CHAPTER I
EXCISE DUTY ON ALUMINIUM, COPPER AND ARTICLES THEREOF

Executive Summary

A review of 118 units manufacturing aluminium, copper and articles thereof was conducted in audit to evaluate whether the valuation rules, cenvat credit rules, existing instructions and orders of the department relating to the manufacture, classification and service tax on services provided/received by these manufacturers were complied with, in addition to verifying whether internal controls existing within the department were adequate to ensure appropriate assessment, collection and allocation of duties from these manufacturers.

Audit review has revealed a few system as well as compliance weaknesses relating to the assessment and collection of duty from the aluminium and copper sector. The payment of duty through cenvat rather than by cash is excessive 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 (cenvat to PLA ratio) 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. A few compliance issues like non-payment of duty on manufactured goods including aluminium dross, undervaluation, incorrect availing of and use of cenvat credit, incorrect classification and non-payment of service tax, incorrect exemption, irregular imports, etc. were also noticed.

The irregularities discussed in this report can easily go undetected due to ineffective internal control mechanism relating to valuation, classification, verification of end use based exemptions, procedures of payment of duty, cenvat procedures, exports/imports and ineffective internal audit (as none of these irregularities pointed out by the external audit, were detected by internal audit/preventive wing etc.). The Government, therefore, needs to take appropriate steps in respect of the existing internal control mechanism in order to ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.

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 already recovered.

Specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report.

1.1 Highlights

System issues:-

- **The percentage of cenvat to duty paid in cash was exceptionally high in aluminium and copper industry indicating possible misuse of cenvat facility, to the detriment of revenue. The Government needs to investigate the reasons and plug loopholes to address this risk.**

(Paragraph 1.6.1)

- **Government did not bring in certain aluminium products under RSP based assessment, despite their suitability. Consequently, the Government lost an opportunity to mitigate the risk of undervaluation and transaction cost of the tax.**

(Paragraph 1.6.2)

- **Standard input-output norms are not prescribed for domestic production, in the absence of which the risk of suppression of production and consequent revenue leakage has not been fully 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.**

(Paragraph 1.6.3)

Compliance issues:-

- **Duty of Rs. 10.62 crore on 'aluminium dross' was not levied/recovered, despite it being brought under the excise tariff for levy of duty.**

(Paragraph 1.7.1.1)

- **Undervaluation of goods due to non-inclusion of additional considerations resulted in revenue loss of Rs. 2.45 crore.**

(Paragraphs 1.7.2.1 and 1.7.2.2)

- **A revenue loss of Rs. 13.44 crore was noticed due to undervaluation in cases relating to captive consumption of goods.**

(Paragraph 1.7.2.3)

- **In 78 cases the assessees had availed of cenvat credit of Rs. 14.64 crore incorrectly.**

(Paragraph 1.7.4)

- **Rs. 1.76 crore of duty was not recovered from three assessees for violating applicable conditions relating to exports/imports.**

(Paragraph 1.7.6)

- **Rs. 8.50 crore of service tax on account 'construction services' and 'business auxiliary services' was not levied and recovered from two manufactures of aluminium.**

(Paragraphs 1.7.7.1 and 1.7.7.2)

1.2 Introduction

'Aluminium and its articles' is one of the twenty commodities yielding major revenue (Rs. 1,272.92 crore) to the Government. The percentage share in the total collection of central excise receipts was 1.29 per cent during the year 2005-06. Aluminium and its articles are classified under chapter 76 of the Central Excise Tariff Act (CETA), 1985. Copper and its articles are classified under chapter 74 of CETA. The revenue earned under this chapter was Rs. 337.19 crore in 2005-06. From the budget 1999-2000, duty at the rate of 16 per cent was levied on both the commodities. There has been no change in the rate of duty since then. From 10 September 2004, education cess at the rate of 2 per cent of the duty is also leviable.

1.3. Audit objectives

Records of selected units manufacturing aluminium, copper and articles thereof and concerned departmental offices were scrutinised in audit to examine:-

- At macro level, adequacy of the provisions of the Act, Rules and instructions issued by the Ministry of Finance/Central Board of Excise and Customs (CBEC) in ensuring proper assessment, collection and allocation of revenue from these commodities and
- At micro level, to seek assurance that:-

(i) Records of the goods manufactured and cleared were properly maintained;

(ii) 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 and correctly classified;

(iii) Credit of duty paid on inputs/capital goods under cenvat was taken correctly;

(iv) Service tax on services provided/received by manufacturers were paid correctly; and

(v) Internal controls were effective to safeguard the interest of revenue.

1.4 Scope of audit

During 2006-07, duty paying units of aluminium and copper and articles thereof in 70 out of 93 commissionerates were 2068. Records of 118 manufacturing units as well as selected range offices for the period 2003-04 to 2006-07 (upto September 2006) were test checked in audit. The audit sample size was 5.71 per cent of the population size.

1.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in

October 2007 and an exit conference was conducted with the Ministry officials in November 2007. The conclusions and recommendations were acceptable and were agreed to by the Ministry to be referred to the policy wing, wherever appropriate. While the written response to the draft review from the Ministry has not been received, responses of the department, wherever received, have been incorporated appropriately.

AUDIT FINDINGS AND RECOMMENDATIONS

1.6 System Issues

1.6.1 Excessive cenvat to PLA ratio in aluminium and copper sector

The amount of duty discharged by the assessee through cash payment by debiting an account current {Personal Ledger Account (PLA)} and by debiting cenvat credit account constitute the gross revenue under the central excise receipts of the Government. Under the cenvat scheme, subject to certain conditions, a manufacturer of final products while discharging the central excise duty on final products, can take credit for the excise duty/service tax paid on any inputs used in the manufacture of these final products. Thus, on the final products he needs to pay the duty in cash after adjusting any cenvat credits which the assessee may have in its account. In other words, only the value addition at each stage is taxed. Accordingly, in an ideal tax structure, the duty payment through cash would be more than the payment made through cenvat credit, given positive value additions at stages of manufacturing cycle and duty rates on final products not being lower than that on inputs.

The trend of revenue of central excise relating to aluminium and articles thereof (chapter 76) and copper and articles thereof (chapter 74) under 70 commissionerates is summarised in the following table:-

Table no. 1

Central excise revenue data relating to aluminium and copper

(Amounts in crore of rupees)

Commodity and chapter	Year	No. of units	Duty paid through PLA	Duty paid through cenvat	Total duty paid	Percentage of cenvat to PLA	All commodities percentage of cenvat to PLA
Aluminium and articles thereof (chapter 76)	2003-04	1110	552.77	1017.54	1570.31	184.08	73.34
	2004-05	1150	826.94	1186.24	2013.19	143.45	77.34
	2005-06	1188	982.18	1522.91	2505.09	155.05	86.34
	2006-07	1229	528.43	1213.20	1741.63	--	--
Copper and articles thereof (chapter 74)	2003-04	812	126.62	1168.38	1295.00	922.75	73.34
	2004-05	816	154.01	1630.95	1784.96	1058.99	77.34
	2005-06	831	210.88	2049.15	2260.03	971.71	86.34
	2006-07	839	114.67	1780.34	1895.01	--	--

Figures furnished by commissionerates. Figures for the year 2006-07 upto September 2006 only.

Audit observed that:-

- The percentage of cenvat availed of to duty paid in cash in respect of aluminium/copper and articles thereof had been consistently and significantly higher than the all India figures for all commodities.
- In Haldia and Ghaziabad commissionerates, percentage of cenvat to duty paid in cash in respect of aluminium and articles thereof during the year 2005-06 was as high as 1,587.70 per cent and 3,632.43 per cent, respectively.
- In Belapur and Bhavnagar commissionerates, percentage of cenvat to duty paid in cash in respect of copper and articles thereof during the year 2005-06 was also as high as 3,772.86 per cent and 13,799.46 per cent, respectively.

Thus, in the aluminium and copper sectors, audit has observed that duty payment through cash has been far less than the duty payment made through use of cenvat credit. The excessive use of cenvat credit indicates the likelihood of misuse of cenvat by these manufacturers. This is further elaborated by the fact that this audit review has identified Rs. 14.64 crore of cenvat credit which had been incorrectly used by these manufacturers. Even earlier, cases of Rs. 67.48 crore cenvat being incorrectly used by the manufacturers of these sectors, had been noticed by audit and pointed out through the Audit Reports 2003 to 2007 on Union Government-Indirect Taxes.

Recommendation

- *The Government should investigate/ascertain the exact reasons for such a high duty payment by cenvat rather than by cash in aluminium and copper sectors and based on such investigation (i) plug the loopholes to avoid misuse of cenvat by aluminium/copper sector; and (ii) incorporate cenvat to PLA ratio as a risk factor based on which internal audit/investigation of a unit should be undertaken.*

1.6.2 Risk of undervaluation not mitigated by resorting to 'Retail sale price' based assessment on certain products

Section 4A of the Central Excise Act, 1944, provides that any goods, in relation to which it is required, under the provisions of the Standards of Weights and Measures Act, 1976 or rules made under the Act or any other law for the time being in force, to declare on the package thereof the retail sale price of such goods, may be charged to duty with reference to retail sale price less such amount of abatement, if any, from such retail sale price as the Central Government may allow by a notification in the official gazette.

The undervaluation of assessable value of excisable goods not covered under MRP based assessments and consequent loss of revenue has been an area of constant concern and audit has been consistently identifying and recommending commodities to be brought under MRP based assessment to mitigate the risk of undervaluation. For instance, when undervaluation of 'soaps' was noticed by audit, it had recommended that this item should be subjected to levy of duty on the basis of MRP [paragraph 3.5(i) of the Audit

Report No. 11 of 1998 (Union Government – Indirect Taxes – Central Excise)]. Soap was subsequently brought under the MRP based assessment. More recently through paragraph 2.5 of Audit Report No. 11 of 2003, medicaments, light fittings, insecticides, compact discs were recommended for levy of duty on the basis of MRP, as undervaluation was noticed. Light fittings have since been brought under MRP based assessment.

Once a product is brought under RSP (section 4A) based assessment, the risk of undervaluation is reduced as the duty is based just on the declared RSP, abatement allowed and the duty rate. The Government has to date notified 99 commodities under this assessment system with abatement ranging between 28.5 per cent (toothbrush) to 50 per cent (mineral water and panmasala).

M/s Hindalco Industries Ltd., Silvassa, in Vapi commissionerate, engaged in the manufacture of branded aluminium foil falling under tariff heading 760719.91 cleared goods in packed form in different sizes and weights. Since the commodity was covered under the provisions of the Standards of Weights and Measures Act/Rules, the assessee had displayed retail sale price on each package.

Test check of records revealed that the assessable value on which the duty was being paid under section 4 was significantly lower than assessable value notionally arrived at under MRP after allowing a maximum 50 per cent abatement on it. On an average, the assessable value under section 4 was noticed to be approximately 33 per cent lower than what would have been the assessable value, had the same been determined under section 4A. The assessable value on which duty was paid ranged between 30 to 42 per cent of the declared MRP/RSP.

Non-coverage of this commodity under section 4A has, therefore, resulted into revenue being foregone to the extent of Rs. 7.65 crore during the period from 2003-04 to 2006-07 (upto September 2006) in one unit alone. The overall revenue foregone due to non-coverage of aluminium foil across the country would be quite significant.

Recommendations

- *To check against undervaluation of aluminium foils and consequent revenue loss, the Government needs to bring this commodity under RSP based assessment (Section 4A).*
- *The Government should strengthen the internal control mechanism existing in the department, through which they monitor the suitability/desirability of a product which could be brought under RSP based assessment. This would (i) mitigate the risk of undervaluation, (ii) ease administration of duty and (iii) mobilise due resources.*

1.6.3 Need for assigning input-output norms to act as a benchmark against suppression of production

Section 37(2) (v) of the Central Excise Act, 1944, empowers the Government to make rules to regulate the production or manufacture of excisable goods. In the erstwhile Central Excise Rules, 1944, the department was empowered to

fix input-output norms. But in the revised Central Excise Rules, 2002, no such provisions have been made. Standard input-output norms have not been prescribed for domestic production on the pattern of standard input-output norms (SION) fixed by 'Director General of Foreign Trade' for export items.

M/s L. Madanlal (Aluminium) Ltd. and M/s Premier Metal Products (Unit II), Howrah in Kolkata II commissionerate are engaged in the manufacture of aluminium notch bars, shots, ingots on job work basis as well as on their own account. They entered into agreements with M/s Indian Aluminium Company Ltd. for conversion of aluminium swarf[1] and scalping[2] into ingot[3] on job charges. In terms of each agreement, normal melting loss of five per cent was to be allowed and in case the actual melting loss was more than five per cent, a deduction from job charges for loss in excess of five per cent was to be made. A test check of their accounts revealed that while the melting loss did not exceed five per cent at any time during the period from 2003-04 to 2005-06 in respect of goods manufactured on job work basis, melting loss shown by the job workers in their books of accounts for the manufacture of same goods on their own account was 7.66, 18.56 and 10.10 per cent respectively. The probability of suppression of production by inflating melting losses as high as 18.56 per cent, therefore, cannot be ruled out in these cases.

While the local conditions and various other factors can effect the volume of production of a commodity, if some indicative input-output norms are prescribed for domestic industry as well, this can act as a benchmark against which the actual production could be measured, and in cases of extreme variations, should trigger a detailed investigation/internal audit.

Recommendation

- *In order to mitigate the risk of suppression of production and consequent revenue leakage, 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.*

1.7 Compliance issues

1.7.1 Manufacture

1.7.1.1 Non-recovery of excise duty on 'aluminium dross'

Section 2(d) of the Central Excise Act, 1944, defines 'excisable goods' as goods specified in the first schedule and the second schedule to the Central Excise Tariff Act, 1985 (5 of 1986) as being subject to a duty of excise.

Aluminium dross[4] and skimming[5] are by-products arising during the course of manufacture of aluminium ingots. Aluminium dross is sold extensively in India and the percentage of recovery of aluminium from aluminium dross

[1] Shavings and chippings of metal.
[2] Machining the surface layer from ingots.
[3] Mass of metal that results from casting molten aluminium into a mould.
[4] The scum that forms on the surface of molten metal as a result of oxidation.
[5] Metal bearing waste arising from smelting and refining of metals

ranges upto 84 per cent. For want of appropriate and distinct entry of aluminium dross in the Central Excise Tariff, this commodity was not subject to a duty of excise till 28 February 2005. On 28 February 2005, the Government inserted a separate and distinct entry of 'aluminium dross' under tariff item 262040.10 in chapter 26, subjecting it to excise duty from that date.

Test check of the records of five units of M/s Hindalco Industries and M/s Balco in Bhubaneswar II, Belapur, Vapi, Raipur and Allahabad commisionerates revealed that they have been selling aluminium dross, grade-wise, at different prices to various buyers. However, the assessees did not pay excise duty on aluminium dross even after 28 February 2005, when it was made excisable. The department also did not initiate any action for recovery of excise duty from these manufacturers. Non-recovery of excise duty on 'aluminium dross' in respect of these five units alone during the period from 1 March 2005 to 30 September 2006 amounted to Rs.10.62 crore.

Non-recovery of excise duty on aluminium dross at geographically dispersed commissionerates even after being notified under the tariff is indicative of weak internal control mechanism to ensure taxing of a particular commodity.

Recommendation

- *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'.*

1.7.1.2 Short accounting of manufactured products

Rule 10 of the Central Excise Rules, 2002, provides that every assessee shall maintain proper records on daily basis, of goods produced or manufactured, quantity received, assessable value and duty paid. Further, rule 4 of the above Rules, stipulates that 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 in the Act/Rules.

(i) Scrutiny of annual stock verification report of M/s Hindustan Copper Ltd., Khetrinagar, in Jaipur II commissionerate, revealed that there were substantial shortages of finished products. These shortages were adjusted in the books of accounts by reducing their closing balance, without assigning any reason. The assessee did not pay and the department did not demand duty of Rs. 33.41 lakh on such shortages.

On this being pointed out (December 2004), the demand for Rs. 33.41 lakh alongwith equal penalty of Rs. 33.41 lakh was confirmed (November 2006) by the department.

(ii) Test check of records of M/s Hindustan Copper Complex Ltd., Ghatshila, in Jamshedpur commissionerate, engaged in the manufacture of copper and articles of copper revealed that 199.706 MT of copper cathodes was short accounted for in their excise records during the year 2001-02. This resulted in non-levy of central excise duty to the extent of Rs. 31.96 lakh on the finished goods not accounted for.

On this being pointed out (March 2004), the department issued (August 2005) a SCN[6] for recovery of duty of Rs. 31.96 lakh, in addition to applicable interest.

1.7.2 Valuation

1.7.2.1 Exclusion of retained sales tax from transaction value

Section 4(3)(d) of the Central Excise Act, stipulates that transaction value of goods chargeable to central excise duty would not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

The Board in their circular dated 30 June 2000, clarified that the words 'actually payable' meant that if tax deferred at the time of transaction was subsequently held as not payable, deduction from the assessable value was not admissible. CEGAT, in the case of M/s Andhra Oxygen Pvt. Ltd. vs. CCE (Tribunal-Kolkata) {2003 (156) 239} held that sales tax collected from buyers and not paid to the sales tax department when it was exempted under the Sales Tax Act, shall be considered as additional consideration flowing to assessees.

(i) M/s Manaksia Ltd. and M/s Versatile Wire Ltd., in Bolpur and Kolkata VII commissionerates respectively, were exempted from the payment of sales tax under section 41 of West Bengal Sales Tax Act, 1994. The sales tax to the extent of Rs. 5.47 crore and Rs. 1.22 crore respectively collected from the buyers during July 2000 to September 2006 was retained by the assessees. This resulted in non-payment of duty to the extent of Rs. 88.61 lakh and Rs. 19.53 lakh respectively on the amount so collected and retained by them.

(ii) M/s Century Extrusions Ltd., in Haldia commissionerate, opted for payment of deferred sales tax under section 40 of the West Bengal Sales Tax Act, 1994. The assessee had accumulated Rs. 3.94 crore representing sales tax by way of collection from buyers during the period from 2000-01 to 2003-04. By paying sales tax liability of Rs. 80 lakh during 2000-01 to 2003-04, they had retained Rs. 3.14 crore under this scheme, which constituted as additional consideration.

This resulted in non-payment of duty to the extent of Rs. 50.24 lakh on the residual amount so collected and retained by the assessee.

1.7.2.2 Other cases of undervaluation

Test check of records revealed that in 16 other cases, there was undervaluation due to non-inclusion of additional considerations resulting in non-payment of duty totalling Rs. 86.90 lakh. Out of this Rs. 14.45 lakh has since been recovered at the instance of audit.

1.7.2.3 Undervaluation of goods captively consumed

Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that where excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in manufacture

[6] Show cause notice

of other articles, assessable value shall be 115 per cent (110 per cent from 5 August 2003) of the cost of production of such goods.

(i) M/s Hindustan Copper Ltd., in Jamshedpur commissionerate, engaged in the manufacture of copper cathode, cleared products to its sister unit for captive consumption at a price on London Metal Exchange rate which was lower than the value arrived at by cost construction method i.e. 115 per cent/110 per cent of cost of production. This resulted in short payment of duty of Rs. 12.79 crore during the period from 2004-05 to 2005-06.

(ii) M/s Manaksia Ltd., in Bolpur commissionerate, engaged in the manufacture of aluminium ingots/sheets, notch bar[7], etc. cleared these products to their sister units for captive use in the manufacture of other articles. Test check of their records revealed that duty was paid by the assessee, at the assessable value arrived at on cost basis without loading 10 per cent on the cost of production, as provided for in the rules. This resulted in undervaluation of goods by Rs. 4.03 crore and consequent short payment of duty of Rs. 64.70 lakh during the period from 2003-04 to 2005-06.

1.7.3 Incorrect classification

Notification dated 1 March 2003 exempts tableware, kitchenware, and household articles falling under heading 76.15 from the whole of excise duty leviable.

Scrutiny of the records of M/s Hindalco Industries Ltd., Silvassa, in Vapi commissionerate, revealed that they had manufactured small aluminium containers for packing of edible items mainly supplied in trains, aeroplanes, buses and by hotel industries etc. and cleared these as casserole (kitchenware) under chapter heading 76.15 for availing exemption from duty. Under explanatory notes in Harmonised Commodity Description and Coding System (HSN) below chapter sub-heading 76.15, aluminium containers are to be classified under chapter sub heading 76.12 as collapsible tabular container. The incorrect classification has resulted in non-levy of duty amounting to Rs. 2.69 crore during the period from April 2003 to March 2006.

1.7.4 Cenvat credit

Under the cenvat scheme, credit is allowed for duty paid on 'specified inputs' and 'specified capital goods' used in the manufacture of finished goods. Credit can be utilised towards payment of duty on finished goods subject to fulfilment of certain conditions. A few cases of incorrect availing of cenvat credit to the extent of Rs. 14.64 crore, were noticed in cases test checked in audit. Some of these are elucidated in the following paragraphs:-

1.7.4.1 Irregular availing of cenvat credit on imported goods

Rule 3(1) of the Cenvat Credit Rules, 2004, stipulates that a manufacturer shall be allowed to take credit for additional duty leviable under section 3 of the Customs Tariff Act paid on any inputs on the receipt of such inputs in the factory manufacturing the final product.

[7] Small size ingot with notches to facilitate breakage for melting.

(i) M/s Metal Link Alloys Ltd., in Daman commissionerate, imported brass scrap, tin ingots, etc. under 'Duty Exemption Entitlement Certificate (DEEC)', where customs as well as countervailing duty were exempt. Although no countervailing duty was paid by the assessee, he incorrectly availed of cenvat credit of Rs. 2.30 crore on these goods.

On this being pointed out (August 2006), the department intimated (October 2006) recovery of Rs. 2.30 crore alongwith interest of Rs. 5.17 lakh.

(ii) M/s Havells India Ltd., in Jaipur I commissionerate, imported goods under the Export Promotion Capital Goods (EPCG) and DEEC schemes during the month of October 2005 and March 2006 respectively, on which no countervailing duty was paid. The assessee, however, availed of cenvat credit of Rs. 42.26 lakh and Rs. 18 lakh on the goods so imported respectively, which was irregular and needs to be recovered.

1.7.4.2 Incorrect grant of cenvat credit under the DEPB scheme

As per the Export and Import Policy 2002-07, cenvat credit on additional customs duty paid through debit under DEPB was not admissible. In the context of this policy, it was held in case of M/s Deepak Spinners Ltd., {2005 (184) ELT 161 (T- Delhi)} by the Customs, Excise and Service Tax Appellate Tribunal (CESTAT), New Delhi that cenvat credit for countervailing duty (CVD) could not be availed of unless it was paid in cash. Mere debit in the 'Duty Entitlement Pass Book (DEPB)' was not sufficient for availing of cenvat credit. However, in terms of the Foreign Trade Policy, 2004-09, which came into effect on 1 April 2005, cenvat credit on additional customs duty/excise duty paid through debit under DEPB has also been allowed.

Scrutiny of the records of M/s Manaksia Ltd., (Unit III), in Bolpur commissionerate, revealed that they had availed of cenvat credit of Rs. 62.28 lakh against CVD debited in DEPB during the period from April 2003 to March 2005. Since the duty was not paid in cash, availing of credit was incorrect and needs to be recovered.

1.7.4.3 Non-reversal of credit on inputs written off

Rule 3 of the Cenvat Credit Rules, 2004, provides that the manufacturer or producer of the final product shall be allowed to take credit for specified duty paid on the inputs received in the factory for use in or in relation to the manufacture of final product. The Board vide circular dated 16 July 2002 clarified that if inputs, spare parts and components etc. were fully written off, credit availed of would be reversed.

M/s Hindustan Copper Ltd., Ghatshila, in Jamshedpur commissionerate, engaged in the manufacture of copper articles had written off inputs, components and spare parts amounting to Rs. 7.51 crore during the period 2004-05 to 2005-06. The assessee, however, did not reverse the cenvat credit of Rs. 1.20 crore availed on these written off items, as required in terms of Board's circular, above. The credit needs to be reversed/recovered.

1.7.4.4 Excess cenvat credit availed on imported raw material

Rule 14 of the Cenvat Credit Rules, 2004, provides that the cenvat credit taken or utilised wrongly shall be recovered alongwith interest from the manufacturers.

M/s Hindustan Copper Ltd., Khetrinagar, in Jaipur I commissionerate, availed of cenvat credit on the quantity of imported raw materials as shown in the bill of entry (BE) instead of the actual quantity of raw material received in the factory during the period April 2005 to September 2006. This resulted in excess availing of cenvat credit to the extent of Rs. 48.28 lakh which was recoverable alongwith interest of Rs. 5.36 lakh.

On this being pointed out (January 2007), the department intimated reversing of cenvat credit of Rs. 28.89 lakh. Action taken for the recovery of the balance amount is awaited (September 2007).

1.7.4.5 Irregular availing of cenvat credit on unspecified capital goods

Rule 2(a) of the Cenvat Credit Rules, 2004, stipulates that cenvat credit on capital goods is admissible only on specified capital goods used in the factory.

M/s Sterlite Industries (India) Ltd., in Tirunelveli commissionerate, manufacturing copper anodes availed of cenvat credit of Rs. 31.57 lakh on unspecified capital goods during the period from March 2005 to April 2005.

On this being pointed out (September 2005), the department issued (June 2006) a SCN for Rs. 49.19 lakh.

1.7.4.6 Input used in manufacture of exempted final products

Rule 6(1) of the Cenvat Credit Rules, 2004, stipulates that cenvat credit should not be allowed on such quantity of inputs which is used in the manufacture of exempted goods. Further, rule 6(3) (b) of rules above stipulates that the manufacturer availing of cenvat credit on inputs used in the exempted goods shall pay an amount equal to ten per cent of the total price excluding sales tax and other taxes, if any, paid on such goods, of the exempted final product charged by the manufacture for sale of such goods at the time of their clearance.

(i) M/s Madras Aluminium Company Ltd., Metturdam in Salem commissionerate, generated electricity by using inputs on which cenvat credit was taken. Since part of the electricity so generated was sold to the Tamilnadu Electricity Board, the assessee was required to pay Rs. 3.32 crore as duty on sale price of exempted final product (Electricity).

(ii) M/s Sterlite Industries (I) Ltd., Silvasa, in Vapi commissionerate, used inputs (furnace oil), on which cenvat credit was taken, for manufacture of exempted as well as dutiable goods, during the period from 23 May 2005 to September 2006. The assessee was required to pay Rs. 28.37 lakh as duty on sale price of exempted goods.

1.7.4.7 Incorrect availing of cenvat credit on service tax on input services

Rule 6(1) of Cenvat Credit Rules, 2004, provides that cenvat credit shall not be allowed on such quantity of input service which is used in the manufacture of exempted goods.

M/s Sterlite Industries India Ltd., in Tirunelveli commissionerate, availed of cenvat credit of Rs. 77.42 lakh on input services which were used in the manufacture of phosphoric acid. Since phosphoric acid so produced was cleared (during the period from November 2004 to October 2005) to fertiliser

manufacturing companies without payment of duty, availing of cenvat credit of Rs. 77.42 lakh was not correct.

On this being pointed out (September 2006), the amount of Rs. 77.42 lakh was reversed (January 2007) by the assessee.

1.7.4.8 Other cases

Sixty nine other cases were noticed in audit where cenvat credit on inputs/capital goods/service tax of Rs. 4.74 crore was incorrectly availed of. Of this, Rs. 66.90 lakh has been recovered.

1.7.5 Exemptions

Notification dated 28 August 1995 as amended from time to time allows a manufacturer to clear excisable goods without payment of duty to a project financed by the Asian Development Bank, provided a certificate from the project implementing authority, duly countersigned by principal secretary of the State Government concerned is obtained. Thus, this exemption is based on end use.

M/s Sterlite Industries (I) Ltd., Silvassa, in Vapi commissionerate, had obtained an appropriate certificate for clearance of conductors to a project funded by the Asian Development Bank and executed by the 'Gujarat Electricity Board'. The certificate allowed clearance of maximum quantity of 3,674 kilometres of conductors (i.e. 50 per cent of the total quantity required for this project) without payment of duty. A scrutiny of the records of the assessee, however, revealed that he had cleared 7,347 kilometres of conductors without payment of duty as against the permissible quantity of 3,674 kilometres for which no revised certificate by the competent authority was issued. This resulted in non-levy of duty to the extent of Rs. 85.03 lakh.

1.7.6 Export

1.7.6.1 Non-payment of duty on goods cleared for export but found short

Notification dated 26 June 2001 as amended from time to time stipulates that in case of shortages noticed, the exporter shall discharge the duty liability on the shortage noticed alongwith twenty four per cent interest thereon.

Scrutiny of the records of M/s NALCO, Angul, in Bhubaneswar I commissionerate, revealed that there were shortages of finished goods lying at the stockyard of the port office for exports during the period from 2003-04 to 2005-06. Even though insurance claim of Rs. 2.08 crore on account of these shortages was claimed by the assessee, applicable excise duty amounting to Rs. 33.20 lakh alongwith interest was not paid by it.

1.7.6.2 Non-levy of duty for non-return of warehousing certificates within due time

Rule 20(l) of the Central Excise Rules, 2002, provides that the Central Government may, by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse or from one

warehouse to another without payment of duty. Further, CBEC vide circular dated 26 June 2001 stipulated that the consignor should receive the duplicate copy of the warehousing certificate, duly endorsed by the consignee, within ninety days of the removal of the goods. If the warehouse certificate is not received within ninety days of the removal or such extended period as the commissioner may allow, the consignor shall pay appropriate duty leviable on such goods.

M/s Hindalco Industries Ltd., in Kolkata II commissionerate, engaged in the manufacture of rolled aluminium sheets, coil etc. had removed some excisable goods to a warehouse without payment of duty under the rules above. Scrutiny of their records revealed that the warehousing certificates were not received by the assessee during the period 2004-05 to 2005-06 even after the expiry of two years. The assessee had also not applied to the jurisdictional commissioner of central excise for extension of time. He was, therefore, required to pay excise duty including education cess to the extent of Rs. 27.16 lakh on the excisable goods in respect of which warehousing certificates were not received.

1.7.6.3 Non-payment of customs and excise duty on goods imported in excess of value prescribed in advance license

Para 4.1 of Export and Import Policy, 2002-07, Volume-I provides that an advance licence shall be issued to allow duty free import of inputs, which are physically incorporated in the export products (making normal allowance for wastage). Further, paragraph 4.1.5 above stipulates that advance licence shall be issued in accordance with the policy and procedure in force on the date of issue of licence and shall be subject to fulfilment of time bound export obligations as may be specified.

M/s Alcobex Metals Ltd., Jodhpur, in Jaipur I commissionerate, engaged in the manufacture of articles of copper, was issued an advance licence dated 3 December 2003 by the Joint Director General Foreign Trade (JDGFT) for duty free import of goods valued at Rs. 9.29 crore with export obligation of Rs. 10.45 crore, based on the annual requirements furnished by the assessee. The validity of licence was 12 months from the date of issue.

Test check of the records of the assessee revealed that he had imported raw material of the value of Rs. 3.51 crore in excess of what was allowed in the licence. On an enquiry from the JDGFT, Jaipur in March 2007, it was revealed that no enhancement was made in original value fixed in advance licence. Since this excess import was in violation of the terms and conditions of the advance licence, the assessee was required to pay customs duty of Rs. 48.49 lakh and countervailing duty of Rs. 67.40 lakh including education cess.

The irregularity also indicates the weak coordination between the licensing authorities and customs and excise functionaries, in monitoring that the imports and exports conform to the prescribed conditions and obligations for ensuring quick recovery of applicable duties in the cases of default. Appropriate steps need to be taken to strengthen the mechanism.

1.7.7 Service tax

Scrutiny in audit revealed that some manufacturers of aluminium, copper and their articles had provided services to clients or received services, which fell under the definition of taxable services. The assessees did not, however, pay the applicable service tax. Lack of information regarding taxable services provided in the excise returns of manufacturers is likely to be a primary reason for non-detection of cases of non-payment of service tax by manufacturers. Some illustrative cases of non-payment of service tax noticed in cases test checked are mentioned in the following paragraphs: -

1.7.7.1 Non-payment of service tax on construction services

Service tax on construction service was levied with effect from 10 September 2004. Construction service means construction of new buildings or civil structures, repairs, alterations or restoration of or similar services in relation to building or civil structure for use of commerce or industry.

M/s S.P. Fabricators Pvt. Ltd., in Belapur commissionerate, is engaged in the manufacture of aluminium profiles doors/windows, etc. A test check of their records revealed that the assessee had also provided construction services as a part of composite contracts which included supply of material. The assessee had rendered such services of the value of Rs. 76.50 crore at Mumbai and Bangalore during the period from April 2005 to September 2006 on which due service tax of Rs. 7.19 crore was not paid.

On this being pointed out (April 2007), the department reported (July 2007) that a show cause notice for Rs.15.04 crore covering the period September 2004 to March 2007 was being issued and further intimated that the assessee has paid Rs. 30 lakh including interest as per its calculation. Further report on recovery of the balance amount has not been received (September 2007).

1.7.7.2 Business auxiliary services

Service Tax on business auxiliary services was levied with effect from 1 July 2003. The scope of business auxiliary services was expanded with effect from 10 September 2004 by including in its definition procurement of goods or services which are inputs for the client.

Test check of the records of M/s Hiren Aluminium Ltd., (Unit-I) Silvassa, in Vapi commissionerate, revealed that they had rendered service to their client by procuring aluminium ingots from M/s National Aluminium Company Ltd. (NALCO). The modus-operandi of the assessee was to place an order on M/s NALCO to deliver the goods direct to its client (consignee). The price charged by the assessee from its client also included the element of commission on account of procurement of goods. From the records of the assessee it was estimated that it had earned Rs. 12.30 crore during the period from September 2004 to September 2006 for rendering this service. The services provided by the assessee being in the nature of business auxiliary service, it was required to pay service tax to the extent of Rs. 1.31 crore.

On this being pointed out (November 2006), the department stated (March 2007) that actual amount of service tax for providing this service was being quantified.

1.7.7.3 Non-payment of service tax on the services provided by a foreign agency

Rule 2(i) (d) (iv) of the Service Tax Rules, 1994, as amended, provides that the person receiving taxable service would have to pay service tax, if the service provider was non-resident or was from outside India and did not have any office in India.

Scrutiny of records of M/s Hawkins Cookers Ltd., Jaunpur, in Allahabad commissionerate, revealed that they had paid Rs. 3.66 crore to a foreign agency for rendering services which were in the nature of 'clearing and forwarding agent's services'. Service tax amounting to Rs. 36.83 lakh was, however, not paid by the assessee in respect of payment to non-resident service provider.

1.7.7.4 Other cases of non-payment/short payment of service tax

Scrutiny of records of the manufacturers of aluminium, copper and their articles revealed that in 21 other cases, service tax of Rs. 44.67 lakh payable on various services provided by them was not paid.

On this being pointed out (April 2006), the department accepted (December 2006) the audit observation in six cases and recovered Rs. 15.21 lakh.

Recommendation

- *Since a large number of manufacturers are also providing services on which service tax is leviable, the Board may consider making necessary changes in the format of excise assessment returns of manufacturers to include information relating to taxable services provided by the manufacturers. This would act as an internal control mechanism for ensuring that the applicable service tax is also paid by the manufacturers.*

1.8 Ineffective internal controls

Under rule 6 of the Central Excise Rules, 2002, the assessee is required to follow self-assessment procedures. The departmental offices are inter-alia, responsible for ensuring the correctness of the assessments made by the assessees, issuing 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 controls, noticed during the course of the audit review are narrated below:-

1.8.1 Inaction of the department on defaults in payment of duty

Rule 8 of Central Excise Rules, 2002, provides that the duty on goods removed from the factory or the warehouse during a month shall be paid by the 5th day of the following month and for the month of March, by 31st day of March.

Further rule 8(3) above stipulates that if the assessee fails to pay the amount of duty by the due date, it shall be liable to pay interest at the rate specified under a notification for the period starting with the first day after the due date of

actual payment of the outstanding amount. If the assessee fails to pay the outstanding amount within 30 days from the due date or for the third time in a financial year, it shall forfeit the facility to pay the dues in instalments under this rule for a period of two months from the date of communication of orders or till such date on which all the dues are paid whichever is later. During this period the assessee is required to pay duty for each clearance through PLA. In the event of any failure, it shall be deemed that such goods have been cleared without the payment of duty and the assessee is liable to penalty not exceeding the amount of duty leviable or ten thousand rupees, whichever is greater.

M/s Indo Foil and Packaging, Korba, in Raipur commissionerate, engaged in the manufacture of aluminium foils and ingots, defaulted in the payment of duty on due dates on 5 occasions between March 2003 and September 2003. However, the department did not take any action for forfeiture of this facility and the assessee continued to utilise cenvat credit of Rs. 46.95 lakh from March 2003 to September 2003 and did not pay duty through PLA, which was irregular.

1.8.2 Other cases

Ten other cases involving short levy of interest amounting to Rs. 17.52 lakh on delayed payment of duty were also noticed. In one case the department accepted the audit observation and recovered Rs. 14,000 from the assessee.

1.8.3 Non-payment of interest on the finalisation of provisional assessment

Section 18(3) of the Customs Act, 1962, inserted with effect from 13 July 2006, stipulates that the importer shall be liable to pay interest on any amount payable to the Central Government, consequent to the final assessment order under sub-section (2) above, at the rate fixed by the Central Government from the first day of the month in which the duty is provisionally assessed till the date of payment.

M/s Hindalco Industries Ltd., Dahej, in Vadodara-II commissionerate, imported copper concentrate for which the duty was provisionally assessed during the period from January 2003 to July 2007. The duty leviable on the goods so imported from time to time was finally assessed after 13 July 2006, the date when section 18(3) was made applicable. While making payment of differential duty as per the final assessment, the assessee, however, did not pay interest under section 18(3) amounting to Rs. 4.68 crore.

The department did not take any action to recover the applicable interest from the assessee.

1.8.4 Non-payment of interest on differential duty

(i) Under section 1lAB of Central Excise Act, 1944, where any duty of excise has been short levied or short paid, the person who is liable to pay the duty shall, in addition to the duty, be liable to pay interest from the first day of

the month succeeding the month in which the duty ought to have been paid till the date of payment of such duty.

Scrutiny of the records of M/s Sterlite Industries (I) Ltd., Silvassa, in Vapi commissionerate, revealed that the assessee had paid differential duty on account of price variation of finished goods after considerable delay. It was, therefore, liable to pay interest from April 2004 to March 2005 and January 2006 to May 2006 on differential duty payment, which worked out to Rs. 16.61 lakh. The department, however, did not take any action for recovery of interest.

On this being pointed out (November 2005), the department accepted the audit observation (August 2006).

(ii) In three other cases, the department failed to recover interest under section 11AB amounting to Rs. 21.91 lakh.

1.8.5 Cases pending adjudication

Section 11A of Central Excise Act, 1944, stipulates that where SCNs had been issued, central excise officer was required to adjudicate those 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 15 commissionerates of central excise, adjudication of 308 SCNs issued to manufacturers of aluminium and articles thereof and copper and articles thereof involving revenue of Rs. 295.40 crore were pending for adjudication. Eighty four per cent of the cases constituting 56 per cent of the total revenue were more than a year old. Approximately 16 per cent of the cases, involving 44 per cent of the value of all outstanding cases, were pending adjudication for more than three years.

Despite the amendment brought in section 11A of the Act providing for fixing of a time limit for adjudication of demand notices, albeit with the qualification 'where it was possible to do so', the cases were yet to be finalised even after three years.

Recommendations

- *There is a need for close monitoring of the disposal of adjudication cases by the commissionerate/Board so that cases involving substantial amounts of revenue do not linger on beyond one year, as prescribed.*
- *The irregularities discussed from paragraph 1.7 to 1.8 of this report can easily go undetected due to ineffective internal control mechanism relating to valuation, classification, verification of end use based exemptions, procedures of payment of duty, cenvat procedures, exports/imports and ineffective internal audit (as none of these irregularities pointed out by the external audit, were detected by internal audit/preventive wing etc.). The Government, therefore, needs to take appropriate steps in respect of the existing internal control mechanism in order to ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.*

1.9 Conclusions

Audit review has revealed a few system as well as compliance weaknesses relating to the assessment and collection of duty from the aluminium and copper sector. The payment of duty through cenvat rather than by cash is excessive indicating possible misuse of cenvat credit facility. 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 compliance issues noticed related to issues like non-payment of duty on manufactured goods including aluminium dross, undervaluation, incorrect availing of and use of cenvat credit, incorrect classification and non-payment of service tax, incorrect exemption, irregular imports, etc. were also noticed.

The irregularities discussed in this report can easily go undetected due to ineffective internal control mechanism relating to valuation, classification, verification of end use based exemptions, procedures of payment of duty, cenvat procedures, exports/imports and ineffective internal audit (as none of these irregularities pointed out by the external audit, were detected by internal audit/preventive wing etc.). The Government, therefore, needs to take appropriate steps in respect of the existing internal control mechanism in order to ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.

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.

1.10 Summary of recommendations

- *The Government should investigate/ascertain the exact reasons for such a high duty payment by cenvat rather than by cash in aluminium and copper sectors and based on such investigation (i) plug the loopholes to avoid misuse of cenvat by aluminium/copper sector; and (ii) incorporate cenvat to PLA ratio as a risk factor based on which internal audit/investigation of a unit should be undertaken.*
- *To check against undervaluation of aluminium foils and consequent revenue loss, the Government needs to bring this commodity under RSP based assessment (section 4A).*
- *The Government should strengthen the internal control mechanism existing in the department, through which they monitor the suitability/desirability of a product which could be brought under RSP based assessment. This would (i) mitigate the risk of undervaluation, (ii) ease administration of duty and (iii) mobilise due resources.*
- *In order to mitigate the risk of suppression of production and consequent revenue leakage, 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.

- *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'.*
- *Since a large number of manufacturers are also providing services on which service tax is leviable, the Board may consider making necessary changes in the format of excise assessment returns of manufacturers to include information relating to taxable services provided by the manufacturers. This would act as an internal control mechanism for ensuring that the applicable service tax is also paid by the manufacturers.*
- *There is a need for close monitoring of the disposal of adjudication cases by the commissionerate/Board so that cases involving substantial amounts of revenue do not linger on beyond one year, as prescribed.*
- *The irregularities discussed in this report can easily go undetected due to ineffective internal control mechanism relating to valuation, classification, verification of end use based exemptions, procedures of payment of duty, cenvat procedures, exports/imports and ineffective internal audit (as none of these irregularities pointed out by the external audit, were detected by internal audit/preventive wing etc.). The Government, therefore, needs to take appropriate steps in respect of the existing internal control mechanism in order to ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.*

CHAPTER II
REFUNDS

Executive Summary

A review of the refund and rebate claims handled by 183 divisions in 83 out of the 93 commissionerates during the years 2003-04 to 2005-06 was conducted to evaluate (i) the adequacy of statutory provisions and instructions issued to mitigate the risk of irregular/erroneous refund causing revenue loss, (ii) performance of the department in disposal of these cases within the stipulated time so as to avoid payment of interest and (iii) adequacy and effectiveness of the internal control mechanism governing refunds for ensuring compliance to applicable rules and procedures.

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

There were 15,738 rebate cases involving refund of Rs. 451.88 crore in 33 commissionerates in which the amount was split up to avoid pre-audit.

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.

Additionally, the department had to incur additional expenditure of Rs. 10.67 crore by way of payment on account of interest due to delay in refunds. Liability of Rs. 40.33 crore of interest had also accrued due to delayed refunds in other cases.

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.

Specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report.

2.1 Highlights

- **In the absence of any prescribed norms, 15,738 rebate cases involving Rs. 451.88 crore were split up to avoid pre-audit.**

(Paragraph 2.6.1)

- **Interest amounting to Rs. 10.67 crore was paid in 96 cases of refunds/rebates due to delay in payment of refunds.**

(Paragraph 2.6.2)

- **Additional liability of interest of Rs. 40.33 crore had accrued in 12,126 cases due to delay in payment of refund/rebate claims.**

(Paragraph 2.6.3)

- **Claims of rebate of excise duty contained in goods exported were not verified through the port of exports even on a selective basis.**

(Paragraph 2.6.4)

- **Against the principles of fairness and transparency, the Government charges interest on delayed payment of duty at rates higher than what it pays on delayed refunds payable to the assessees.**

(Paragraph 2.6.5)

- **Contrary to the prescribed procedures, suo moto credit of Rs. 3.65 crore of duty/cenvat credit was taken in nine refund cases.**

(Paragraph 2.7.1)

- **Duty/cenvat credit of Rs. 15.07 crore was incorrectly sanctioned in 36 cases.**

(Paragraph 2.7.2)

- **In 74 cases, incorrect valuation of exported goods resulted in excess rebate of duty of Rs. 12.97 crore.**

(Paragraph 2.7.3.2)

2.2 Introduction

Section 11B of the Central Excise Act, 1944, provides that any person claiming refund of any duty of excise may make an application in prescribed form for refund of such duty before the expiry of one year from the relevant date and the application shall be accompanied by such documentary or other evidence as the applicant may furnish to establish that the amount of duty of

excise in relation to which such refund is claimed was collected from, or paid by him and the incidence of such duty has not been passed on by him to any other person.

'Refund' includes rebate of duty of excise paid on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India. Section 11BB of Central Excise Act, 1944, provides that interest at the specified rates is payable to the applicant, if the duty is not refunded within three months from the date of receipt of the application for such a refund.

2.3 Audit objectives

The review was conducted to assess:-

(i) the adequacy of statutory provisions and instructions issued to mitigate the risk of irregular/erroneous refunds causing revenue loss;

(ii) performance of the department in disposal of refund cases within the stipulated time so as to avoid payment of interest; and

(iii) adequacy and effectiveness of the internal control mechanism governing refunds for ensuring compliance with applicable rules and procedures.

2.4 Scope of audit

Claim files relating to refunds including rebates in 183 divisions operating under 83 out of 93 commissionerates, were test checked in audit. The period covered under audit review was from 2003-04 to 2005-06. During the period 4,64,986 of refunds including rebates were sanctioned by these commissionerates and involved an amount of Rs. 9,446.01 crore.

2.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in November 2007 and an exit conference was conducted with the Ministry officials in November 2007. The conclusions and recommendations were acceptable and were agreed to by the Ministry to be referred to the policy wing, wherever appropriate. While the written response to the draft review from the Ministry has not been received, responses of the department, wherever received, have been incorporated appropriately.

AUDIT FINDINGS AND RECOMMENDATIONS

2.6 System issues

2.6.1 Absence of internal controls to mitigate the risk of avoiding pre-audit

In terms of the prescribed procedures, all refund claims involving rupees five lakh or more are to be pre-audited at the level of the jurisdictional

commissioner. Claims for amounts exceeding Rs. 50,000 but below rupees five lakh are to be compulsorily audited after the payment. Claims for amounts below Rs. 50,000 were to be post audited, selectively.

Further, the Board after analysing certain fraudulent rebate claims on forged documents, had observed (December 2004) that one of the reasons for these irregularities was that "the rebate claims for the same exporter were sanctioned for an aggregate amount exceeding rupees five lakh on a single day by restricting individual claims to below rupees five lakh to circumvent the requirement of pre-audit of rebate claims exceeding rupees five lakh. These cases were not taken even for post-audit." Accordingly, the Board had reiterated its instructions for scrupulous observance of the procedures for pre-audit and post-audit of refund/rebate claims. The Government has, however, not prescribed any periodicity, duration, transaction or amount based thresholds required to apply for a refund claim.

Scrutiny of rebate cases in a few selected divisions revealed that in the absence of such norms, the assessees had split up the claims so that each individual claim was kept below rupees five lakh, notwithstanding the fact that all these claims were in respect of goods exported on the same day under the same shipping bill. The avoidance of pre-audit not only contravenes the instructions of the Board but also increases the probability of excess grant of rebate with consequent loss to revenue.

The synopsis of refund/rebate cases relating to the same day and where the amounts were split below rupees five lakh is mentioned in the following table:-

Table no. 1

(Amounts in crore of rupees)

No. of commissionerates	Period	No. of cases after splitting up the amount	Total amount involved
33	2003-04	3907	107.92
	2004-05	4749	148.55
	2005-06	7082	195.41
	Total	**15738**	**451.88**

A few illustrative cases are mentioned in the succeeding paragraphs:-

(i) M/s Ranbaxy Labs Ltd., in Chandigarh commissionerate, submitted rebate claims amounting to Rs. 2.58 crore during the period from 2004-05 to 2005-06 by splitting up the amounts of rebate claims pertaining to the same days so as to keep each individual claim below rupees five lakh. Accordingly, these claims were not subjected to pre-audit. Subsequently, the internal audit department had pointed out the excess payment of rebate of Rs. 14.43 lakh in the course of post-audit of these rebate claims.

(ii) M/s FCI OEN Connectors Ltd., in Cochin commissionerate, filed a rebate claim for Rs. 35.13 lakh with the assistant commissioner, central excise division in April 2005. The assistant commissioner submitted the refund claim to the commissioner for pre-audit as the amount of claim had exceeded rupees five lakh. The commissioner on 5 August 2005 directed the assistant

commissioner to settle the claim in relaxation of the restriction for pre-audit of claim exceeding rupees five lakh as one time measure. The assistant commissioner accordingly sanctioned the rebate claim in August 2005 for an aggregate amount of Rs. 35.13 lakh in a single day. The action of the commissioner not to pre-audit the claim and sending back the case to the assistant commissioner for disposal was in contravention of the instructions of the Board, as the commissioner had no discretion in the matter.

(iii) M/s Andhra Organics Ltd., in Visakhapatnam I commissionerate, submitted 20 rebate claims aggregating Rs. 57.58 lakh on a single day viz. 4 April 2005, the amount of each claim being less than rupees five lakh. The entire amount of Rs. 57.58 lakh was sanctioned vide one order-in-original in a single day on 7 April 2005.

The reply of most of the divisional officers to the observations of audit in this regard was that there was nothing in the rules/instructions to prevent the assessee to present each claim of less than rupees five lakh.

Recommendation

- *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 refund/rebate 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.*

2.6.2 Absence of time limit for disposal of refunds resulting in payment of interest

Section 11BB of the Central Excise Act, 1944, provides that if any duty ordered to be refunded, is not refunded within three months from the date of receipt of application, interest at the prescribed rate would also be paid from the date immediately after the expiry of three months from the date of receipt of such application till the date of payment. The Board vide its circulars dated 2 January 2002, 1 October 2002 and 8 December 2004 issued strict instructions for payment of refunds/rebates/pre-deposits within a period of three months. Further, the Board instructed the commissioners to devise a suitable mechanism to ensure timely disposal of refund/rebate cases. However, the Act/Rules do not prescribe a time limit for disposal of refund cases.

It was noticed in audit that despite executive instructions of the department for payment of refund within a period of three months and for fixing of responsibility for delays, the department had to pay interest of Rs. 10.67 crore due to delay in grant of refunds in 96 cases.

The main cause of the delayed payments of refunds in these cases appears to be absence of statutory provisions prescribing a time limit for disposal of refund cases.

A few illustrative cases are mentioned in the succeeding paragraphs:-

(i) M/s Rourkela Steel Plant, in Bhubaneswar II commissionerate, applied for a refund of Rs. 12.49 crore on 26 September 1996. The refund claim was sanctioned on 1 September 1997 i.e. after almost a year. Subsequently, the assessee made an application on 6 October 1997 claiming interest on delayed refund. On rejection of his application, the assessee filed an appeal with the Commissioner (Appeals), who allowed the appeal with relief on 21 May 2004 on the ground that the refund application was complete in all respects on 17 October 1996. The department had to ultimately pay interest of Rs. 94.73 lakh on 27 March 2006 for delay beyond three months.

The delay on the part of the department in sanctioning refund despite the application for refund being complete in all respects resulted in payment of Rs. 94.73 lakh on account of interest.

(ii) The Bombay High Court in a judgement in the case of M/s Suvidhe Ltd. Vs. UOI {1996 (82) ELT 177 (Bom.)}, which was confirmed by the Supreme Court, held that the amount of pre-deposit in excess of the duty payable was bound to be refunded without the assessee having to file a claim for refund.

M/s Nestle India Ltd., in Mysore commissionerate, had paid rupees seven crore as pre-deposit in terms of the Commissioner (Appeals) order dated 16 September 1997. On confirmation of the demand for Rs. 6.23 crore, in a de novo proceeding on 28 December 1999, the assessee requested for a refund of balance amount of Rs. 77.10 lakh on 28 March 2000. The assistant commissioner of central excise, however, asked the assessee on 7 April 2000 to file a regular claim under section 11 of the Act. On a writ petition by the assessee for refund of pre-deposit, the High Court of Karnataka, applying the ratio of the judgement of the Bomaby High Court directed the department on 7 March 2003 to refund the amount of Rs. 77.10 lakh alongwith interest at the rate of fifteen per cent from the date of the order till the date of payment.

The insistence of the department on the assessee filing a regular claim in spite of a settled law resulted in payment of additional amount of Rs. 37.96 lakh by way of interest, in addition to the loss of Rs. 10,000 being costs awarded for litigation.

(iii) M/s Gillette India Ltd., Duracell Division, in Delhi III commissionerate, filed (27 February 2000 to 7 June 2000) a rebate claim of Rs. 2.80 crore relating to exported goods alongwith relevant documents. Although all the documents were complete, the deputy commissioner sanctioned the rebate claim of Rs. 2.80 crore only in January 2001. However, the applicable interest on account of the delay in payment of rebate was not paid. On an appeal by the assessee, the CESTAT, New Delhi transferred the appeal to the Ministry of Finance, Department of Revenue for appropriate consideration. Since the claim was complete in all respects at the time of its submission, the Ministry of Finance remanded the case to the Commissioner (Appeals) and instructed that the responsibility for delay may also be fixed. The department had to pay interest of Rs. 36.96 lakh additionally in January 2006 due to its failure in sanctioning refund within three months. The responsibility for the delay in payment of refund, however, had not been fixed.

On this being pointed out (June 2006), the department stated (April 2007) that an enquiry to fix the responsibility for causing delay in payment of refund claim was being conducted.

2.6.3 Refund/rebate claims delayed beyond three months attracting the additional liability of interest

The Board vide its circulars dated 2 January 2002 and 10 October 2002 clarified that while all necessary action should be taken to ensure that no interest liability was attracted, should the liability arise the legal provision for payment of interest be scrupulously followed. The commissioners were also asked to devise a suitable mechanism to ensure timely disposal of refund/rebate cases.

Test check of the records revealed that in 12,126 cases the refunds including pre-deposits and rebates were not sanctioned within three months and this entailed an interest liability of Rs. 40.33 crore. While interest in these cases had not yet been paid, the Government have created an additional liability of Rs. 40.33 crore on account of interest in terms of provisions of section 11BB of the Central Excise Act, by delaying payment of refunds beyond three months. The delay in sanctioning refund beyond three months ranged from three days upto nine years. The delays in payment of refunds need to be addressed through prescribing an automated system.

A few illustrative cases are mentioned in the succeeding paragraphs:-

(i) M/s Maruti Udyog Ltd., in Delhi III commissionerate, filed (between May 1998 and July 2004) refund claims of pre-deposit/modvat credit duty paid under protest in 10 cases amounting to Rs. 28.63 crore. The department refunded the duty of Rs. 28.63 crore between December 2002 and October 2004 but did not pay interest for the delayed period beyond three months. There was delay in sanctioning refund claims ranging from five months to more than five years which resulted in creation of Rs. 14.19 crore as interest liability to the Government.

The reply of the department to the audit observations in general was that the assessee had not claimed interest and accordingly interest had not been paid.

(ii) CESTAT vide order dated 18 May 2005 ordered for refund of rupees one crore to M/s Modern Denim, in Ahmedabad II commissionerate. In terms of the circular dated 8 December 2004, pre-deposit of rupees one crore was to be refunded by the department within three months of the orders of CESTAT unless stay was granted by a superior court.

However, on the specific orders of the commissioner, Ahmedabad to delay the payment, the refund was made only on 1 April 2006 after the close of the financial year. The department has incurred an interest liability of Rs. 8.01 lakh for the delay of beyond three months.

(iii) On the orders of CESTAT in September 2004, M/s Pasupati Spinning and Weaving Mills, in Gurgaon commissionerate, was sanctioned a refund of Rs. 17.97 lakh in March 2005. But the payment had not been made till the date of audit (February 2007) as the case was pending with the commissioner for pre-audit since the amount exceeded rupees five lakh. The delay of more

than two years in paying the refund has created a liability of Rs. 2.34 lakh as interest.

Recommendations

- *The Government may consider providing statutory time limit for disposal of refund cases.*
- *In spite of the instructions of the Board, the commissioners have failed to devise a suitable monitoring mechanism to ensure timely disposal of refund cases. The Board should, therefore, 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.*

2.6.4 Rebate claims not re-verified through port of export

The Board, while referring to instances of the fraudulent claims of rebate of duty on forged documents, instructed on 17 December 2004 that instructions issued by the Board from time to time regarding verification of rebate claim including details of payment of duty and proof of export may be strictly followed. The proof of export being the most important documents for claiming rebate, the commissionerate of central excise, Vadodara vide trade notice dated 21 January 2005 issued instructions for re-verification of at least five per cent of the proof of export through port of export in respect of rebate claims.

The status of re-verification of rebate claims through port of export relating to cases test checked in audit is mentioned in the following table:-

Table no. 2

(Amounts in crore of rupees)

No. of commissionerates	Rebate claim sanctioned		No. of cases where re-verification was made	
	No.	Amount	No.	Amount
9	2670	43.82	43	2.92

Audit observed that except for Vadodara I commissionerate, no other commissionerate has taken steps for re-verification of proof of export through the port of export. Further, 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.

Recommendation

- *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.

2.6.5 Differential rates of interest on delayed payment of duty and delayed refunds

Normally excise duty is payable by the 5th of the following month on clearance of goods in a particular month. For delayed payment of duty by the assessee, interest at the rate of thirteen per cent per annum is charged under section 11AB of the Central Excise Act, 1944. Similarly, under section 11DD of the Act, interest at the rate of fifteen per cent per annum is levied on the assessee for any amount collected in excess of the duty paid on excisable goods. These interests are charged from the first day of the month succeeding the month in which the amount ought to have been paid till the date of payment of duty.

However, where the duty paid to the Government is in excess and becomes due for refund to the assessee, and the refund is delayed by the Government beyond three months, interest under section 11BB of the Act at the rate of only six per cent per annum is paid.

The different rates of interest on delayed payment of duty and its refunds are violative of fairness and transparency. There is, therefore, a need for these rates of interest to converge.

Recommendation

- *The Government may consider amending the provisions of the Act/Rules to levy uniform rates of interest on delayed payment of duty as well as refunds to make the system fair both to the assessee and the Government*.

2.7 Compliance issues

2.7.1 Suo moto credit taken of the amount of duty/cenvat

Section 11B of the Central Excise Act, 1944, provides for claiming refund of the excise duty by making an application for refund before the expiry of one year from the relevant date. There is, however, no provision in the Central Excise Act/Rules under which suo moto credit of the excise duty/cenvat can be taken. The CESTAT in the cases of M/s Indian Oil Corp. Ltd. vs. Commissioner of Central Excise, New Delhi in its decision dated 27 January 2003 {2003 (153) ELT 355 (Tri. Delhi)} held that only course of action as provided for under section 11B was required to be taken in cases of refunds.

Audit noticed that in nine cases involving Rs. 3.65 crore, the assessees had irregularly taken credit in PLA/cenvat account without going through the legal process of claiming refund under section 11B. While this was violative of the existing procedures, the correctness of the refunds was also in doubt, not having been examined by the department as no claim was filed, examined and appropriate amount sanctioned subsequently. Additionally, the assessees benefited by way of immediate credit which became available to them for further use.

A case is illustrated below:-

On finalisation of the provisional assessment case, M/s Galerial India Ltd., in Chandigarh commissionerate, was entitled to the refund of Rs. 66.15 lakh on account of cenvat credit. The assessee, suo moto, took credit in their cenvat account on 27 September 2000 without following the procedure for claiming refund under section 11B.

On this being pointed out (October 2004), the department stated (November 2005) that credit was availed on the basis of the orders passed by the Tribunal. The reply of the department is not tenable as the Tribunal had held that Rs. 66.15 lakh on account of cenvat credit was payable. For payment of this amount, the department should have insisted on the assessee to follow proper procedure as envisaged in section 11B.

2.7.2 Disposal of refund claims

2.7.2.1 Cases of incorrect refunds

Test check of records revealed incorrect refund of duty of Rs. 8.43 crore in 24 cases. A few illustrative cases are mentioned in the succeeding paragraphs:

(i) In cases where the burden of duty has been passed on, the refunds are credited to the 'Consumer welfare fund (CWF)'. Rule 3 of the Consumer Welfare Fund Rules, 1992, stipulates that if any amount which has been credited to the fund is ordered subsequently as payable to any claimant, the amount will be paid from the fund.

M/s Ashok Leyland Ltd., in Nagpur commissionerate, was allowed refunds of Rs. 90.48 lakh and Rs. 45.53 lakh on 30 June 2003 and 11 December 2003 respectively by crediting these to CWF on ground of 'unjust enrichment'. The assessee went in appeal to the Commissioner (Appeals) who ordered the amounts to be refunded to the assessee on 28 November 2003. The amount of Rs. 90.48 lakh and Rs. 45.53 lakh was refunded to the assessee without debit to the CWF to which these amounts had already been credited earlier. Payment of refund to the assessee without debit to CWF apart from being incorrect, also resulted in extra burden on the exchequer to the extent of Rs. 1.36 crore.

(ii) M/s Pfizer Ltd., in Chandigarh commissionerate, was sanctioned a refund of Rs. 2.94 lakh, being the difference between the amount of pre-deposit (rupees two crore) made by the assessee and the amount of duty (Rs. 1.97 crore) confirmed and recoverable from the assessee. It was noticed in audit that while sanctioning the refund, Rs. 98 lakh on account of interest required to be paid by the assessee under section 11AB of the Central Excise Act for delayed payment of duty was not taken into consideration.

On this being pointed out in audit (September 2006), the department admitted the audit observation and stated (January 2007) that action to recover interest was being taken. Further progress in the case has not been intimated (October 2007).

(iii) Section 11B(2)(d) of the Central Excise Act, 1944, provides that the amount determined as refund would be paid to the applicant if it is relatable to

the excise duty paid by the manufacturer and if the incidence of such duty has not been passed on to any other person.

M/s Sarvesh Refractory, M/s Green Assam Cooperative (P) Ltd. and M/s Bausch and Lomb Eye Care (I) Ltd., in Bhubaneswar II, Dibrugarh and Jaipur II commissionerates, were sanctioned refund of Rs. 13.40 lakh, Rs. 9.08 lakh and Rs. 7.04 lakh on 26 March 2004, 2 February 2005 and 27 February 2006. Grant of refunds in these cases to the manufacturers was incorrect as the incidence of duty had already been passed on to the buyers. This resulted in incorrect refund of duty of Rs. 29.52 lakh in these cases.

2.7.2.2 Incorrect refund of cenvat credit

Rule 5 of the Cenvat Credit Rules, 2004, provides that a manufacturer or provider of output service may be allowed refund of cenvat credit in respect of input or input service used in the manufacture of exported goods, which could not be utilised for payment of duty of excise on final product cleared for home consumption or service on output service, subject to certain safeguards, conditions and limitations, as specified.

Test check of relevant records revealed incorrect refund of cenvat credit of Rs. 6.64 crore in 12 cases.

A few illustrative cases are mentioned in the succeeding paragraphs:-

(i) M/s FACT Ltd. (Petrochemical Division), in Cochin commissionerate, claimed a refund of Rs. 49.22 lakh of modvat credit and Rs. 32.26 lakh as interest on 19 March 1997 for goods exported under 'Value based advance licence (VABAL)'. On the claim being rejected by the department, the assessee went in appeal before the CEGAT. The CEGAT vide its order dated 10 February 2003 ordered examination of the case after verification of the records by a nominated cost accountant. Based on the cost accountant's certificate dated 29 March 2005, the department allowed (3 May 2006) a refund of Rs. 49.22 lakh of modvat credit and Rs. 24.51 lakh as interest. On scrutiny of the refund case in audit, it was observed that the cost accountant while giving the certificate, had not taken into consideration the fact that the assessee had not maintained prescribed separate accounts of credit taken on inputs utilised for manufacture of export products, or maintained price store ledger or RG 23A for the entire period covered under the refund claim, inter-alia. The cost accountant's certificate was, thus, not based on all relevant facts and the refund paid to the assessee was incorrect.

On this being pointed out (September 2006), the department issued (December 2006) a demand-cum-show cause notice for an amount of Rs. 73.73 lakh. Further progress in the case has not been received (October 2007).

(ii) M/s Kothari Ford and Frag Services, M/s Vysali Pharmaceuticals Ltd., M/s White Circle Oxide, in Kanpur, Visakhapatnam and Cochin commissionerates, were sanctioned refund of cenvat credit to the extent of Rs. 3.15 lakh, Rs. 7.22 lakh and Rs. 6.57 lakh, respectively. Test check of records revealed that these manufacturers were simultaneously manufacturing products for home consumption and the cenvat credit could have been utilised on payment of goods cleared for domestic market.

Failure to take into account the likely utilisation of cenvat credit for payment of duty on goods cleared for home consumption resulted in incorrect grant of rebate of cenvat credit of Rs. 16.94 lakh.

2.7.3 Rebate

2.7.3.1 Incorrect rebate

Section 11 B of the Central Excise Act, 1944 read with Chapter 8 Part V Paragraph 8.3 of CBEC's Central Excise Manual of Supplementary Instructions provides that while presenting the claim for rebate of duty paid on material used in the manufacture or processing of exported goods, all specified documents are to be presented alongwith the claim.

On scrutiny of the rebate claims filed by M/s Hindustan Latex Ltd., Thiruvananthapuram totalling Rs. 49.74 lakh, it was noticed that essential documents such as original copy of ARE-2 (application for removal of goods for export under the claim for rebate of duty paid on excisable material) duly endorsed by the customs officer and duplicate copy of the ARE-2 received from the customs officer in a sealed cover were not presented by the assessee alongwith the rebate claim. Although the prescribed documents were not presented, yet the rebate was sanctioned in January 2006. This resulted in grant of rebate of Rs. 49.74 lakh for the period from April 2003 to December 2005, the correctness and basis of which was not verifiable.

2.7.3.2 Incorrect valuation

(i) The Board's circular dated 3 February 2000 read with paragraph 8 of Chapter 8 of CBEC's Central Excise Manual of Supplementary Instructions provides that for the purpose of a rebate claim, the value would be 'transaction value' and conform to section 4 or section 4A of the Central Excise Act, 1944, as the case may be. Further, rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that the value of excisable goods will be the 'transaction value' and would exclude the cost of transportation from the place of removal upto the place of delivery of such excisable goods.

Scrutiny of the records revealed that in 74 cases, the manufacturers/exporters claimed and were granted excess rebate of duty totalling Rs. 12.97 crore by including the element of freight for arriving at the value of goods. The refund paid was Rs. 109.37 crore, whereas that actually payable after excluding the inadmissible freight was Rs. 96.40 crore.

A few illustrative cases are mentioned in the succeeding paragraphs:-

(i) Rule 8 and 9 of the Central Excise (Valuation) Rules, provide that where the goods are not sold but are used for consumption in the manufacture of other articles by the assessee or a related person, the value of the goods shall be 110 per cent of the cost of production or manufacture of such goods.

M/s FCI OEN Connectors Ltd., Mulanthuruthy, in Cochin commissionerate, exported their goods to their holding company and fellow subsidiary companies under claim for rebate. But the rebate on duty was claimed on invoice price instead of on the value determined under rule 8 (110 per cent of

the cost of production) of the Valuation Rules. Non-adoption of valuation on the basis of cost of production resulted in excess payment of rebate to the extent of Rs. 2.38 crore during the period April 2004 to March 2007.

(ii) M/s Ranbaxy Laboratories Ltd., in Chandigarh commissionerate, cleared goods namely 'Provastalin' for export under claim for rebate as well as in the domestic market. Test check of records revealed that whereas the value on which the rebate on duty was claimed was shown to be Rs. 41.40 lakh per kilogram, the transaction value for domestic clearance was rupees seven lakh per kilogram. The non-determination of the value of export goods as per the transaction value under section 4 resulted in excess rebate of Rs. 2.03 crore during the period 2003-04.

(iii) M/s J.K. Industries Ltd., Mettagalli, in Mysore commissionerate, was allowed rebate of Rs. 3.69 crore during the period August 2003 to June 2004 in seven cases. It was noticed that the value on which rebate of duty was granted also included the element of freight amounting to Rs. 96.37 lakh. The inclusion of freight element in the value of goods resulted in excess rebate of Rs. 23.12 lakh.

2.7.3.3 Rebate as well as exemption availed on exported goods

Two notifications, both dated 14 November 2002, allow refund of duty paid in cash, on goods manufactured and cleared on payment of duty from specified area i.e. Jammu and Kashmir. Another notification dated 26 June 2001, issued under rule 18, grants rebate of duty paid on excisable goods or duty paid on materials used in the manufacture or processing of such goods, on export out of the country, except for Nepal and Bhutan.

During the review of rebate claims of Jammu Division, in Chandigarh commissionerate, it was noticed that M/s Bharat Box (Unit I), M/s Jay Ambay Corporation and M/s Ind Swift Lab Ltd., were granted rebate of Rs. 1.29 crore during the period from 2005-06 to 2006-07 for export of goods. The amount of Rs. 1.29 crore paid in cash in PLA on account of these exported goods was also refunded to the manufacturers in terms of notification dated 14 November 2002, which was an area based exemption. This resulted in refund of the same amount of duty twice.

On this being pointed out (June 2007), the department issued (July 2007) show cause notices for duty of Rs. 1.27 crore to M/s Jay Ambay Corporation and M/s Ind Swift Lab Ltd. The show cause notice to M/s Bharat Box (Unit I) involving a rebate of Rs. 1.70 lakh was not issued as the period of one year has already lapsed.

2.7.3.4 Other cases of incorrect rebate

Test check of records revealed that in 54 other cases, incorrect rebates totalling Rs. 6.84 crore were granted by the department.

2.7.4 Irregular refunds despite claims being time barred

Notification dated 6 August 2003 provides that motor vehicles after clearance being registered for use solely as an ambulance or as a taxi are exempted from the payment of 'special excise duty (SED)'. However, while clearing the

goods, the manufacturer has to pay SED and is subsequently eligible for refund of SED after the vehicles have been registered for the above mentioned purposes. The manufacturer has to file a claim for refund of the said amount of duty before the expiry of six months from the date of payment of duty on the said motor vehicles, alongwith the required documents.

(i) Test check of records revealed that M/s Hindustan Motor Ltd. and M/s Honda Siela Car, in Chennai II and Noida commissionerates, had filed refund claims after the expiry of the prescribed period of six months after clearance. The time barred claims of Rs. 7.74 lakh and Rs. 2.33 lakh were sanctioned resulting in irregular refund of Rs. 10.07 lakh.

(ii) In 72 other cases of Delhi III and Noida commissionerates, irregular refunds of Rs. 21.37 lakh were made by the department where claim for the refund was filed after the prescribed period of six months from the clearance of the vehicles.

2.8 Other issues

2.8.1 Delay in scrutiny of refund/rebate cases by ranges

Paragraph 3.1 of Chapter 9 of CBEC's Central Excise Manual of Supplementary Instructions provides that the range officer should complete scrutiny of the refund claim within two weeks from the date of receipt of the claim and send the report to the concerned assistant/deputy commissioner of central excise.

In view of the provisions of section 11BB of the Central Excise Act providing for payment of interest for delay beyond three months, it is necessary to ensure that the preliminary scrutiny is completed in the range office within the stipulated period of two weeks. Any delay in scrutiny at the initial stage could lead to payment of interest by the Government to the assessee.

It was noticed that scrutiny of refund cases at the range level was delayed in 3,875 refunds cases out of 21,242 cases that were received (between April 2003 to March 2006) by 98 ranges in 29 commissionerates. The delay in scrutiny ranged from 22 to 345 days.

2.8.2 Amount of refund not credited into consumer welfare fund (CWF)

Section 11B (2) of the Central Excise Act, 1944 provides for whole or part of the duty of excise paid by the applicant to be credited to the CWF in cases where refund is not paid to the assessees on the ground that incidence of duty had been passed.

Further, the circular of the Board dated 17 January 1992 stipulates that the pay and accounts officer (PAO) of the concerned commissionerate will collect the sanction order from the concerned divisions issued during the month and draw a consolidated cheque/draft in favour of the controller of accounts, Ministry of Civil Supplies and Public Distribution, New Delhi and transfer the amount by the 10th of every month. The Ministry of Civil Supplies and Public Distribution manages this fund.

Scrutiny of refund/rebate records and information furnished by the PAO/department revealed that in 35 cases of 17 commissionerates refund of Rs. 27.96 crore which was required to be credited to the CWF had not been credited till the date of audit (February 2007). While in Kolkata commissionerate, Rs. 14.98 lakh sanctioned for crediting into consumer welfare fund in June 2005 was yet to be credited, in other cases the delays ranged between 1 to 42 months. The non-crediting of the refunds into CWF tantamount to inflation of the Government revenue to that extent.

2.8.3 Pre-audit/post-audit of refund/rebate claims not done/delayed

2.8.3.1 Pre-audit

Board's circulars dated 15 March 2002 and dated 1 March 2005 provide that all refund claims involving an amount of rupees five lakh or above should be subjected to pre-audit at the level of the jurisdictional commissioner.

The status of cases required to be pre-audited in divisions test checked is mentioned in the following table:-

Table no. 3

(Amounts in crore of rupees)

No. of commissionerates	No. of divisions	Period	Cases sent for pre-audit		Cases pending for pre-audit	
			No.	Amt.	No.	Amt.
11	23	April 2003 to March 2006	2782	71.66	717	12.91

It was noticed that:-

(a) More than one fourth of the cases were pending for pre-audit.

(b) In two Divisions of Mumbai III and Pune I commissionerates, 68 cases were pending for pre-audit beyond three months. Interest liability of Rs. 3.09 crore has accrued in these cases till April 2007.

(c) In some cases, refund claims exceeding rupees five lakh were sanctioned without pre-audit.

A few illustrative cases are mentioned in the following paragraphs:-

(i) M/s Kerala State Electricity Board (KSEB) filed an application for refund of Rs. 8.84 lakh in December 2003. The Deputy Commissioner, Kozhikode Division sanctioned the amount on 24 March 2004 even though it exceeded rupees five lakh and ought to have been pre-audited at the level of the commissioner.

(ii) Paragraph 8.1 of Chapter 9 of CBEC's Manual of Supplementary Instructions stipulates that in all cases of refund/rebate claims involving rupees five lakh or above which are subjected to pre-audit, a suitable order-in-original shall be passed by deputy/assistant commissioner. In four cases of refunds sanctioned during the period 2006-07 and involving aggregate amount of Rs. 1.02 crore, no order-in-original was issued by the assistant commissioner of Thrissur Division in Cochin commissionerate.

(iii) M/s IOC Ltd., Barauni, in Patna commissionerate, filed a refund claim of Rs. 25.32 lakh in December 2003. It was sanctioned by the deputy commissioner on 31 March 2004 even though the claim was required to be pre-audited at the level of the commissioner in terms of the instructions of the Board.

2.8.3.2 Post-audit

Board's circulars dated 15 March 2002 and 1 March 2005 provide that refund/rebate claims above Rs. 50,000 but below rupees five lakh should be subject to compulsory post-audit at the level of additional/joint commissioner (Audit). Further, the claim papers are to be sent for post-audit within a week and post-audit should be completed within three months.

The status of post-audit of refund cases in test checked divisions is mentioned in the following table:-

Table no. 4

(Amounts in crore of rupees)

No. of commissionerates	No. of divisions	Cases sent for post-audit		Cases pending for post-audit	
		Number	Amount	Number	Amount
21	44	21336	413.73	10285	165.74

It was noticed that:-

(i) Forty eight per cent of the cases had not been post-audited till the time (March 2007) of this review.

(ii) Seventy seven cases for the period from April 2003 to September 2006 were not sent for post-audit by Moovattupazha division in Cochin commissionerate.

2.9 Conclusions

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 refund/rebate claims with respect to periodicity, causative transaction, revenue threshold, etc. not being prescribed.

Statutory time limit for disposal of a refund case has not been prescribed. The department had to incur additional expenditure of Rs. 10.67 crore by way of payment on account of interest in 96 cases of delayed refunds. Additional liability of Rs. 40.33 crore of interest had also accrued due to delayed refunds in other cases.

The tendency of the department to sanction rebate claims without a re-verification through port of export even on a small scale indicated weak

control mechanism to ensure payment of rebate claims only in cases of genuine exports.

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.

2.10 Summary of recommendations

- *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.*
- *In spite of the instructions of the Board, the commissioners have failed to devise a suitable monitoring mechanism to ensure timely disposal of refund cases. The Board should, therefore, 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.*
- *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 Government may consider amending the provisions of the Act/Rules to levy uniform rates of interest on delayed payment of duty as well as refunds to make the system fair both to the assessee and the Government.*