdictional Assistant Commissioner (Custom and Central Excise) for denovo adjudication by the Commissioner (Appeals)/Tribunal, between July 1992 and January 2000. The assessee suspended paper manufacturing from 18 September 2002. However, the cases had not been adjudicated even after a lapse of more than three years from the date of remand. This resulted in unintended and undue financial accommodation of Rs.5.86 crore to the assessee.

On this being pointed out (June 2003), the Ministry admitted the objection (November 2004).

## 7.5 Other cases

In 17 other cases of demands, the Ministry/the Department had accepted objections involving duty of Rs.96.82 lakh and reported recovery of Rs.12.50 lakh in 13 cases till January 2005.

# CHAPTER VIII : NON-LEVY OF DUTY

Rules 9 and 49 read with rule 173G of the Central Excise Rules, 1944, prescribe that excisable goods shall not be removed from the place of manufacture or storage unless excise duty leviable thereon has been paid. If any manufacturer, producer or licencee of a warehouse, removes excisable goods in contravention of these rules or does not account for them, then besides such goods becoming liable for confiscation, a penalty not exceeding the duty on such excisable goods or ten thousand rupees, whichever is greater, is also leviable under rule 173Q. Similar provisions exist in rules 4 and 25 of the Central Excise Rules, 2002 which came into force from 1 March 2002 in place of the aforesaid Rules. Some illustrative cases of non-levy of duty noticed in test check are given in the following paragraphs :

## 8.1 Non-levy of additional duty on goods exported

Under rule 13 of the Central Excise Rules, 1944 (now rule 19 of the Central Excise Rules, 2002), read with notification dated 22 September 1994 as amended, excisable goods meant for export outside India may be cleared from the factory of a manufacturer or warehouse without payment of duty under bond. Rule 2(7) of the said Rules read with rule 2(e) of the Central Excise Rules, 2002 defines the term 'duty' to mean duty payable under section 3 of the Central Excise Act. Additional duty/special additional excise duty leviable under the Finance Act is not exempt from payment of duty on goods cleared for export, since this duty is distinct and different from that leviable under section 3 of the Act ibid.

The Supreme Court in the case of M/s. Modi Rubber Limited {1986 (25) ELT 849 SC} held that notification is issued under rule 8(1) of the Central Excise Rules, simpliciter without reference to any other statute and therefore, exemption granted under the notification must be construed as limited only to the duty of excise payable under the Central Excise Act and not to special, auxiliary or other kind of duty leviable under the Finance Act.

**8.1.1** M/s. Mangalore Refinery and Petro Chemicals Limited, in Mangalore Commissionerate of Central Excise, exported under bond 1,81,820.684 kilo litre of motor spirit (petroleum product) during December 2000 to August 2002 without payment of additional excise duty and special additional excise duty amounting to Rs.41.09 crore leviable thereon under the Finance Act, 1998 and 2002.

**8.1.2** Four units of M/s. IOC in Allahabad, Goa, Haldia and Mumbai Commissionerates of Central Excise, exported under bond 1,59,700 kilo litre of high speed diesel oil to Nepal, 22,852.46 kilolitre of motor spirit to Singapore and 27,868 kilo litre as ship stores to foreign run vessels between April 2001 and March 2004 without payment of additional duty of Rs.25.21 crore as leviable under the Finance Acts, 1999 and 2003.

On the above cases being pointed out (between July 2003 and April 2004), the Ministry stated (December 2004) that the relevant clause of the Finance Act extended the provisions of Central Excise Act and Rules for levy and collection of additional duty of excise, therefore the provisions of rebate of central excise duty would be applicable to additional duty as well.

The Ministry's reply is not tenable in view of Supreme Court decision in the case of Modi Rubber Limited upholding that exemption from duty of excise did not mean exemption from

special excise duty or additional duty of excise. Further notification dated 26 June 2001 had been amended on 24 March 2003 to cover additional duty of excise leviable on tea and tea waste under the Finance Act, 2003 but no such amendment had been made for motor spirit and high speed diesel.

## 8.2 Non-levy of duty on goods lost in transit

The Board in circular dated 23 September 2002 prescribed the procedure of accountal of petroleum products moved through pipelines without payment of duty. As such the assessees were required to submit annual account within 60 days from the end of the financial year duly certified by the chartered accountants. The Department would assess such clearances after condoning the limit of transit loss of 0.25 per cent on exceeding of which highest value and highest rate of duty applicable for the particular product during the quarter/period would be taken as basis of assessment.

M/s. IOC (Haldia refinery), in Haldia Commissionerate of Central Excise, was allowed to clear a portion of its petroleum products through different pipelines without payment of duty. Scrutiny of records of movement of such products revealed that there was loss of motor spirit and superior kerosene oil during 2002-03 beyond condonable limit of 0.25 per cent. Duty leviable on such transit loss amounted to Rs.4.32 crore. The assessee had neither paid duty nor had the Department demanded it.

On this being pointed out (June 2003), the Ministry stated (November 2004) that transit loss had not been exceeded for all products taken together.

The contention is not tenable since this was in violation of Board's circular dated 23 September 2002. As a result loss of one product was set off against another product which was not in order.

## 8.3 Non-levy of duty on goods not recorded

As per rules 9 and 49 of the Central Excise Rules, 1944 (rule 4 of the Central Excise Rules, 2002 from 1 March 2002), no excisable goods, on which any duty is payable, shall be removed without payment of duty from any place, where they are produced or manufactured or from a warehouse, unless otherwise provided. Duty not paid or short paid by suppressing facts, or by fraud/mis-statement etc., attracts penalty equal to the duty determined under section 11 AC of the Central Excise Act, 1944.

Test check of records of M/s. Durgapur Steel Plant, in Bolpur Commissionerate of Central Excise, revealed non-accounting of removal of 58,120.824 $M^3$of oxygen (chapter 28) and short accountal of production of 1,50,434.110 tonne of molten and granulated slag (chapter 26). Escapement of central excise duty amounted to Rs.3.24 crore, with an equal amount of penalty.

On this being pointed out (March 2003), the Ministry admitted the objection and stated (August 2004) that SCN for Rs.2.41 crore had been issued while for the remaining amount it was under issue.

## 8.4 Non-levy of duty on goods captively consumed

Rules 9 and 49 of the Central Excise Rules, 1944 (now rule 4 of Central Excise Rules, 2002), prescribe that excisable goods manufactured in any place and consumed or utilised as such whether in a continuous process or otherwise, in such place shall be deemed to have been removed from such place immediately before such consumption or utilisation.

**8.4.1** M/s. Kerala State Road Transport Corporation (KSRTC), in Thiruvananthapuram Commissionerate of Central Excise, manufactured bodies for motor vehicles and used them in their body building units. Duty was not paid on them which was not correct.

On this being pointed out (April 2001 and April 2004), the Ministry accepted the objection and stated (October 2004) that demand of Rs.3.34 crore for the period from September 2000 to May 2004 had been confirmed.

**8.4.2** M/s. Kesoram Rayon, Hooghly, in Kolkata IV Commissionerate of Central Excise, manufactured sulphuric acid and cleared a portion thereof to fertilizer units without payment of duty as per notification dated 1 March 1999 as amended. Some portion was also cleared for manufacture of filament yarn and cellophane within its factory without payment of duty as per notification dated 23 July 1996. The assessee also cleared sulphuric acid on payment of duty outside the factory. However scrutiny of the manufacturing process of sulphuric acid revealed that reasonable quantity of sulphuric acid was used at intermediate stages. Duty on use of such acid was leviable since final sulphuric acid was cleared for fertilizers units and captively consumed for filament yarn and cellophane availing exemption. This resulted in non-levy of duty of Rs.77.76 lakh during the period from July 2000 to February 2004.

On this being pointed out (February 2003), the Ministry stated (November 2003 and December 2004) that the assessee used double contact method and asserted the transient nature of material which they did not reckon as goods for central excise purposes. According to them acid was neither segregated nor its quantity ascertainable and not being considered marketable was not excisable.

The reply of the Ministry is not tenable since sulphuric acid from the circulating tank was used at an intermediate stage for manufacture of final sulphuric acid of the same strength. Also, part of such final sulphuric acid so produced in the absorption tower was sold outside. The quantity of such sulphuric acid could have been ascertained. The instant product was marketable since both at intermediate stage and when sold it had the same strength. Removal of an excisable product in the continuous process is also reckoned as clearance for the purpose of charging duty under rules 9 and 49 ibid.

## 8.5 Non-levy of duty on samples

As per provisions of rule 4 of the Central Excise Rules, 2002 read with para 3.2 of chapter 11 of the Board's Manual of Supplementary Instructions, the manufacturer, in respect of samples drawn by in-house laboratory for testing quality and adherence to product specifications, is required to maintain a proper account of receipts and the utilisation of samples thereof. He is to make issue entries for the samples in daily stock account and also pay duty on them before removal for test purposes.

**8.5.1** M/s. Vashisti Detergents Limited, in Pune II Commissionerate of Central Excise, had removed goods (samples) for in-house laboratory testing of quality and specification. It was

noticed that the assessee had neither paid duty on such removal nor followed the procedure laid down by the Board. This resulted in non-levy of duty of Rs.82.27 lakh during April 2000 to March 2003.

On this being pointed out (July 2003), the Ministry stated (December 2004) that samples for testing were drawn before the goods were packed and being in a semi finished condition they were not liable to duty. In support thereof, it quoted the decisions in the case of M/s. Bhansali Engineering Polymers Limited {2002 (143) ELT A175 (SC)}.

The reply of the Ministry is not tenable in view of the specific instructions of the Board vide para 3.2 ibid that duty is to be charged on samples taken for testing in the laboratory inside the factory. The case law cited by the Ministry is also not applicable as the facts of the case differ in as much as, in the instant case, the assessee kept no proper accounts. Also, the Board has neither modified nor withdrawn its instructions in this regard.

**8.5.2** M/s. Dabur (India) Limited, Baddi and M/s. Ranbaxy Laboratories Limited, Paonta Sahib in Chandigarh I Commissionerate of Central Excise, engaged in manufacture of medicaments drew samples which were required to be retained in the factory under the provisions of the Drugs and Cosmetics Act. Although exemption on samples stood withdrawn with effect from 1 March 1994, no duty was paid on these samples between April 1997 and September 2003 which resulted in non-levy of duty of Rs.38.74 lakh.

On this being pointed out (between December 1999 and April 2004), the Ministry admitted the objection partly and stated (November 2004) that no duty on control samples was chargeable after 1 September 2001 unless they were removed for testing etc. as clarified by the Board. It also intimated that the assessees had paid duty of Rs.17.69 lakh for the period from April 1999 to April 2003 between July 2001 and August 2004.

The reply of the Ministry is not tenable as drawing of samples and retaining them for specified period amounted to utilisation of manufactured goods as such, in the place of manufacture itself, in terms of Tribunal judgement in the case of M/s. Aristo Pharmaceuticals Limited {2000 (121) ELT 386 (Tribunal)} and M/s. Mapra Laboratories Private Limited {2001 (127) ELT 695}. Also the samples retained in the factory were packed in the form of regular trade packing and were capable of being marketed. Hence, these were excisable goods as per section 2(d) and (f) and 3 of the Central Excise Act, 1944. Supplementary instructions issued by the Board cannot be construed to be an exemption notification. Therefore in the absence of specific exemption notification, duty on samples was recoverable.

## 8.6 Other cases

In 169 other cases of non-levy of duty, the Ministry/the Department had accepted objections involving duty of Rs.5.43 crore and reported recovery of Rs.3.25 crore in 159 cases till January 2005.

# CHAPTER IX : VALUATION OF EXCISABLE GOODS

Ad valorem rates of duty are charged on a wide range of excisable commodities. The valuation of such goods is governed by section 4 of the Central Excise Act, 1944, read with the Central Excise (Valuation) Rules, 1975 and Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000. The valuation of excisable goods introduced with effect from 14 May 1997 with reference to retail sale price is governed by section 4A. Some illustrative cases of short levy due to incorrect valuation are narrated in the following paragraphs :

## 9.1. Incorrect adoption of value of goods manufactured by export oriented unit

Proviso to section 3 of Central Excise Act, 1944, stipulates that duties of excise leviable on excisable goods manufactured by a 100 per cent export oriented unit (EOU) and allowed to be sold in India, shall be an amount equal to the aggregate of the duties of customs leviable under the Customs Act, 1962 on like goods manufactured outside India if imported into India, and where the said duties of customs are chargeable with reference to their value, the value of such excisable goods shall be determined in accordance with the provisions of the Customs Act, 1962, and the Customs Tariff Act, 1975.

M/s. Uniworth Textiles Limited, (EOU) Butibori, in Nagpur Commissionerate of Central Excise, cleared waste fabrics (rejects) under domestic tariff area to their other unit on payment of duty at Rs.160 per linear metre, whereas the cost of production even of the cheapest variety of cloth itself was more than Rs.500 per linear metre. Since the assessee could not produce invoices, the correctness of the value adopted for payment of duty was doubtful. Accordingly Department was asked (November 1998) to ascertain the correctness thereof.

The Ministry of Finance (the Ministry) admitted the objection in principle and intimated (September 2004) confirmation of demand of Rs.24.61 crore with imposition of equal penalty thereon.

## 9.2 Undervaluation of goods manufactured on jobwork

The Supreme Court in the case of M/s. Ujagar Prints and others {1988(38) ELT 595}, ruled that the value of goods manufactured on job work basis shall be determined by adding processing charges (job work charges) to the landed cost of raw materials, including all costs incurred for bringing the raw materials to the premises of the job worker.

**9.2.1** M/s. Mandovi Pellets Limited, in Goa Commissionerate of Central Excise, converted iron ore fines into pellets for M/s. Ispat Industries Limited (IIL) and M/s. Vikram Ispat Limited (VIL) on job work basis. The agreement entered into with M/s. IIL stipulated that the assessable value of ore fines would be Rs.1,710 per tonne (cost of iron ore fines Rs.750 + processing charges Rs.960 per tonne). Instead, duty was paid on Rs.1350 per tonne. Adoption of lower assessable value resulted in short levy of Rs.1.37 crore between 2000-01 and 2002-03.

In the case of jobwork done for M/s. VIL, the assessee adopted assessable value at Rs.1,423 per tonne instead of Rs.1,727 per tonne (cost of iron oxide fines Rs.400 + freight Rs.340 + processing charges Rs.987). Adoption of lower assessable value resulted in short levy of Rs.42.71 lakh between 2000-01 and 2002-03. The total short levy on the above clearances amounted out to Rs.1.80 crore.

On this being pointed out (July 2003), the Ministry stated (December 2004) that M/s. Mandovi Pellets Limited consumed approximately 30 per cent of the iron ore fines received from M/s. IIL/M/s. VIL and the balance 70 per cent procured locally. Therefore the price of raw material cleared to M/s. Mandovi Pellets Limited would be 30 per cent of the cost of raw material plus freight charges plus conversion charges which worked out to be less than the value adopted for payment of duty.

Reply of the Ministry is not tenable as M/s. Mandovi Pellets Limited had availed Cenvat credit on iron ore fines received from M/s. IIL/M/s. VIL. While justifying Cenvat credit, in an earlier case Ministry had stated that iron ore fines, powder form of iron ore pellets were obtained during storage of pellets. Therefore it argued that duty paid on fines was the duty on clearance of inputs as such. By this contention either Modvat credit should not have been allowed or purchase value of the input should have been adopted i.e. Rs.1500 per tonne.

**9.2.2** M/s. Indian Acrylic Limited, in Ludhiana Commissionerate of Central Excise, manufactured acrylic fibre and cleared it to its subsidiary unit M/s. Indlon Chemicals Limited on payment of duty. M/s. Indlon Chemicals Limited converted fibre into acrylic yarn from job workers who cleared the yarn back to M/s. Indlon Chemicals Limited on payment of duty. Audit noticed that the full job charges as received by the job workers as well as freight expenses were not included in the assessable value. This resulted in under valuation of goods to the extent of Rs.4.34 crore and consequent short payment of duty of Rs.79.85 lakh during the period from April 2000 to March 2002.

On this being pointed out (July 2003), the Ministry stated (November 2004) that liability for short payment of duty lay with the job worker and that the transaction between job worker and M/s. Indlon Chemicals Limited were on principal to principal basis.

The fact remains that full job charges as well as freight expenses were not included in assessable value and hence differential duty was recoverable.

**9.2.3** M/s. Ferro Alloys Corporation, in Nagpur Commissionerate of Central Excise, manufactured iron and steel products on job work basis out of raw material supplied by M/s. Tata Iron and Steel Company. Audit scrutiny revealed that the assessable value was declared at Rs.25,112 per tonne during 1995-96 taking into account the cost of raw material as Rs.17,230 per tonne and the burning loss of 10 per cent. The cost of raw material had increased to Rs.20,030 per tonne during 1997-98 and to Rs.22,500 per tonne during November 1998 to March 1999 but the assessable value for payment of duty had not been revised. Non-revision of assessable value resulted in undervaluation of goods and consequent short payment of duty of Rs.28.59 lakh during the period from April 1997 to March 1999.

On this being pointed out (April 1999), the Ministry admitted the objection and intimated (November 2004) confirmation of demand of Rs.1.75 crore (including penalty of Rs.95.48 lakh) against which assessee had gone in appeal.

**9.2.4** M/s. Aparna Udyog, in Pune-I Commissionerate of Central Excise, converted rough forged rings into machinised bearing rings on job work basis and supplied the finished rings to M/s. TISCO. Duty was paid on the value of raw material cost plus nominal job charges.

Scrap generated during the job work (about 45 per cent) was sold and sale proceeds of Rs.3.14 crore were retained by the assessee. This was an additional consideration in addition to the job charges and required inclusion in assessable value and resulted in short levy of Rs.50.10 lakh during the period from February 1999 to September 2003.

On this being pointed out (June 2003), the Ministry admitted the objection (August 2004).

**9.2.5** M/s. Rallies India Limited, in Nagpur Commissionerate of Central Excise, manufactured goods on job work basis for M/s. FMC Rallies Limited, Bangalore and entered into an agreement with the principal manufacturer for the purpose. After production, assessee marketed the product in the brand name owned by the principal manufacturer and earned commission of Rs.36.98 lakh on sale during July 2001 to October 2001. The assessee paid duty on the value determined as cost of raw material plus processing charges. The profit earned by way of commission on sales was not included in the assessable value, which was not correct.

On this being pointed out (December 2001), the Department stated (March 2004) that demand for Rs.35.08 lakh covering the period from July 2001 to July 2002 had been confirmed besides imposing penalty of Rs.33.50 lakh. The Ministry admitted the objection in principle (October 2004).

## 9.3 Incorrect adoption or non-adoption of assessable value on the basis of MRP

**9.3.1** 'Other food preparation containing cocoa' (heading 18.04) has been brought under section 4A of the Central Excise Act from 1 March 2000 for assessment to duty on the basis of maximum retail price (MRP).

M/s. Cadbury India Limited, Malanpur in Indore Commissionerate of Central Excise, paid excise duty on 'dairy milk eclairs' (heading 18.04) on value under section 4 instead of under section 4A on the grounds that product was less than twenty grams in weight and exempt from affixing retail sale price in terms of rule 34(b) of Standards of Weights and Measures (Packaged Commodities) Rules, 1977. This view was upheld by the Department's order in original dated 14 December 2001. Since the product was sold to ultimate buyers in numbers and not by weight or measure, rule 34(b) was not applicable. Therefore, the product was chargeable to duty on the basis of MRP.

On this being pointed out (June 2002), the Department intimated (July 2003) confirmation of demand of Rs.1.28 crore for the period from March 2000 to November 2002 and imposition of penalty of Rs.10 lakh. The Ministry admitted the objection (November 2004).

**9.3.2** The Board clarified (November 1999) that multi piece packages containing individual pieces of less than 10 grams/10 ml by weight or measure would be assessed to duty under section 4A of the Central Excise Act and exemption contemplated in rule 34 (b) of the Standards of Weights and Measures (Packaged Commodities) Rules, 1977, would be applicable to package containing a commodity and not to multi-piece packages.

M/s. Naisa Industries, in Daman Commissionerate of Central Excise, manufactured satinique and car wash (chapters 33 and 34) and cleared them in multi piece packages containing sachets/pouches each having less than 10 grams/10 ml by weight/measure. MRP was printed on each sachet/pouch. Duty was paid under section 4 instead of under section 4A of the

Central Excise Act. This resulted in short levy of duty of Rs.30.44 lakh between April 2002 and February 2003.

On this being pointed out (March 2003), the Department intimated (March 2004) issue of SCN for Rs.1.38 crore for the period from September 2000 to March 2003. The Ministry admitted the objection (November 2004).

**9.3.3** Explanation 2 below section 4A of the Central Excise Act, 1944, provides that where more than one retail sale price is declared on a package of excisable goods the maximum of such retail sale price shall be deemed to be the retail sale price for the purpose of section 4A. It further provides that where different retail sale prices are declared on different packages for the sale of goods in packaged form in different areas, each such retail sale price shall be the retail sale price for the purpose of valuation of the excisable goods intended to be sold in the area to which the retail sale prices relates.

M/s. Gujarat Gold Coin Ceramics Limited, in Rajkot Commissionerate of Central Excise, cleared ceramic tiles to customers all over India, during the year 2002-03 without mentioning the area on the package. The assessee declared different MRPs for bulk and normal sales in the same area. Since the assessee had not printed separate MRPs for separate regions, the highest MRP declared had to be considered for purpose of levy of duty. Short payment of duty during the year 2002-03 amounted to Rs.14.28 lakh.

On this being pointed out (August 2003), the Ministry admitted the objection and stated (September 2004) that SCN for Rs.65.16 lakh for the period from November 2002 to October 2003 had been issued and for the past period it was under preparation.

**9.3.4** As per of section 4A of the Central Excise Act, 1944, assessment can be made in respect of only those cases where the manufacturer is legally obliged to print the MRP on the packages of goods under the provisions of the Standards of Weight and Measures Act, 1976, or the rules made thereunder or any other law for the time being in force.

(a) M/s. Bata India Limited, in Kolkata I Commissionerate of Central Excise, entered into a rate contract with Department of Police and different collieries for bulk supply of 'industrial boots' and 'mines safety boots'. The assessee cleared such footwear during March 2001 to November 2002 on payment of duty under MRP under section 4A of the Act ibid. MRP was not printed on the packages. Since bulk clearances to such Departments on the basis of agreement with them were not to be termed as retail sale to ultimate consumers, the value of such footwear was to be determined under section 4 of the Act, ibid. This resulted in short payment of duty of Rs.51.07 lakh

On this being pointed out (December 2001), the Ministry admitted the objection (November 2004).

(b) M/s. Bengal Waterproof Limited, in Kolkata III Commissionerate of Central Excise, engaged in the manufacture of footwear, cleared industrial rubber knee boots in bulk to industrial buyers including government organisation on payment of duty on MRP without printing the retail prices on the packages. Since bulk clearances to such departments on the basis of agreement with them were not to be termed as retail sale to ultimate consumers, the value of such footwear ought to have been determined under section 4 instead of under MRP. This resulted in short payment of duty of Rs.40.63 lakh during January 1999 to 31 December 2003.

On this being pointed out (September 2003), the Ministry admitted the objection (October 2004) and reported issue of SCN.

## 9.4 Incorrect adoption of transaction value

Section 4 of the Central Excise Act, 1944, stipulates that where duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall be the transaction value. It further stipulates that transaction value means the price actually paid or payable for the goods, when sold.

### *9.4.1 Discount*

M/s. Hindustan Paper Corporation Limited, Panchgram in Shillong Commissionerate of Central Excise, cleared 62851.479 tonne of paper to different sale depots between June 2002 and May 2003 on which quantity and cash discount on assessable value ranging from Rs.1,550 to Rs.2,150 per tonne was availed. Scrutiny of sale invoices/sale journals of the depots revealed that the discounts were not actually passed on to the buyers. Therefore, such discount amounting to Rs.11.72 crore availed was not correct and resulted in undervaluation of goods with consequential short levy of duty of Rs.1.63 crore.

On this being pointed out (August 2003), the Ministry stated (October 2004) that the assessments were made provisionally and differential duty would be collected upon finalisation of the assessments.

Trade discount is permissible deduction from assessable value if allowed in accordance with normal practice of the wholesale trade. In this case, the discount was not actually passed on to the buyers and hence it was not a permissible deduction. This was also pointed out in earlier Audit Report (2001-02) and the Ministry had admitted the objection.

### *9.4.2 Round trip kilometre (RTKM) charges*

The Board clarified on 1 July 2002 that if the assessee was recovering an amount from the buyer towards the cost of return fare of the empty vehicle from the place of delivery, the said amount would not be available as a deduction.

(a) M/s. Haldia Petrochemical Limited, in Haldia Commissionerate of Central Excise, cleared benzene, butadiene, cyclopentane, C6 raffinate, etc., on payment of duty and paid the cost of transportation from the factory to the buyer as also the cost of return fare of empty vehicle based on RTKM. The two way transportation cost was recovered from the buyers but not included in the assessable value. Such deduction was not admissible as per rule and Board's circular cited supra. Incorrect adoption of value thus resulted in short levy of duty of Rs.one crore during the period from 1 April 2001 to 31 December 2003.

On this being pointed out (January 2004); the Ministry stated (October 2004) that the CESTAT had held that transportation charges incurred for return journey of specialised vehicles were permissible for deduction {2004 (61) RLT 480 (CESTAT)}. Though the Ministry had accepted the Tribunal's decision, the Board has not withdrawn circular of July 2002 ibid.

(b) Test check of records of M/s. I.O.C. in Hyderabad IV Commissionerate of Central Excise, revealed that they cleared motor spirit and high speed diesel oil to various distribution outlets on payment of duty on ex-storage prices and collected additional amounts in the name of free delivery zone charges over and above ex-storage prices but did not include them in

assessable value. Supplies were also made to distribution outlets located outside the free delivery zone for which they also collected transportation charges at a fixed rate per kilometre for the round trip kilometre distance (RTKM) in excess of 39 kilometre and claimed exemption on the entire amount under rule 5 of valuation rules. Free delivery zone charges collected from customers were includible in the assessable value of goods (ex-storage prices) as they did not represent transportation charges. Similarly, no exemption was admissible on the transportation charges collected in respect of return trip of empty tankers in the case of supplies made to outlets located beyond free delivery zone since exemption in such cases was to be limited only to the extent of onward freight. This resulted in short levy of duty of Rs.53.46 lakh between April 2001 and August 2002.

On this being pointed out (January 2004), the Ministry stated (November 2004) that the free delivery zone (FDZ) and RTKM were in the nature of transportation charges which were not includible in the assessable value.

Ministry's reply is not tenable since these charges constitute additional consideration in respect of goods sold and were includible in the assessable value in terms of section 4(3)(d) of the Central Excise Act. The Ministry had in a similar case admitted the objection on FDZ charges vide para 9.4(i)(a) of Audit Report for the year ended 31 March 2001.

## 9.5 Incorrect adoption of value of goods cleared to related persons

As per rule 8 read with proviso to rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, where excisable goods are not sold by the assessee but are consumed by him or on his behalf by a related person for manufacture of other articles, the assessable value of such goods shall be one hundred and fifteen per cent of the cost of production or manufacture of such goods.

**9.5.1** M/s. Lakshmi Auto Components Limited in Hosur, in Chennai III Commissionerate of Central Excise, manufacturing parts and accessories of IC engines and motor vehicles on sub contract basis cleared their goods on payment of duty to M/s. TVS Motor Company Limited who in turn captively consumed them in the manufacture of two wheelers. The assessee became a subsidiary of M/s. TVS Motor Company Limited from November 2001. Audit scrutiny revealed that the assessable value arrived at on cost basis in respect of 20 components included fifteen per cent profit margin in respect of the conversion cost only without including fifteen per cent the profit margin on the raw material cost. This resulted in short levy of duty of Rs.47.17 lakh in respect of eight components alone for the period July 2000 to October 2001. It was also revealed that higher assessable value on cost basis in respect of two other component parts was arrived at by the chartered accountant in July 2000 but the assessee continued to adopt the lower assessable value and discharged duty thereon. This resulted in short levy of duty of Rs.22.22 lakh for the period from July 2000 to October 2002. Total duty short levied amounted to Rs.69.39 lakh.

On this being pointed out (December 2001 and November 2002), the Ministry admitted the objection and stated (November 2004) that two demands for Rs.88.29 lakh were issued in February and March 2003 covering the period from July 2000 to October 2001 and February 2002 to January 2003. The assessee had paid duty of Rs.2.64 lakh for the period from November 2001 to January 2002 in October 2004.

**9.5.2** M/s. Castrol India Limited, in Vapi Commissionerate of Central Excise, cleared lubricating oil to its sister unit and paid duty on the assessable value determined at a hundred and fifteen per cent of the cost of production. The assessee did not include administrative overheads relating to production in the cost of production. This resulted in short levy of duty of Rs.46.14 lakh between November 2001 and June 2003.

On this being pointed out (August 2003), the Ministry admitted the objection and stated (August 2004) that SCN was being issued.

## 9.6 Adoption of lower value of goods transferred to sales depot

Section 4(1)(b) of the Central Excise Act, 1944, read with rule 7 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, effective from 1 July 2000, envisages that where excisable goods are not sold by the assessee at the time and place of removal but are transferred to a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the places of removal, the value shall be the normal transaction value of such goods sold from such other places.

Audit in September 2002 pointed out adoption of lower assessable value in respect of medicaments transferred to sales depots by M/s. Parenteral Drugs (India) Limited in Indore Commissionerate of Central Excise thereby resulting in short levy of duty of Rs.20.93 lakh during December 2000 to June 2002. The Ministry intimated (October 2003) recovery of duty of Rs.20.73 lakh and interest of Rs.1.60 lakh in February 2003. Subsequent verification of Central excise records of the assessee revealed (September 2003) that the irregularity persisted. There was further short levy of duty of Rs.25.27 lakh during the period from July 2002 to July 2003. The Department did not take any action to recover duty. Interest of Rs.5.56 lakh was also recoverable for delayed payment.

On this being pointed out again (September 2003), the Ministry admitted the objection and intimated (November 2004) that the entire amount of differential interest had been recovered.

## 9.7 Other cases

In 101 other cases of valuation of excisable goods, the Ministry/the Department had accepted objections involving duty of Rs.5.01 crore and reported recovery of Rs.2.40 crore in 92 cases till January 2005.

# CHAPTER X : EXEMPTIONS

Under section 5A(1) of the Central Excise Act, 1944, Government is empowered to exempt excisable goods from the whole or any part of the duty leviable thereon either absolutely or subject to such conditions as may be specified in the notification granting the exemption. Some of the major cases of incorrect allowance of exemption noticed in audit are detailed in the following paragraphs:

## 10.1 Incorrect grant of exemption on final product

**10.1.1** By notification dated 1 March 2002, low sulphur heavy stock (LSHS) intended for use as fuel for the generation of electrical energy by electricity undertakings owned or controlled by Central Government or any State Electricity Board or any local authority or a person licensed under the Indian Electricity Act, 1910 to supply electrical energy, or a person who had obtained sanction to engage in the business of supplying electrical energy in a specified area, was eligible for exemption from the whole of duty of excise.

M/s. Kochi Refineries Limited, Ambalamugal in Cochin Commissionerate of Central Excise, availed exemption during 2002-03 and supplied LSHS without payment of duty to M/s. Samalpathy Power Company and Madurai Power Corporation Limited which did not engage in supply of electrical energy in a specified area. Since the condition was not fulfilled, exemption availed of Rs.20.98 crore during 2002-03 was incorrect.

On this being pointed out (May 2003), the Ministry of Finance (the Ministry) admitted the objection (December 2004).

**10.1.2** Formulations of bulk drugs specified in the notifications dated 1 March 2001 and 1 March 2002 are exempt from payment of duty. Hydrocortisone is a drug specified in the notifications ibid.

M/s. Ind-Swift Limited (Unit-II), in Chandigarh Commissionerate of Central Excise, manufactured formulations of hydrocortisone acetate and cleared the goods without payment of duty after availing exemption under the aforesaid notifications. The grant of exemption was not correct as hydrocortisone acetate was not specified in the notification and was distinct from hydrocortisone as per Indian Pharmacopoeia. This resulted in incorrect availment of exemption of Rs.4.72 crore during the period from June 2001 to March 2003.

On this being pointed out (September 2002 and October 2003), the Ministry stated (September 2004) that hydrocortisone included hydrocortisone acetate.

The reply of the Ministry is not tenable as the notification included only hydrocortisone and not other form of drugs.

**10.1.3** Under notification dated 25 August 1995 (as amended), all excisable goods are exempt from the whole of the duty of excise when supplied to projects financed by World Bank and approved by Government of India provided a certificate, from the executive head of the project implementing authority and countersigned by an officer not below the rank of Joint Secretary to Government of India to the effect that the said goods were required for the execution of the said project was produced before clearance of the goods.

M/s. BPL Telecom Limited, Palakkad, in Calicut Commissionerate of Central Excise, manufactured and supplied PLCC equipment and EPABS worth Rs.2.22 crore to Power Grid Corporation of India during the period July 2001 to December 2001 at nil rate of duty, availing the benefit under the notification. As the project was not financed by the World Bank and the required certificate as stipulated in the notification was not produced by the assessee, the availment of exemption was not correct and resulted in non-payment of duty of Rs.36.49 lakh.

On this being pointed out (January 2002), the Ministry admitted the objection and stated (August 2004) that SCN for Rs.1.36 crore had been issued. The assessee had paid Rs.36.49 lakh and interest of Rs.10.68 lakh was yet to be recovered.

## 10.2 Incorrect grant of exemption on goods manufactured on job work

By notification dated 25 March 1986, as amended, specified goods manufactured in the factory on job work basis and used in relation to the manufacture of final products falling under Central Excise Tariff, are exempt from the whole of the duty leviable thereon. Electricity does not fall under Central Excise Tariff. However, rule 2 of the Cenvat Credit Rules provides Cenvat credit facility to inputs used for generation of electricity which is used for manufacture of final products, within the factory of production.

M/s. Haldia Petrochemicals Limited, in Haldia II Commissionerate of Central Excise, manufactured residual fuel gas and cleared it outside the factory without payment of duty for generation of electricity on job work basis. A major portion of such electricity was returned to the assessee who used the same in the manufacture of final products. Clearance of goods without payment of duty was not correct as electricity was not specified as excisable goods in the Tariff. This resulted in evasion of duty of Rs.6.00 crore from November 2000 to March 2003.

On this being pointed out (January 2004), the Ministry stated (November 2004) that the Cenvat credit scheme was basically to avoid cascading effect of taxes. Therefore it would be unfair to deny credit on technicalities.

The Ministry's contention is untenable since application of sub rule 5(a) of rule 4 of the Cenvat Credit Rules, 2002, was restricted to cases where the goods returned from the job worker were covered under the schedule to the Central Excise Tariff Act, 1985 which was not the case here. Further, intermediate goods sent to the job worker for generation of electricity outside the factory of production did not satisfy the definition of inputs as per rule 2. However, it had admitted the objection in a similar case in the previous Audit Report.

## 10.3 Exemption granted without notification under Central Excise Act

Notifications issued under the powers derived from section 5A of the Central Excise Act, 1944 allow/grant exemption from duty.

Two units each of M/s. IOCL and M/s. BPCL in Hyderabad II and Mumbai IV Commissionerates of Central Excise, were allowed exemption of duty on Aviation Turbine Fuel (ATF) supplied to aircrafts on foreign run during the period from 23 November 2002 to 28 February 2003 on the basis of notification dated 18 November 2002 issued by Ministry of

Civil Aviation. Since the said notification was not issued in pursuance of provisions contained in section 5A of the Central Excise Act which was done only on 1 March 2003, exemption availed in the interim was not correct. Duty of Rs.74.17 lakh was, therefore, leviable on the clearances made during the period of January 2003 to February 2003.

On this being pointed out (June 2003 and June 2004), the Ministry admitted the objection and reported (August and December 2004) confirmation of demand of Rs.17.29 lakh in two cases and issue of SCN for Rs.62.86 lakh in the third. Action taken to recover duty in the fourth had not been intimated.

## 10.4 Other cases

In 37 other cases of exemption, the Ministry/the Department accepted objections involving duty of Rs.1.34 crore and reported recovery of Rs.61.54 lakh in 36 cases till January 2005.

# CHAPTER XI : CESS NOT LEVIED OR DEMANDED

Cess is levied and collected in the same manner as excise duty under the provisions of various Acts of Parliament.

Some of the cases in which cess was not levied or demanded or not correctly accounted for are mentioned below:

## 11.1 Cess not collected due to inconsistency between the Act and the Rules

Under section 12 of the Rubber Act, 1947, cess at the rate notified by the Government of India from time to time is leviable on all rubber produced in India and is to be collected by the Rubber Board in accordance with the Rules made in this behalf, from the owner of the estate or from the manufacturer by whom such rubber is used. Cess rates have varied between Rs.0.40 per kilogram in 1975 to Rs.1.50 per kilogram with effect from September 1998.

Non-levy of cess on natural rubber exported had been pointed out in earlier Audit Reports. The Rubber Board had stated (February 1994) that cess could not be collected from the producers of rubber since under the Rules, they could do so only from the manufacturers. On the inconsistency between the Act and the Rules being pointed out repeatedly in audit, the Board submitted (October 1997) proposals for amending the Act and the Rules suitably, to the Ministry of Commerce. This amendment has not yet been done. From 1 September 2003 rate of cess has been fixed at zero paise per kilogram on rubber produced in India and procured for export by exporters of natural rubber but the inconsistency between the Act and Rules still persists. This led to revenue loss of Rs.11.35 crore during April 2000 to March 2003.

On this being pointed out (August 2004), the Ministry of Commerce confirmed the facts (December 2004).

## 11.2 Cess under Textile Committee Act not levied

As per section 5A(1) of the Textile Committee Act, 1963, and the notification issued by the Ministry of Commerce on 1 June 1977, cess at the rate of 0.05 per cent is leviable on textiles and textile machinery manufactured in India. The authority to collect such cess is vested with the 'Textile Committee' in accordance with the provisions of the Textile Committee (Cess) Rules, 1975 constituted under the Act ibid.

Test check of records of 50 assessees in Belapur, Faridabad, Gurgaon, Jaipur I, II, Rohtak, Surat and Thane II Commissionerates of Central Excise, engaged in manufacture and processing of textile articles and materials revealed that they did not pay textile cess amounting to Rs.3.25 crore between April 1990 and March 2003. No action was taken by the Textile Committee for collection of cess from these assessees in accordance with the rules ibid.

On this being pointed out (between May 2002 and April 2004), the Ministry of Textiles stated (November 2004) that cess of Rs.0.12 crore had been recovered from seven assessees whereas action was being initiated for recovery of cess from forty assessees and in remaining three the matter was subjudice.

## 11.3 Non-levy of cess on automobiles

As per Ministry of Industry's orders dated 9 September 1985 and 22 March 1990, cess at the rate of 1/8 per cent ad valorem is leviable on tractors of power take-off exceeding 25 horse power with effect from 1 October 1985 and on other automobiles with effect from 22 March 1990 respectively.

M/s. Bharat Earth Movers Limited, in Bangalore I Commissionerate of Central Excise, manufactured inter-alia Tatra and HMV (tractors) vehicles fitted with engines of power take-off exceeding 25 horse power and cleared them for defence purpose. The assessee did not pay cess of Rs.18.89 lakh during the period from October 1999 to August 2000.

On this being pointed out (October 2000), the Department stated (August 2001) that since tractors had not been explicitly indicated in the first schedule to the Industrial Development and Regulation Act 1951, demanding cess was not legally correct.

The reply is not tenable as tractors in the instant case were liable to cess under Ministry's order of September 1985 and March 1990 ibid. The Department had issued SCN in February 2001 demanding cess of Rs.16.28 lakh for the period from January 2000 to August 2000. Reasons for not issuing SCN from October 1999 to December 1999 had not been furnished (July 2004).

Reply of the Ministry of Industry had not been received (January 2005).

## 11.4 Non-crediting of interest on cess on rubber to the Consolidated Fund of India

Section 12 of the Rubber Act, 1947, stipulates that the proceeds of cess on rubber should be credited to the Consolidated Fund of India. In the absence of provisions in the Act to collect penal interest on belated payment of cess, the Board decided to collect it at the rate of 12 per cent, effective from 1 April 1988, which on account of being related to delayed payment of cess, ought to have been credited to Government account.

The Rubber Board, Kottayam, however, collected penal interest of Rs.47.20 lakh during the period from April 2001 to March 2003 and credited it to 'general fund', appropriated by the Board.

On this being pointed out (October 2003), the Ministry of Commerce stated (December 2004) that the arrangement carried its approval.

The contention is not tenable since penal interest on the analogy of the cess itself should appropriately be credited to the Consolidated Fund of India and the action of the Board in this regard is highly irregular.

## 11.5 Other cases

In four other cases of cess, the Department had accepted the objections involving cess of Rs.9.06 lakh and reported recovery of Rs. 9.06 lakh till January 2005.

# CHAPTER XII : MISCELLANEOUS TOPICS OF INTEREST

## 12.1 Escapement of duty by reduction of the balance of finished goods

Rule 4 of Central Excise Rules, 2002, stipulates that no excisable goods shall be removed without payment of duty.

Rule 10 of the Rules further provides that every assessee shall maintain proper records on a daily basis in a legible manner indicating therein particulars regarding description of the goods produced or manufactured, opening balance, quantity produced or manufactured, inventory outputs, quantity removed assessable value, the amount of duty payable and particulars regarding amount of duty actually paid.

Test check of records of M/s. Bridgestone Indian Private Limited, Pithampur, in Indore Commissionerate of Central Excise revealed that 73,755 passenger car radial tyres of various sizes manufactured by the assessee were destroyed by fire on 11 November 2002. On 29 November 2002, the assessee reduced the recorded balance in production register (RG-I) to that extent without payment of duty of Rs.3.17 crore. Audit noticed that though Cenvat credit of Rs.68.82 lakh (approximately) had been availed on inputs used in manufacture of such tyres and an amount of Rs.4.82 crore was also received as compensation from the insurance company, no action was taken by the Department for recovery of duty.

On this being pointed out (October 2003), the Ministry of Finance (the Ministry) admitted the objection (October 2004).

## 12.2 Duty collected but not paid to Government

Section 11D of the Central Excise Act, 1944, stipulates that every person who is liable to pay duty and has collected any amount in excess of the duty assessed or determined and paid on any excisable goods under this Act, shall forthwith pay the amount so collected to the credit of Central Government.

**12.2.1** M/s. Larsen and Toubro Limited, Kooya, in Bhavnagar Commissionerate of Central Excise cleared 12,01,856 tonne cement during March 1999 and December 2000 and charged duty of Rs.350 per tonne from customers but paid excise duty at the rate of Rs.332 per tonne to the credit of Government account. This resulted in incorrect collection and retention of central excise duty of Rs.2.16 crore.

On this being pointed out (December 2002), the Ministry admitted the objection in principle and intimated (October 2004) issue of SCNs for Rs.1.98 crore for the period from April 1999 to December 2000.

**12.2.2** M/s. Shreyans Industries Limited, in Nawan Shahar and Ahmedgarh in Jalandhar and Ludhiana Commissionerates of Central Excise, manufactured and sold paper to Government departments at rates which were inclusive of excise duty. Audit scrutiny revealed that the assessees availed exemption from payment of duty for the first clearance of 3,500 tonne in respect of supplies made to the departments during April 2001 but at the same time collected duty through cum duty price which was not deposited with the Government.

On this being pointed out (January 2003 and November 2003), the Department stated in one case (September 2003) that SCN for Rs.2.57 crore had been issued for the period from 1 April 2000 to 5 June 2001 covering clearances not only for Government departments but private parties as well. Reply in the other had not been received (April 2004).

The Ministry admitted the objection (November 2004).

**12.2.3** In the case of M/s. Vimal Moulders (I) Limited Vs. Commissioner of Central excise, New Delhi, CESTAT while dealing with the question of recovery of amounts collected from customers under similar provisions of rule 57CC of erstwhile Central Excise Rules, 1944, held that the amount of eight per cent paid by manufacturer but collected from customers was to be deposited with Central Government as excess collection of duty as per the provisions of section 11D of Central Excise Act, 1944 {2004 (164) ELT 302}.

(a) M/s. Mishra Dhatu Nigam Limited, in Hyderabad II Commissionerate of Central Excise, availed Cenvat credit on inputs meant for use in the manufacture of dutiable as well as exempted metal goods. Since they did not maintain separate inventory for the inputs, they paid eight per cent of value of exempted goods cleared. However, liability on this account was passed on to the buyer by means of debit notes between June 2001 and February 2004. The amount of Rs.1.94 crore so collected was not recovered by the Department.

On this being pointed out (April 2003 and May 2004), the Ministry stated (October 2004) that the amount of eight per cent was shown by the assessee separately in the invoice not as excise duty but reversal of amount under rule 57CC and hence section 11D would not be applicable to this case.

Reply of the Ministry is not tenable as the relevant debit note explicitly showed recovery of "excise duty at the rate of eight per cent as per rule 57CC". Therefore section 11D was attracted in terms of CESTAT decision in M/s. Vimal Molders (I) Limited case.

(b) M/s. SRF Limited, Manali, M/s. Pennar Industries Limited and M/s. Electro Steel Castings Limited Khardah, in Chennai I, Kolkata III and Hyderabad I Commissionerates of Central Excise, manufacturing both dutiable and exempted excisable goods availed Modvat credit on common inputs but did not maintain separate accounts. Therefore, the assessees paid an amount equal to eight per cent of the price of exempted goods from Modvat account. Scrutiny of the invoices revealed that the assessees at the same time collected such amount through invoices from the customers but did not remit the same to Government account. The amount recoverable amounted to Rs.76.32 lakh between January 2002 and October 2003.

On this being pointed out (between July 2002 and January 2004), the Ministry partly admitted the objection (between September and December 2004).

(c) M/s. Mukund Limited (MBD), in Belapur Commissionerate of Central Excise, had supplied certain equipments (dryers) to ship building centre, Vishakapatnam during 1 April 2000 to 31 March 2001 by claiming full exemption from duty under notification dated 16 March 1995 as amended. Company had reversed an amount of eight per cent under the provisions of rule 57AD (2) of the Central Excise Rules, since they had not maintained separate account of inputs used for production of exempted goods. It was observed in audit that they had issued separate invoices to customers and had collected the amount of Rs.69.12 lakh pertaining to duty of excise reversed by them at the time of clearance of exempted goods. Check of accounting treatment of excess collections showed this amount was accounted for under the head 5822- excise duty – dryers.

On this being pointed out (October 2001), the Ministry admitted the objection and stated (December 2004) that SCN for Rs.70.77 lakh had been issued in April 2002.

## 12.3 Default in payment of duty and incorrect utilisation of Cenvat credit

Rule 8 of Central Excise Rules, 2001, (previously rule 49 of the Central Excise Rules, 1944) stipulates that where an assessee defaulted in fortnightly payment of an instalment beyond 30 days or on three occasions in a financial year, he would forfeit the facility to pay the dues in instalment under this rule for a period of two months, starting from the date of communication of the order passed by the Assistant Commissioner or Deputy Commissioner of Central excise, as the case may be, in this regard or till such date on which dues are paid, whichever was later and during this period, the assessee shall be required to pay duty for each consignment by debit to the account current. In the event of any failure, it shall be deemed that such goods had been cleared without payment of duty and he would be liable to penalty not exceeding the amount of duty leviable or ten thousand rupees which ever was greater.

(a) M/s. Decan Alloys (P) Limited, Hosur in Chennai III Commissionerate of Central Excise, engaged in manufacture of re-rolled products of steel defaulted in fortnightly payment of duty on three occasions between May and July 2001. The jurisdictional Assistant Commissioner/Deputy Commissioner ought to have issued necessary orders in July 2001 forfeiting the facility to pay the dues in instalments and debarring the assessee to use Cenvat credit, as provided in the rule cited in para 1 supra. As the Department had not issued any such order, the assessee utilised Cenvat credit of Rs.1.32 crore during July and August 2001.

On this being pointed out (June 2004), the Ministry admitted the objection (November 2004).

(b) M/s. Sree Rajendra Mills Limited in Salem Commissionerate of Central Excise, manufacturing cotton yarn (chapter 52) paid duty amounting to Rs.2.74 lakh relating to the goods cleared during the first fortnight of March 2002, payable on 20 March 2002, after thirty one days delay i.e. on 20 April 2002. Similarly, M/s. TCM Limited Metturdam in the same Commissionerate manufacturing inorganic chemicals (chapter 28) paid duty of Rs.7.50 lakh payable on 5 September 2000 in three equal instalments of Rs.2.50 lakh each i.e. between December 2000 and February 2001. As the Department had not issued any order forfeiting facility of payment on fortnightly basis and had not debarred the assessee from using Cenvat credit, they had utilised Cenvat credit of Rs.12.62 lakh during May 2002 to June 2002 and Rs.22.01 lakh during the period from October 2000 to January 2001 respectively.

On this being pointed out (between June 2002 and May 2003), the Ministry admitted the objection in principle and stated (October 2004) that the Commissionerate had followed a slightly flexible approach as the default had taken place in the initial stages of the scheme.

The Ministry's reply is not tenable as Board's letter of 20 October 2000 provides for immediate checking of the monthly returns and strict enforcement of rule provision to provide deterrent against any delay in payment. Non-issue of order forfeiting the fortnightly payment facility led to incorrect utilization of Cenvat credit of Rs.34.63 lakh which would otherwise have been paid by cash.

(c) M/s. Panyam Cements and Minerals Limited, and M/s. Spartek Ceramics India Limited, in Tirupathi Commissionerate of Central Excise and M/s. BHPV Limited in

Visakhapatnam Commissionerate of Central Excise, engaged in the manufacture of cement ceramics tiles and engineering goods, defaulted in paying central excise duties aggregating to Rs.2.98 crore due for the months July 2003, October to December 2003 and March to September 2003 respectively. The Department did not initiate any action for penalty.

On this being pointed out (September 2003 and February 2004), the Ministry admitted the objection and stated (September 2004) that M/s. BHPV Limited had paid Rs.1.55 crore and action had been initiated to recover dues from the remaining two assessees by issue of SCN/attaching goods.

(d) M/s. Cadbury India Limited, Malanpur in Indore Commissionerate of Central Excise, engaged in manufacture of cocoa preparations and wafer products did not make full payment of duty by the due date relating to an instalment of February 2002 and two instalments of March 2002 in the financial year 2001-02. The short payment was made good in August 2002. Department did not initiate any action to forfeit facility to pay the dues in instalments as required in the rule. As a result, two months revenue of Rs.1.50 crore escaped realisation in cash on clearance of goods on consignment basis.

On this being pointed out (April 2003), the Ministry stated (October 2004) that non-payment of full amount of duty was either due to clerical mistake or incorrect availment of Cenvat credit and was rectified by paying the amount in August 2002.

The Ministry's reply is not acceptable as the facility to pay the dues in instalments should have been forfeited in any case.

## 12.4 Other cases

In 421 other cases of miscellaneous nature, the Ministry/the Department had accepted objections involving duty of Rs.5.96 crore and reported recovery of Rs.5.23 crore in 406 cases till January 2005.

# CHAPTER XIII: SERVICE TAX RECEIPTS

## 13.1 Tax administration

Service tax was introduced from 1 July 1994 through the Finance Act, 1994. Administration of service tax has been vested with the central excise department under the Ministry of Finance (the Ministry). The Board has set up a separate apex authority headed by Director General Service Tax (DGST) at Mumbai for its administration. Commissioners of central excise have been authorised to collect service tax within their jurisdiction. The number of services under the net has increased from 26 in 1999-2000 to 58 in 2003-04.

## 13.2 Trend of receipts *

The revenue projected through annual budget and actual receipts from service tax during the years 1999-2000 to 2003-04 is exhibited in the table below:-

**(Amount in crore of rupees)**

| Year | No. of services covered by tax | Budget estimates | Revised budget estimates | Actual receipts | Difference between actual receipts and budget estimates | Percentage variation |
|---|---|---|---|---|---|---|
| 1999-2000 | 26 | 2300 | 2000 | 2128 | (-) 172 | (-) 7.48 |
| 2000-01 | 26 | 2200 | 2200 | 2612 | 412 | 18.73 |
| 2001-02 | 41 | 3600 | 3600 | 3302 | (-) 298 | (-) 8.28 |
| 2002-03 | 51 | 6026 | 5000 | 4122 | (-) 1904 | (-) 31.60 |
| 2003-04 | 58 | 8000 | 8300 | 7890 | (-) 110 | (-) 1.38 |

* Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs).

It can be seen that except for the year 2000-01, the actual collections had been lower than the budget estimates all through the five years period. Shortfall ranged from Rs.110 crore to Rs.1,904 crore or 1.38 to 31.60 per cent over budget estimates during these years. In three of the five years, the budget estimates had to be scaled down, of which during 2002-03 and 2003-04, the collections failed to match even the reduced estimates.

## 13.3 Outstanding demands *

The number of cases and amount involved in demands for service tax outstanding for adjudication/recovery as on 31 March 2004 is given below:

**(Amount in crore of rupees)**

| | | As on 31 March 2003 | | | | As on 31 March 2004 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Number of cases | | Amount | | Number of cases | | Amount | |
| | | More than five years | Less than five years | More than five years | Less than five years | More than five years | Less than five years | More than five years | Less than five years |
| (a) | **Pending with** Adjudicating officers | 4 | 15192 | 0.03 | 351.31 | 41 | 28950 | 2.02 | 703.66 |
| (b) | **Pending before** | | | | | | | | |
| (i) | Appellate Commissioners | 4 | 375 | 2.30 | 46.23 | 0 | 837 | 0.00 | 86.56 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| (ii) | Board | 8 | 2 | 0.02 | 0.70 | 0 | 14 | 0.00 | 0.12 |
| (iii) | Government | 0 | 0 | 0.00 | 0.00 | 0 | 0 | 0.00 | 0.00 |
| (iv) | Tribunals | 2 | 69 | 0.11 | 78.88 | 0 | 292 | 0.00 | 81.11 |
| (v) | High Courts** | 6 | 92 | 0.00 | 15.49 | 8 | 148 | 0.00 | 25.31 |
| (vi) | Supreme Court | 0 | 6 | 0.00 | 2.64 | 0 | 14 | 0.00 | 5.69 |
| (c) | **Pending for coercive recovery measures** | 16 | 687 | 0.27 | 3.98 | 16 | 5489 | 0.01 | 39.73 |
| | **Total** | **40** | **16423** | **2.73** | **499.23** | **65** | **35744** | **2.03** | **942.18** |

* Provisional figure furnished by the Ministry and relates to 92 Commissionerates

** The Ministry intimated that the amount when rounded off amounts to zero

A total of 35,809 cases involving tax of Rs.944.21 crore were pending as on 31 March 2004 with different authorities, of which 80.96 per cent were with the adjudicating officers of the Department. The pendency with the adjudicating officers has increased from 15,196 in 2002-03 to 28,991 cases in 2003-04 i.e an increase of about 91 per cent.

## 13.4 Fraud/presumptive fraud cases *

The position of fraud/presumptive fraud cases alongwith the action taken by the Department against defaulting assessees during the period 2001-02 to 2003-04 is depicted in the following table :

**(Amount in crore of rupees)**

| Year | Cases detected | | Demand of duty raised | Penalty imposed | | Duty collected | Penalty collected | |
|---|---|---|---|---|---|---|---|---|
| | Number | Amount | Amount | Number | Amount | Amount | Number | Amount |
| 2001-02 | 225 | 23.85 | 10.18 | 178 | 0.84 | 12.56 | 157 | 0.13 |
| 2002-03 | 195 | 40.26 | 14.46 | 22 | 3.08 | 1.56 | 6 | 0.01 |
| 2003-04 | 983 | 173.66 | 131.24 | 215 | 30.25 | 14.89 | 102 | 0.09 |
| **Total** | **1403** | **237.77** | **155.88** | **415** | **34.17** | **29.01** | **265** | **0.23** |

* Provisional figure furnished by the Ministry and relates to 92 Commissionerates

The above data reveals that while a total of 1,403 cases of fraud/presumptive fraud were detected during the years 2001-04 by the Department, involving tax of Rs.237.77 crore, the Department raised a demand of Rs.155.88 crore only and recovered Rs.29.01 crore (18.61 per cent). Similarly, out of penalty of Rs.34.17 crore imposed, the Department recovered only Rs.0.23 crore (0.67 per cent).

## 13.5 Contents

This section features a review "Service tax on consulting engineers, architects and interior decorators services" with financial implication of Rs.518.63 crore and contains 20 paragraphs (including cases of total under assessment) featured individually or grouped together with a revenue implication of Rs.17.56 crore. The Ministry/the Department had accepted audit observations in 19 paragraphs involving Rs.17.25 crore and recovered Rs.0.33 crore till January 2005.

# CHAPTER XIV: REVIEW ON SERVICE TAX ON CONSULTING ENGINEERS SERVICES, ARCHITECTS SERVICES AND INTERIOR DECORATORS SERVICES

## 14.1 HIGHLIGHTS

- **Measures taken by the Department to bring unregistered service providers into tax net proved ineffective and inadequate. Audit identified 376 active but unregistered service providers in 41 Commissionerates of Central Excise, with loss of revenue of Rs.95.21 crore.**

**(Paragraph 14.7)**

- **Service tax of Rs.10.40 crore was not paid by Government undertakings providing consultancy services.**

**(Paragraph 14.8)**

- **Service tax of Rs.52.17 crore on services rendered by foreign service providers in India was not paid by 89 assessees receiving taxable services in 37 Commissionerates of Central Excise.**

**(Paragraph 14.9)**

- **Service tax of Rs.6.99 crore was not levied by the Department on 24 technical institutes providing technical consultancy.**

**(Paragraph 14.10)**

- **Service tax of Rs.11.95 crore on account of erection and commissioning activities was not levied by the Department on eight assessees.**

**(Paragraph 14.11)**

- **Service tax of Rs.3.35 crore on account of technical advice, designing and development charges was not levied by the Department.**

**(Paragraph 14.12)**

- **In 64 Commissionerates of Central Excise around 21 per cent of the returns due were not submitted by assessees, while 12 per cent were received late.**

**(Paragraph 14.13)**

- **Inadequate assessment/verification of service tax returns by the Department led to short payment of Rs.27.42 crore on account of suppression of taxable value by assessees in 31 Commissionerates of Central Excise.**

**(Paragraph 14.16)**

## 14.2 Introduction

Service tax on 'consulting engineers services' was levied with effect from 7 July 1997. Section 65(25) of the Finance Act, 1994, defines consulting engineer as "any professionally qualified engineer or engineering firm who either directly or indirectly renders any advice, consultancy or technical assistance in any manner to a client in one or more disciplines of engineering."

Service tax on 'architects' and 'interior decorators' services was levied with effect from 16 October 1998. Section 65(6) of the Finance Act, 1994 defines architect as "any person whose name for the time being is entered in the Register of Architects maintained under section 23 of the Architects Act, 1972, and also includes any commercial concern engaged in any manner, whether directly or indirectly in rendering services in the field of architecture". Section 65(49) of the Finance Act, 1994, defines interior decorator to mean and include " any person who is engaged in the business of providing advice, consultancy, technical assistance or any other service directly or indirectly relating to planning, designing or beautification of spaces, whether man-made or otherwise and also includes a landscape designer".

Section 69 of the Finance Act, 1994 read with rule 4 of the Service Tax Rules, 1994, provides that every person liable to pay service tax shall make an application for registration to the concerned central excise officer in form ST-1 within a period of 30 days of the service tax becoming leviable.

## 14.3 Audit objectives

The review was conducted in audit to seek assurance that: -

(i) the monitoring mechanism devised to ensure that all potential assessees providing the above three services had been brought under the purview of service tax was adequate;

(ii) tax administration was efficient and effective in ensuring compliance to legislations and rules.

## 14.4 Scope of audit

For this purpose, records of 76 out of 92 Central Excise Commissionerates covering 19 States were checked. Period covered under audit was from 1997-98 to 2002-03. The findings are contained in the succeeding paragraphs.

## 14.5 Trend of revenue

The table below indicates the trend of revenue in respect of test checked Commissionerates of Central Excise.

**Consulting engineer services**

**(Amount in crore of rupees)**

| No. of Commis-sionerates | 1997-98 | | 1998-99 | | 1999-2000 | | 2000-01 | | 2001-02 | | 2002-03 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. |
| 76 | 3311 | 35.61 | 4898 | 67.69 | 5844 | 79.72 | 6877 | 92.81 | 8247 | 97.14 | 9802 | 145.98 |

**Architects**

**(Amount in crore of rupees)**

| No. of Commiss-ionerates | 16.10.1998 to 1999 | | 1999-2000 | | 2000-01 | | 2001-02 | | 2002-03 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. |
| 71 | 3549 | 1.22 | 4771 | 6.34 | 5520 | 13.59 | 6436 | 31.31 | 6768 | 20.48 |

**Interior decorators**

**(Amount in crore of rupees)**

| No. of Commiss-ionerates | 16.10.1998 to 1999 | | 1999-2000 | | 2000-01 | | 2001-02 | | 2002-03 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. | No. of assessees | Amt. |
| 54 | 543 | 1.37 | 876 | 1.09 | 1019 | 2.18 | 1251 | 2.28 | 1424 | 3.07 |

- Despite an increase in the number of registered consulting engineers in Mumbai III and II Commissionerates of Central Excise by 18.69 per cent and 13.41 per cent in the year 2002-03, there was decrease in revenue by 21.85 per cent and 20.48 per cent respectively.
- Similarly, in Salem and Bangalore III Commissionerates of Central Excise, while there was increase of registered consulting engineers by 120 and 28.97 per cent during 2002-03, revenue decreased by 57.98 and 19.73 per cent respectively.
- Even though there was an increase of 5.16 per cent in the number of architects registered with the Commissionerates of Central Excise, there was a significant decrease in revenue during 2002-03 compared to 2001-02.
- Increase of 60 per cent in the registration of architects in Meerut I Commissionerate of Central Excise, did not match revenue which decreased by 17.76 per cent. Similarly in Ahmedabad I Commissionerate of Central Excise against the increase of 3.62 per cent in registration there was a fall in revenue by 32.75 per cent in 2002-03.

## 14.6 Inadequate efforts by the Department in bringing unregistered service providers into tax net – survey and raids

Prevention of tax evasion and widening of tax base are two of the important functions of tax administration for optimum tax realisation. With increasing reliance on voluntary compliance by tax payers at large, it becomes necessary for the Department to collect and utilise information from various sources to curb evasion of tax by unscrupulous assessees.

The Central Board of Excise and Customs (the Board) issued instructions to all Commissionerates of Central Excise on 5 November 1999 to undertake survey and intelligence gathering to identify tax evaders with a view to improve the working of their service tax cells. The position of surveys and raids undertaken by some Commissionerates for the period 1998-99 to 2002-03 and its impact on revenue is as follows: -

**(Amount in crore of rupees)**

| No. of Commissionerates | No. of surveys | No. of raids | No. of persons evading service tax identified | | | Additional revenue realised |
|---|---|---|---|---|---|---|
| | | | Consulting engineers | Architects | Interior decorators | |
| 33 | 2538 | 13 | 240 | 47 | 14 | 8.25 |

- It was noticed that in some of the major earning Commissionerates such as Mumbai I, IV, V, Hyderabad I & II, Jamshedpur, Mangalore, Chandigarh, Allahabad, no survey/raid had been conducted at all.
- In Calicut, Dibrugarh and Ranchi Commissionerates though 367, 178 and 13 surveys respectively were conducted during 1997-98 to 2003-04, no revenue was realised.
- In Pondicherry Commissionerate from 416 surveys conducted during 1997-98 to 2003-04, only Rs.0.51 lakh was realized.

Audit further noted that no target of minimum surveys or raids was fixed for any Commissionerate of Central Excise.

## 14.7 Escapement from tax net due to non-registration

Measures taken by the Department to widen the assessee base in these services being considered inadequate and ineffective, an effort was made by audit on a limited scale in the Commissionerates of Central Excise to gauge the extent of evasion of tax by active service providers. With this in view, secondary records such as those of municipal authorities, income tax department, sales tax records, annual accounts of the companies etc. were verified.

It was revealed that 376 active service providers (consulting engineers 223, architects 105 and interior decorators 48) in 41 Commissionerates had not registered themselves with the central excise department. Service tax evaded by them was Rs.95.21 crore besides interest of Rs.54.59 crore and penalty of Rs.95.21 crore under sections 75, 75A, 76, 77 and 78 of the Finance Act, 1994.

Some illustrative cases are given below:

### *14.7.1 Service tax for rendering technical advice/design development under turnkey project not paid*

M/s. Himachal Futuristic and Communication Limited under Chandigarh I Commissionerate of Central Excise received gross amount of Rs.1429 crore from M/s. Shyam Telelink Limited, New Delhi for rendering service towards civil works, design and development work on turnkey project during the years 1999-2000 to 2001-02. But the assessee neither registered with the Department nor paid any service tax. This resulted in non-payment of service tax of Rs.23.57 crore besides interest and penalty of Rs.33.87 crore calculated at 33 per cent of gross payment as service charges .

On this being pointed out (February 2001), the Department did not accept the objection stating therein that unless the company provided consultancy to a client, the company activities could not be termed as those of consulting firm. Reply of the Department is not tenable as the agreements entered into with their clients included complete installation,

commissioning and services and acceptance of optical fibres cable system. The assessee, however, got himself registered in July – August 2003.

Government issued notification only on 21 August 2003 providing that where the gross amount charged also included the value of materials sold under turnkey projects, service tax would be calculated on a value which was equivalent to 33 per cent of the gross amount so charged from customers. This was also clarified by Regional Advisory Committee (RAC) in their meeting held on 24 September 2003 at Mumbai.

Audit noticed in addition that, since the assessee had been providing consultancy such as project/engineering in the discipline of engineering service prior to issue of notification dated 21 August 2003 they were liable to pay service tax as consulting engineer from July 1997.

**14.7.2** Scrutiny of annual accounts along with income tax returns of the following service providers engaged inter-alia in providing taxable services as consulting engineer and architect showed that they neither registered with central excise department nor paid any service tax. This resulted in non-payment of service tax, interest and penalty to the tune of Rs.47.19 crore as shown below: -

**(Amount in crore of rupees)**

| Sl. No. | Commissio -nerate | Name of service provider | Year of IT returns | Gross value of the service | Value of service taxable i.e. 33 per cent | Service tax payable | Interest | Penalty |
|---|---|---|---|---|---|---|---|---|
| 1. | Kolkata V | Simplex Concrete Piles (I) Limited | 2000-01 to 2001-02 | 801.32 | 264.43 | 13.22 | 6.54 | 13.22 |
| 2. | Kolkata V | Simplex Projects (Pvt.) Limited | 1998-99 to 2001-02 | 109.53 | 36.14 | 1.81 | 1.12 | 1.81 |
| 3. | Kolkata I | KND Engineering Technologies | 1998-99 to 2000-01 | 129.03 | 42.58 | 2.13 | 1.82 | 2.13 |
| 4. | Kolkata I | Senbo Engineering | 1998-99 to 2000-01 | 75.00 | 24.75 | 1.24 | 0.91 | 1.24 |

This was pointed out to the Department (April 2004); their reply was awaited.

## 14.8 Non-payment/short payment of service tax for providing consultancy service by Government undertakings

**14.8.1** Scrutiny of annual accounts of M/s. Electronics Corporation of India in Hyderabad III Commissionerate of Central Excise for the year 2002-03 revealed that the company had realised an amount of Rs.69.87 crore on account of various services rendered to customers during the year 2002-03. These services fell within the ambit of definition of consulting engineer service. The company had neither got itself registered as service tax assessee nor paid service tax. This resulted in non-payment of service tax of Rs.3.49 crore, besides interest of Rs.0.91 crore and aggregate penalties of Rs.3.49 crore towards non-payment of service tax, non-filing of service tax returns (ST-3) and concealment of income. Non-payment of service tax on consulting engineer services by the same company for the period 1997-98 to 1999-2000 pointed out in Audit Report No.11 of 2004 was accepted by the Ministry of Finance.

On this being pointed out (June 2003), the Department issued (June 2003) show cause notice (SCN) for Rs.2.77 crore to the assessee.

**14.8.2** Verification of sales tax records of M/s. BHEL, in Trivandrum Commissionerate of Central Excise revealed that they received payment of Rs.138.12 crore as installation and commissioning charges during March 1997 to March 2001 on which service tax was payable on account of consulting engineer services. Non-payment thereof amounted to Rs.6.91 crore besides interest of Rs.2.79 crore and penalty of Rs.6.91 crore leviable thereon.

This was pointed out to the Department (August 2003), reply had not been received so far.

## 14.9 Non-levy of service tax on services rendered by foreign service providers

Sub clause (iv) of rule 2(d) of the Service Tax Rules inserted with effect from 16 August 2002 provided that for taxable service provided by a person who was non-resident or was from outside India, and did not have an office in India, the person receiving taxable service in India was liable to pay service tax.

Test check revealed that 89 assessees in 37 Commissionerates of Central Excise, had availed services falling under the category of "consulting engineers" from foreign consultants and paid service charges of Rs.1043.29 crore during 1997-98 to 2002-03. Since services had been rendered in India, service tax of Rs.52.17 crore was liable to be paid by these assessees besides interest of Rs.21.91 crore and penalty of Rs.52.17 crore. It was seen that income tax had been deducted at source before releasing payment to foreign consultants/service providers.

Some illustrative cases are given below: -

**14.9.1** M/s. TISCO Limited, Jamshedpur under Jamshedpur Commissionerate of Central Excise availed technical services/know how from M/s. Nippon Steel Japan and paid Rs.97.82 crore during 1998-99. Service tax amounting to Rs.4.89 crore besides interest of Rs.3.71 crore and penalty of Rs.4.89 crore leviable thereon remained unpaid.

This was pointed out to the Department (March 2004); their reply had not been received.

**14.9.2** Similarly, another assessee, M/s. TVS Motor Company Limited in Chennai III Commissionerate of Central Excise availed services such as technical assistance, technical information including technical know how, trade secrets falling under the category of consulting engineer from M/s. Suzuki, Japan and paid service charges of Rs.46.42 crore during the period from 1999-2000 to 2001-02. Since service had been rendered in India, service tax of Rs.2.32 crore was payable, besides interest of Rs.0.89 crore and penalty of Rs.2.32 crore leviable thereon but the same had not been demanded by the Department.

This was pointed out to them (March 2004); their reply had not been received.

**14.9.3** M/s. Motor Industries Company Limited in Bangalore I Commissionerate of Central Excise engaged in the manufacture of goods falling under chapter 84 of Central Excise Tariff received technical services/know how from Ms. Bosch, Germany and paid Rs.75.35 crore during 1999-2000 to 31 August 2003. However, no service tax was paid either by service provider or by service receiver. The Department did not issue SCNs. This resulted in non-

payment of service tax amounting to Rs.3.77 crore besides interest of Rs.1.12 crore and penalty of Rs.3.77 crore.

Department's reply on this being pointed out in December 2003 had not been received.

## 14.10 Short payment of service tax by technical institutes providing technical consultancy services

Scientific and technical services were brought within the ambit of service tax with effect from 16 July 2001. Technical institutes providing scientific and technical services paid service tax under the new head. However, it was seen in audit that these institutes had been providing technical consultancy in the disciplines of engineering since 1997-98 and were, therefore, liable to pay service tax as consulting engineer from July 1997.

Twenty four technical institutes in 12 Commissionerates of Central Excise had been providing technical consultancy services since 1998-99. However, these institutes did not pay service tax for services rendered prior to 16 July 2001 in any capacity. It was also noticed that service tax was short paid by them even after 16 July 2001. The total service tax payable worked out to Rs.6.99 crore besides interest of Rs.3.83 crore and penalty payable of Rs.6.99 crore.

Some of the cases are illustrated below: -

**14.10.1** M/s. Indian Institute of Technology, Mumbai and Roorkee in Mumbai III and Meerut Commissionerates of Central Excise, respectively undertook project consultancy covering engineering projects, testing, evaluation and standardization and received an amount of Rs.43.59 crore from various clients during July 1997 to March 2003. However, the institutes registered themselves under scientific and technical services and paid service tax only with effect from October 2002 instead of from 17 July 1997. This resulted in short payment of service tax of Rs.2.18 crore besides interest of Rs.1.25 crore and penalty of Rs.2.18 crore leviable thereon.

On this being pointed out (April 2004), the Department intimated that SCN had been issued to IIT Roorkee (March 2004). In the case of IIT Mumbai, Department's reply was awaited.

**14.10.2** Similarly three other institutes viz. M/s. Indian Institute of Technology (IIT), Chennai , M/s. National Institute of Ocean Technology (NIOT), Chennai and Society for Applied Microwave Electronics Engineering and Research (SAMEER), Chennai in Chennai IV Commissionerate of Central Excise rendered services such as planning, designing, engineering, development and research work etc. to various clients and received an amount of Rs.38.65 crore during the years 1997-98 to 2002-03. No service tax was paid either under consulting engineering services or under scientific and technical services. This resulted in non-payment of service tax of Rs.1.93 crore besides an interest of Rs.1.33 crore and penalty of Rs.1.93 crore.

On this being pointed out (March and April 2004), the Department in the first two cases stated that there were no major difference between the various disciplines of engineering and sciences and technology services. The service rendered as scientific and technical consultancy would also be chargeable as consulting engineering service so long as services were rendered only by firms and not by institutions.

Department's reply is not tenable as the services provided by these institutes fell clearly within the ambit of consulting engineer services and hence were liable for service under that head.

## 14.11 Non-payment of service tax on erection and commissioning charges

Board's letter dated 18 December 2002, stated that the work of erection and commissioning of machineries and plants, was definitely one of providing "technical assistance", and was, therefore, in the nature of services provided by a "consulting engineer" and hence taxable.

Test check of records of eight assessees in seven Commissionerates of Central Excise revealed that they did not discharge service tax on amount of Rs.239.04 crore collected between 1998-99 and 2003-04 towards erection and commissioning activities from their customers. This resulted in non-payment of service tax amounting to Rs.11.95 crore besides interest of Rs.2.76 crore and penalty of Rs.11.95 crore thereon.

An illustrative case is as under: -

M/s. Bharat Heavy Electricals Limited (BHEL) in Chennai II Commissionerate of Central Excise collected Rs.179.15 crore as erection and commissioning charges from their customers during the period 2002-03. Though such services were covered under the ambit of 'consulting engineering services', service tax of Rs.8.96 crore besides interest of Rs.1.14 crore and penalty of Rs.8.96 crore leviable thereon was not paid.

This was pointed out to the Department (March 2004); their reply was awaited.

## 14.12 Non-payment/short payment of service tax on account of technical advice, design and development charges

Thirty four assessees in 23 Commissionerates of Central Excise collected Rs.66.91 crore during the years 1997-98 to 2002-03 towards charges on account of rendering technical advice, designs and development etc. However, they did not pay service tax of Rs.3.35 crore besides interest of Rs.0.86 crore and penalty of Rs.3.35 crore leviable thereon.

## 14.13 Ineffective monitoring of returns from registered service providers

According to section 70 of the Finance Act, 1994, every person liable to pay service tax was required to file a quarterly return in form ST-3 by 15$^{th}$ of the month following the quarter upto October 1998 and thereafter half yearly by 25$^{th}$ of the month following the half year, failure of which attracted penalty under section 77 subject to a maximum of Rs.1000 after 16 July 2001.

The position of submission of returns by registered service providers during the period from 1997-98 to 2002-03 is is as follows: -

| No. of Commissi-onerates | No. of assessees registered | No. of returns due | No. of returns received | No. of returns received by due date | No. of returns received late | No. of returns not received | Penalty leviable (Amount in crore of rupees) |
|---|---|---|---|---|---|---|---|
| 64 | 41844 | 87785 | 68978 | 60428 | 8550 | 18807 | 1.56 |

Analysis in audit revealed that: -

- Twenty one per cent of the returns due were not submitted by registered persons.
- Twelve per cent were received late.
- In some Commissionerates i.e. Bhubaneshwar I and II, Salem, Indore, non-receipt of consulting engineer returns ranged as high as 30 to 54 per cent.
- Penalty of Rs.1.56 crore leviable on account of non-filing of returns had not yet been recovered.

Scrutiny of records of 17 Commissionerates of Central Excise revealed that 168 assessees under the category of consulting engineers, architects and interior decorators, though registered provided services attracting service tax but had neither filed service tax returns nor paid the service tax leviable thereon. Non-payment of service tax and non-submission of returns attracted interest payment and penalty thereof. This resulted in non-payment of service tax of Rs.1.72 crore besides interest of Rs.0.87 lakh in addition to penalty of Rs.1.72 crore during the period 1997-98 to 2002-03.

## 14.14 Assessment/verification procedure not effective to check under-assessment

Prior to 16 July 2001, on filing of a quarterly return (form ST-3) by the assessee, the central excise officer was required to pass an order in writing assessing the taxable value of service and determining the amount of service tax payable under section 71 ibid. From 16 July 2001 onwards, the scheme of self-assessment procedure was introduced under which every person liable for service tax himself assessed tax and furnished to the superintendent of central excise a half yearly return in form ST-3. For the purpose of verification, he was empowered to call for any accounts, documents or other evidence from the assessee, as deemed necessary. Under section 72, the Assistant/Deputy Commissioner was vested with powers to make best judgment assessment after taking into account all the material documents which has been gathered. Section 78 provided for penalty for suppressing value of taxable service.

The position of the assessments finalised by the Department for 1998-99 to 2002-03 in respect of consulting engineers, architects and interior decorators services pertaining to 59 Commissionerates of Central Excise test checked in audit revealed the following: -

**Prior to 16 July 2001**

**(Amount in lakh of rupees)**

| No. of Commissi-onerates | No. of returns received | Assessed | Pending assessment | Additional demands raised | | Recovery | |
|---|---|---|---|---|---|---|---|
| | | | | No. | Amount with interest and penalty | No. of demands | Amount |
| 59 | 43913 | 28390 | 15523 | 298 | 20.57 | 113 | 4.70 |

- About 35.35 per cent of the returns received prior to 16 July 2001 were still to be assessed by the Department. In Nasik Commissionerate, such non-assessment was as high as 96.7 per cent for the years 1998-99 to 2002-03, in Pune II 44.25 per cent for 1999-2000 to 2001-02 and 33.94 per cent in Mumbai I Commissionerates.

**After 16 July 2001**

**(Amount in lakh of rupees)**

| No. of Commissi-onerates | No. of returns received | Verified | Pending verification | Additional demands raised | | Recovery | |
|---|---|---|---|---|---|---|---|
| | | | | No. | Amount with interest and penalty | No. of demands | Amount |
| 62 | 35451 | 28618 | 6883 | 191 | 241.94 | 27 | 1.40 |

After the self assessment procedure was introduced with effect from 16 July 2001, more than 19.27 per cent of the returns were yet to be verified as to the correctness of the amount paid during the period August 2001 to March 2003.

- In Nasik Commissionerate 76.38 per cent, in Goa 64.41 per cent, in Delhi II 35.73 per cent and in Vadodara I 33.60 per cent returns were pending verification.
- Only a meagre 0.59 per cent of the demands raised were recovered.

## 14.15 Non-exercise of provisions under section 72 of the Finance Act – best judgment assessment

Under section 72, the Assistant Commissioner of Central Excise or as the case may be, Deputy Commissioner has been vested with the powers to make best judgment assessment after taking into account all the material documents gathered.

Scrutiny of assessments for the years 1998-99 to 2002-03 furnished by registered service providers in nine Commissionerates of Central Excise revealed that none of them except Mumbai III, V and Ghaziabad had called for any additional information or documents at the time of checking of returns. They also did not invoke provisions of section 72 for framing any best judgment assessment during the years.

**(Amount in lakh of rupees)**

| Sl. No. | Commissi-onerate | No. of returns received | Period | Additional demands raised under section 73 | | Recovery made | |
|---|---|---|---|---|---|---|---|
| | | | | No. | Amount with interest and penalty | No. of cases | Amount |
| 1. | Mumbai III | 92 | 1998-99 to 2002-03 | 2 | 97.10 | | |
| 2. | Mumbai V | 532 | 1998-99 to 2002-03 | 92 | 6.14 | 41 | 1.30 |
| 3. | Ghaziabad | 132 | 2000-01 to 2002-03 | 10 | 218.00 | -- | -- |

## 14.16 Suppression of taxable value by assessees

Sample cross verification of half yearly returns (ST-3) with income tax returns and commercial records of 142 assessees (88 consulting engineers, 51 architects and 3 interior decorators) in 31 Commissionerates of Central Excise was carried out in audit to ascertain the

extent of correctness of tax paid by the assessees during the years 1997-98 to 2002-03. Audit detected undervaluation of cases with consequential short payment of service tax of Rs.27.42 crore besides interest of Rs.6.04 crore and penalty of Rs.27.42 crore leviable thereon.

Some illustrative cases are given below: -

**14.16.1** Comparative scrutiny of income tax department records and annual report of M/s. CMPDIL under Ranchi Commissionerate of Central Excise revealed undervaluation of Rs.154.62 crore for the years 1998-99 to 2001-02 on account of design/exploration and drilling services rendered to M/s. Coal India Limited. This resulted in short payment of service tax of Rs.7.76 crore besides interest of Rs.5.10 crore and penalty of Rs.7.76 crore leviable thereon.

**14.16.2** Similarly, scrutiny of service tax records and annual accounts of M/s. MECON Limited in Ranchi Commissionerate of Central Excise revealed undervaluation of Rs.90.79 crore for the years 1999-2000 to 2001-02 received on account of consultancy charges. Non-disclosure in service tax returns (ST-3) resulted in escapement of service tax of Rs.4.54 crore besides interest of Rs.0.52 crore and penalty of Rs.4.54 crore.

This was pointed out to the Department (March 2004). Their reply was awaited.

## 14.17 Non-payment of interest on delayed payment of service tax

**14.17.1** Under section 75 of the Finance Act, 1994, it is stipulated that every person liable to pay tax in accordance with the provisions of section 68 or rules made thereunder and who fails to credit the tax or any part thereof to the account of Government within the period prescribed, would pay simple interest at the rates specified from time to time for delay in remittance of such tax.

Scrutiny of case records of service tax in five Commissionerates of Central Excise revealed that nine assessees had not paid service tax within the prescribed period during March 1998 to October 2003. Thus, they were liable to pay interest of Rs.1.17 crore which had also not been demanded by the Department except in a case in Ranchi Commissionerate where the Department accepted the omission and issued a notice demanding payment of Rs.34.93 lakh (March 2004).

**14.17.2** Vide section 76 of the Finance Act, a person liable to pay service tax in accordance with the provisions of section 68 or the rule made thereunder, who fails to pay such tax would pay in addition a penalty which would not be less than one hundred rupees but which could extend to two hundred rupees for every day during which such failure continued such that penalty under the clause not exceed the amount of service tax that he failed to pay.

Scrutiny of records, showed that in 405 cases in 18 Commissionerates of Central Excise, assessees paid tax after the due dates during 1999-2000 to 2002-03 with delays ranging from four days to 1,317 days. However, penalty of Rs.79.45 lakh under section 76 had not been levied by the Department.

## 14.18 Service tax collected but not credited to Government account

Rule 6 of the Service Tax Rules, 1994, prescribed that service tax on the value of taxable services received during any calendar month shall be paid to the credit of Central Government by 25th of the month immediately following the said calendar month.

Three consulting engineers in Chennai II, Ghaziabad and Hyderabad II Commissionerates of Central Excise collected an amount of Rs.107.05 lakh as service tax from their clients during 1997-98 to 2001-02 but remitted only Rs.49.37 lakh to Government account. Thus, Rs.57.68 lakh remained un-remitted. This also entailed levy of interest and penalty amounting to Rs.79.76 lakh.

## 14.19 Delay in adjudication

The Board in its circular dated 5 November 1999 stipulated that SCNs issued to service providers be finalised within six months.

Test check of records of six Commissionerates of Central Excise revealed that adjudication of 60 SCNs issued to service providers involving a revenue of Rs.23.96 crore were pending of which 54 were more than a year old.

## 14.20 Non-realisation of confirmed demands

Section 11 of the Central Excise Act, 1944, empowers an officer to levy duty or require the payment of any sum due to Government by deducting the amount so payable from any amount payable or due to the assessee. In the event of non-recovery he can prepare certificate signed by him specifying the amount due from the person liable to pay the same and send it to the collector of the district in which such person resides or conducts his business and the said collector, on receipt of such certificate, is to proceed to recover from the said person the amount specified therein as if it were an arrear of land revenue. Further, rule 230 of the Central Excise Rules, 1944, also provides for recovery of dues. For late payment interest is leviable under the Act/Rules.

The aforesaid section of Central Excise Act, 1944, has been made applicable to service tax vide section 83 of the Finance Act, 1994.

Test check revealed, however, that in Bangalore III Commissionerate of Central Excise demands aggregating Rs.88.11 lakh besides interest of Rs.31.54 lakh and penalty of Rs.1.22 lakh were confirmed against eight assessees during February 1999 to December 2003 but the Department had not initiated any action to effect recovery. This was pointed out in April 2004; reply was awaited.

## 14.21 Inadequate internal audit of service tax assessee's record/creation of service tax cells

Audit scrutiny revealed coverage by internal audit of eight Commissionerates of Central Excise only during 2002-03 which had resulted in issue of demands of Rs.17.83 crore against 60 service providers. Further scrutiny showed that in 43 cases, the demands amounting to

Rs.11.42 crore were pending adjudication and in only 4 cases was, an amount of Rs.1.38 lakh recovered.

The Board had desired vide their instructions of December 1997 that service tax cells be created in each Commissionerate. It was seen that there was staggered creation. Between 1998 and 2000 only 26 and by end of 2003 only 76 had been created.

## 14.22 Conclusion

**Review revealed that measures taken by the Department through surveys and raids to bring potential service providers into tax net were insufficient. Non-coverage of a large number of the Commissionerates by internal audit resulted in these services escaping departmental scrutiny. There had been virtually no recourse to section 72 of the Finance Act. Ineffective monitoring of returns from registered service providers was also in evidence. There is a need to tone up tax administration to prevent escaping of revenue.**

The above observations were pointed out to Ministry in September 2004. They were largely in agreement with the need to tone up administration. Board intimated (November 2004) that several new initiatives had been taken recently to augment revenue, such as setting up of exclusive service tax Commissionerates, street to street survey and introduction of tax payer friendly scheme for registration of service providers.

# CHAPTER XV : NON-LEVY/SHORT LEVY OF SERVICE TAX

Test check of records relating to service tax assessments revealed cases of non-payment, non-levy or non-recovery, some of which are given below :

## 15.1 Non-payment of service tax

### *15.1.1 Banking and financial services*

"Banking and financial services" were brought into ambit of service tax with effect from 16 July 2001 vide notification dated 9 July 2001. Banking and other financial services have been defined as interalia to include financial leasing services including equipment leasing and hire purchase by a body corporate. The Ministry of Finance (the Ministry) had clarified on 9 July 2001 that in case of hire purchase agreement, finance charges together with processing charges/documentation charges form part of the consideration for the services rendered, thereby constituting value of taxable service on which service tax is payable.

M/s. Bajaj Auto Finance Limited, in Pune I Commissionerate of Central Excise, engaged in leasing and hire purchase business, collected an amount of Rs.102.31 crore as interest charges, documentation fee and subvention charges on account of services provided in respect of hire purchase contracts during 16 July 2001 and 31 March 2003. Service tax of Rs.5.12 crore was not paid on the amount.

On this being pointed out (October 2003), the Ministry admitted the objection and intimated (October 2004) issue of show cause notice for Rs.5.23 crore in June 2004.

### *15.1.2 Clearing and forwarding agents services*

Services provided by clearing and forwarding agents are chargeable to service tax with effect from 16 July 1997 vide section 65(12) of Finance Act 1994 as amended by Finance Act, 1997. In the case of M/s. Prabhat Zarda Factory (India) Limited Vs. Commissioner of Central Excise, Patna {2002 (145) ELT 222}, the Tribunal held that procuring orders and passing them on to the principal for execution in lieu of commission was within the scope of services provided by clearing and forwarding agents even if goods were not directly dealt with by them.

Six assessees in Ahmedabad I, Kanpur I, Meerut I and Noida Commissionerates of Central Excise, received Rs.41.77 crore between April 1999 and March 2003 in lieu of commission from customers for rendering services on account of procurement/booking of orders for goods, distribution of goods etc. Such services were liable to service tax of Rs.2.09 crore which was not paid by them and were recoverable with interest and penalty equal to service tax.

On this being pointed out (between January 2003 and April 2004), the Ministry admitted the objection (August and October 2004).

## 15.2 Escapement of service tax

Rule 4 of the Service Tax Rules, 1994 stipulates that every person liable for paying service tax shall make an application in the prescribed form to the concerned Central Excise Officer

for registration within a period of thirty days from the date on which service tax under section 66 of the Finance Act, 1994 is levied, or within 30 days from the commencement of his business. Rule 7 provides for submission of half yearly return by the assessee whereupon the tax is assessed by the Central Excise Officer. Sections 75A, 76 and 77 of the Finance Act, 1994 prescribe levy of penalties for failure to register, to pay service tax, or to furnish prescribed returns respectively.

(a) Test check of records of M/s. CEAT Limited in Mumbai and Nasik Commissionerates of Central Excise, and scrutiny of income tax assessment order for the assessment year 1999-2000 revealed payment of Rs.8.22 crore to M/s. RPG Enterprises Limited, Mumbai for providing management consultancy services by the latter. Service tax of Rs.41.12 lakh due thereon was not paid. Since details of total amount charged, service tax deposited or returns filed by M/s. RPG Enterprises were not available, audit requested (January 2003) the Department to ascertain them.

On this being pointed out (December 2003), the Ministry admitted the objection and stated (August 2004) that a SCN for Rs.4.90 crore had been issued.

(b) Test check of records in Delhi II Commissionerate of Central Excise, revealed that M/s. Nirulas Corner House (P) Limited engaged in providing management consultancy and technical assistance to its franchises was not registered with the Department. The consultant collected service charges of Rs.7.62 crore from clients during 1999-2000 to 2002-03 on which service tax of Rs.38.08 lakh was payable. The Department had not taken any action to realise the same.

On this being pointed out (September 2003), the Ministry admitted the objection and stated (September 2004) that SCN for the amount had been issued.

## 15.3 Non-levy of service tax on services rendered by foreigners

Rule 6 of Service Tax Rules, 1994, provides that where a person liable to pay service tax is a non-resident or is from outside India, such person or any other person authorised by him, shall pay it by demand draft alongwith the return prescribed within 30 days from the date of raising bill on the client, to the Commissioner of Central Excise in whose jurisdiction the taxable service has been rendered.

The Finance Act, 1994, and the Service Tax Rules, 1994, do not provide for a mechanism to effect recovery in cases where no other person in India is authorised such by the service provider. There is no provision either for deducting tax at source before making payment to the service provider.

(a) Test check of records of M/s. Jindal Steel and Power Limited, Raigarh in Raipur Commissionerate of Central Excise, revealed (December 2003) that the assessee received services of consulting engineer and management consultancy from M/s. NKK Japan and paid service charges of Rs.24.23 crore between April 2000 and August 2002. As services were rendered in India service tax amounting to Rs.1.21 crore was leviable but the same was not done.

On this being pointed out (December 2003), the Ministry confirmed the facts (October 2004).

(b) Test check of records in Delhi II Commissionerate of Central Excise, revealed that M/s. Denso India Limited received management consultancy services from foreign

consultants and paid service charges of Rs.3.76 crore during 2001-02. Since the said services were rendered in India, service tax amounting to Rs.18.80 lakh was leviable. However, no service tax was recovered and paid to the Government.

On this being pointed out (January 2004), the Ministry admitted the objection (October 2004).

## 15.4 Non-recovery of service tax

Under the Finance Act, 1994, service tax is payable by the service provider. Service tax on services rendered by 'transport operators' has been levied with effect from 16 November 1997. Service Tax Rules provided for recovery of service tax from the recipients of services. The Supreme Court in case of Laghu Udyog Bharti {1999 (112) ELT 365 (SC)} ruled that the recipients of services cannot be made liable to pay service tax and that the Service Tax Rules made in this regard are ultra vires the Finance Act, 1994. The Finance Act, 1994, was amended with retrospective effect vide section 117 of the Finance Act, 2000 to provide service tax recovery from the recipient of the service from 16 November 1997 to 1 June 1998.

Test check of records of thirteen assessees in Chennai I, II, III, Coimbatore, Mumbai I, IV, Trichy and Tirunelveli Commissionerates of Central Excise revealed that they did not pay service tax of Rs.67.26 lakh on freight charges paid to goods transport operators during the period from 16 November 1997 to 1 June 1998. No action was taken by the Department for recovery.

On this being pointed out (December 2000 and July 2003), the Ministry stated (July and November 2004) that amount of Rs.21.30 lakh had been recovered from eight assessees and demand for Rs.20.74 lakh had been raised in the remaining five.

## 15.5 Non-realisation of interest on delayed payment of service tax

Rule 6(4) of the Service Tax Rules, 1994, stipulates that for provisional assessment of service tax, the rules pertinent to Central Excise Rules, 1944 (now Central Excise Rules, 2002) would apply. Rule 7 of the Central Excise Rules, 2002 provides that Assistant Commissioner or Deputy Commissioner shall pass an order for final assessment as soon as the relevant information for finalising the provisional assessment is available but within a period not exceeding six months from the date of order making the provisional assessment. Rule also provides for levy of interest on the amount payable to Central Government consequent on order for final assessment. Section 75 of the Finance Act, 1994, provides for levy of interest for delayed payment of service tax.

M/s. United India Insurance Company Limited, Chennai in Chennai II Commissionerate of Central Excise, was allowed provisional payment of tax for the year 2000-01. The final service tax return was filed by the assessee on 7 January 2002 showing short payment of tax of Rs.1.97 crore which the assessee paid on that date. However, the interest due for the delayed payment of service tax was not realised by the Department till April 2003.

On this being pointed out (April 2003), the Ministry admitted the objection and stated (September 2004) that the assessment for the period from April 1994 to March 2003 had been finalised confirming demand of Rs.2.06 crore (interest Rs.1.76 crore and tax Rs.0.30 crore).

## 15.6 Incorrect adjustment of service tax

Sub rule (3) of rule 6 of the Service Tax Rules, 1994, provides that where an assessee has paid to the credit of Central Government service tax in respect of a taxable service which is not so provided by him either wholly or partially for any reason, the assessee may adjust the excess service tax so paid by him against his service tax liability for the subsequent period, if he has refunded the value of taxable service and the service tax thereon to the person from whom it was received.

Test check of records of M/s. Spice Communication Limited, in Chandigarh Commissionerate of Central Excise, revealed that assessee had paid service tax of Rs.209.09 lakh as against Rs.218.02 lakh payable for the period from April to September 1999. The balance amount of Rs.8.93 lakh was shown as adjustment on account of service tax already paid. However details relating to adjustment were not on record. Such an adjustment was therefore incorrect.

On this being pointed out (February 2001), the Ministry admitted the objection (December 2004).

## 15.7 Other cases

In 26 other cases of non-levy of service tax, the Ministry/the Department had accepted objections involving tax of Rs.1.14 crore and reported recovery of Rs.25.99 lakh in 21 cases till January 2005.

**New Delhi** **(MINAKSHI GHOSE)**
**Dated : 29 March 2005** **Principal Director (Indirect Taxes)**

**Countersigned**

**New Delhi** **(VIJAYENDRA N. KAUL)**
**Dated : 29 March 2005** **Comptroller and Auditor General of India**