OVERVIEW

This report is presented in three sections: -

Section 1	**Chapters I and II**	**Central Excise**
Section 2	**Chapter III**	**Service Tax**
Section 3	**Chapters IV, V and VI**	**Customs**

SECTION 1 – CENTRAL EXCISE

This section contains two reviews:-

1. Excise duty on aluminium, copper and articles thereof

The audit review has revealed a few systems as well as compliance deficiencies.

The payment of duty through cenvat rather than by cash is excessive in the aluminium and copper sectors indicating possible misuse of cenvat credit facility. This is an area of concern, which the Ministry needs to address, after investigating the reasons for such excessive cenvat credit use by these sectors and include this criterion as a risk factor for investigation/internal audit of manufacturers.

Further, by not bringing certain products under the RSP based assessment, the Government lost an opportunity to reduce the risk of undervaluation and transaction cost of the duty.

Additionally, in the absence of standard input-output norms for the domestic industry, the risk of suppression of production has not been adequately mitigated. The Government may consider fixing standard input-output norms for domestic production on the lines of SION for exports. Any significant fluctuation in actual production from these norms should act as a trigger for further detailed investigation/internal audit.

Duty on 'aluminium dross' was not levied/recovered, despite it being brought under the excise tariff for levy of duty. To ensure collection of applicable duty on 'dross', the Government may consider inserting an appropriate chapter/section note to deem the process of dross production as 'manufacture'.

The total additional revenue which could come to the Government, as a result of this audit intervention (review) is Rs. 62.57 crore. Of this, observations with money value of Rs. 12.42 crore have been accepted (till October 2007) by the department and Rs. 4.68 crore recovered.

2. Refunds

The audit review has revealed a number of system as well as compliance weaknesses.

Internal controls for mitigating the risk of splitting up of claims to avoid pre-audit and consequential higher risk of incorrect grant of rebates/refunds, were conspicuous by their absence due to the specific manner of submission of rebate/refund claims with respect to periodicity, causative transaction, revenue threshold, etc. not being prescribed. The Government, therefore, needs to prescribe the specific manner of submission of claims for rebate/refund of duty which could be aligned with the manner of payment of duty/returns that are generally monthly. This would ensure that the claims beyond a particular limit are necessarily subjected to the prescribed internal controls.

The Government may consider providing statutory time limit for disposal of refund cases and devise an effective monitoring mechanism to ensure that the additional liability for payment of interest is not accrued because of delays in disposal of refund cases. Additionally, in view of the fact that provisions in the Act exist for the payment of interest in cases where refunds are delayed beyond three months, mechanism including automated ones should be introduced to ensure that the interest is actually paid to the assessees, wherever due.

The tendency of the department to sanction rebate claims without a re-verification through port of export even on a small scale is indicative of weak control mechanism to ensure payment of rebate claims only in cases of genuine exports. To mitigate the risk of payment of rebate in cases of fraudulent exports, the Board may consider fixing a selective percentage of exports for re-verification from the actual port of exports and ensure that these checks are exercised.

The concept of different rates of interest on delayed payment of duty and its refunds is not in the interest of fairness and transparency. There is a need for these rates of interest to converge.

The additional revenue which would accrue to the Government because of this audit intervention (review) is Rs. 16.36 crore.

SECTION 2 – SERVICE TAX

This section contains a review:-

3. Service tax on rent-a-cab scheme operators' services, photography services and health club and fitness centre services

The audit review has revealed a few systems as well as compliance deficiencies.

The internal control mechanism existing in the department to bring unregistered service providers into tax net were ineffective and inadequate. Key performance indicators (KPIs) like minimum surveys to be conducted by a commissionerate to identify potential assessees were not prescribed, in the absence of which their performance could not be evaluated. Consequently, a large number of active unregistered service providers were escaping from the service tax net and audit could identify 8,394 of these, with actual service tax of Rs. 34.04 crore and further an estimated service tax leakage of Rs. 27.91 crore. (This is approximately 37 per cent of the total revenue collected from these services).

Further, the procedure for conducting survey needs to be streamlined to collect information about potential assessees from various sources including from income tax department. In all the cases identified by audit, of service providers who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by these service providers and take appropriate action.

Additionally, inter-governmental and inter-departmental coordination and control mechanism to ensure that only registered assessees provide services and pay applicable tax, needs to be strengthened, which would mitigate the risk of evasion of tax by service providers to the Government sector, who do not voluntarily register.

Decline in revenue from selected services in a few commisionerates, despite increase in tax base needs to be investigated and mechanism put in place to ensure that the decline is not due to evasion.

Further, internal controls to detect and take proactive action against 'stop filers' were ineffective and resulted in evasion of revenue of Rs. 31.27 crore. The department needs to devise an effective mechanism to detect 'stop-filers' in time and collect government revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.

Internal control mechanism to verify the correctness of returns filed was inadequate and ineffective and audit noticed several cases of short levy of service tax and evasion of service tax by suppression of value of services.

To address the cause of these irregularities, the Board may consider putting in place a mechanism for checking/verification of returns. This checking may be reinforced by detailed scrutiny of a few selected cases. The selection of the cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records, etc.

Correlation of income tax data and service tax data is an important key factor for correct evaluation of service tax liability. Allotment of PAN based service tax codes (STC) numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.

The Ministry agreed (December 2007) with all the recommendations included in the review.

The total additional revenue which could come to the Government as a result of this audit intervention (review) is Rs. 158.94 crore.

SECTION 3 - CUSTOMS

This section contains three reviews:-

4. Promotional measures

The audit review of the three duty free credit entitlement schemes for (i) status holders, (ii) service providers and (iii) vishesh krishi upaj yojana (VKUY) revealed system as well as compliance weaknesses relating to issue of duty credit certificates/scrips and in ensuring their appropriate utilisation.

There was no mechanism to correlate declared export performance/foreign exchange earnings with other statutory records like annual accounts, foreign inward remittance certificate (FIRC), bank realisation certificate (BRC), income tax (IT) returns, etc. This facilitated issue of excess duty credit certificates/scrips. The Government may prescribe additional documents like annual accounts to be verified before tax benefits based on export performance are granted.

The inappropriate use of duty credit certificates/scrips subsequent to these being issued related to (i) cases where end-use of the goods imported under the certificates was not verified, (ii) payment of additional duty incorrectly through the certificates, (iii) payment of duty through the credit certificates/scrips despite having insufficient credit, (iv) import of inadmissible goods, etc.

There is an urgent need to put in place control mechanisms to plug the loopholes/lapses pointed out in the cases discussed in the review. Further, the existing controls to verify data furnished by exporters to obtain duty free benefits should be strengthened. The Ministry of Commerce in coordination with the Ministry of Finance needs to strengthen the internal controls governing issue of duty credit certificates/scrips under DFCE/SFIS/VKUY as well as those relating to subsequent utilisation of these credit certificates/scrips, to ensure that the benefits derived by the importers/exporters are the intended ones and commensurate with the duty foregone.

The duty credit incorrectly granted/used in the deficiencies noticed in the test check by audit was Rs. 349.67 crore. The Government needs to recover the applicable duty foregone wherever these credits had already been utilised inappropriately, in addition to initiating appropriate penal actions.

5. Target plus scheme (TPS)

The audit review has revealed system as well as compliance weaknesses relating to issue of duty credit certificates and ensuring their appropriate utilisation. The main cause of the irregularities noticed in audit is the complete reliance of the scheme on the declarations furnished by exporters and certified by the CAs for grant of TPS certificates. The non-correlation of these declarations with other statutory documents like annual accounts, BRCs and IT returns, was a risk area which was left unmitigated by the department. The Ministry may consider prescribing additional documents (like P&L A/c, IT returns, etc.) to be verified before arriving at the trade benefits to be provided to the exporters under other existing or future similar schemes, where tax benefits are given based on export performance. This would mitigate the risk of obtaining of benefits fraudulently under the FTP/schemes.

The revenue implication of this review is Rs. 294.95 crore and this amount needs to be recovered/certificates withdrawn/amended.

6. Special economic zones (SEZs)

The audit review has revealed system as well as compliance weaknesses relating to policy and procedures governing the management and functioning of SEZ units in ensuring that these functioned as intended.

There was no restriction on 'deemed exports' being reckoned as exports enabling the units to attain positive net foreign exchange earning (NFE) predominantly through deemed exports rather than actual exports. The Government may consider restricting reckoning of deemed exports for the purpose of calculating NFE by an appropriate scale.

The units under domestic tariff area (DTA) were put under disadvantageous position as no provision had been made to recover duty foregone on inputs procured by the SEZ units and used in the manufacture of products which were cleared at 'nil' rate of duty in DTA. The Government needs to address this disparity to ensure a level playing field for the units in the DTA as well as in the SEZ.

The SEZ scheme relies mainly on self-certification and does not require the 'quarterly/annual performance reports (QPRs/APRs)' to be supported by other statutory documents like annual accounts, customs records, income tax (IT) returns, bank realisation certificates (BRC), etc. This facilitated a few units to provide incorrect/inconsistent data in their QPRs/APRs. The NFEs derived on the basis of this inconsistent data cannot be relied upon. The Government needs to address this concern.

While the revenue implication of this audit review is Rs. 246.72 crore, an additional Rs. 1,724.67 crore was foregone or could not be recovered in the absence of enabling provisions.