# Chapter VII

# Effectiveness of Internal Controls

## 7.1 Introduction

Internal control is an integral process carried out by an entity's management and personnel which is designed to address risks and provides reasonable assurance that in pursuit of the entity's mission, the entity is achieving the following general objectives:

- executing orderly, ethical, economical, efficient and effective operations;
- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- safeguarding resources against loss, misuse and damage.[100]

## 7.2 Audit findings

During the course of examination of records, we observed certain cases where due processes were not followed by departmental officers. We communicated these observations to the Ministry through 34 audit paragraphs involving revenue of ₹ 32.76 crore. The Ministry accepted (December 2015) the audit observations in 22 audit paragraphs and initiated/completed corrective action in 18 cases involving revenue of ₹ 25.51 crore which are listed in Appendix III. The Ministry did'nt agree with 10 audit observations and yet to respond to two observations (December 2015). These 16 observations are covered under two major headings i.e. Internal Audit and other lapses.

## 7.3 Internal Audit

Internal audit is one of the main compliance verification mechanisms in the department. Internal audit teams carry out audit at assessee premises by following prescribed procedures for examination of records of the assessee to ascertain the level of compliance with the prescribed rules and regulations. Internal audit is authorised under the Central Excise Rules, 2002 to access the records of assessees at their registered premises. The Directorate General of Audit with its seven zonal units at Ahmedabad, Mumbai, Delhi, Bangalore, Kolkata, Chennai and Hyderabad is to provide a focal link between the Commissionerates (who actually implement the audit process) and the Board on all audit-related matters. On the one hand, it aids and advises the Board in policy formulation and on the other, it guides and provides functional direction in planning, co-ordination, supervision and conduct of audits at the

[100] INTOSAI GOV 9100 – Guidelines for Internal Control Standard for Public Sector

local level. Earlier, audit work was carried out by Commissionerate through audit cells, manned by an Assistant/ Deputy Commissioner and auditors and headed by an Additional/Joint Commissioner. Internal audit parties consisting of Superintendents and Inspectors carry out the audits. After restructuring of the department (August 2014), 45 exclusive Audit Commissionerates have been created to look after the audit work.

We sought to get an assurance whether internal audit of the asessees, due for audit was conducted by Commissionerates as per frequency norms prescribed by the Board.[101] We also tried to assess the quality of actual audit done by internal audit parties by verifying some assessee records already audited by internal audit parties. We came across certain instances of non-detection assessees' lapses by internal audit parties.

### 7.3.1 Non-conducting of internal audit resulting in lapse committed by the assessees remained unnoticed

We noticed 10 cases where internal audit was due but not conducted by the department. Ministry/department admitted observation in all cases and initiated/taken action in eight cases. These eight cases are detailed in appendix III. Remaining two cases are illustrated in following paragraphs :

#### 7.3.1.1 Non-detection of non-reversal of Cenvat credit in consequence to refund order

Rule 5 of Cenvat Credit Rules, 2004, allows refund of Cenvat credit of inputs and input services used in the manufacture of exported goods, if the adjustment of such credit is not possible for payment of Central Excise Duty or Service Tax by the manufacturer or the provider of output service.

M/s Lakshminarayana Mining Company, Siddapur Village, Bellary, a 100% Export Oriented Undertaking, in Belgaum Commissionerate had filed refund claim of ₹ 162.12 lakh during the period from April 2009 to June 2010 in respect of unutilized Cenvat credit on input services consumed for manufacture of exported goods. The department sanctioned (March 2010 and November 2012) refund of ₹ 86.81 lakh vide three different OIOs and rejected the remaining amount of ₹ 75.31 lakh, on the grounds that the assessee was not eligible to avail Cenvat credit of such services. On receipt of the said refund orders the assessee should have reversed the Cenvat credit in lieu of which refund was sanctioned. The assessee should also have reversed the Cenvat credit for the amount where refund order held credits as ineligible. However, verification of ER-2 returns revealed that the assessee did not reverse Cenvat credit of ₹ 162.12 lakh mentioned above. Though the

[101] Refer table 1.9 of chapter 1 of this report

statutory returns were filed regularly, the department did not take any action to ensure that the Cenvat credit had been reversed by the assessee.

It was also observed that no internal audit of the assessee was conducted by the department during 2010-11 to 2012-13.

When we pointed this out (March 2013), the department stated (June 2014) that the assessee reversed Cenvat credit of ₹ 86.81 lakh and exhibited the same in ER-2 returns for the month of April 2013. Department further stated (February 2015) that the assessee reversed the balance amount of ₹ 75.31 lakh and exhibited the same in ER-2 returns for the month of June 2013.

This non-reversal of ₹ 162.12 lakh would have gone unnoticed, had it not been pointed out by audit.

Ministry confirmed the reversal of credit of ₹ 162.12 lakh. For not conducting internal audit, it stated that audit could not be conducted due to manpower constraints.

Audit is of the opinion that Board should issue suitable instruction to field formations to ensure reversal of credit in such cases.

### 7.3.1.2 Non- detection of short levy of Central Excise duty

As per extant rules 9 and 10 of the Central Excise (Valuation) Rules 2000 (existed upto 30.11.2013), where excisable goods are not sold by an assessee except or through a related person which inter alia includes interconnected undertaking, the value of goods shall be the normal transaction value at which these are sold by the related person at the time of removal, to buyers (not being related person). Thereby, meaning that these rules were not applicable in case assessee sold goods partly to related buyers and partly to unrelated buyers.

Further, as per Clause (1) below section 4 (3) (b) of Central Excise Act 1944, interconnected undertaking are related for the purpose of valuation of Excisable goods. As per explanation 1 (ii) below section 4 (3) (b) of the Act, if Managing Director of one body corporate is Managing Director of the other, than both are deemed to be under same management and thereby they are interconnected.

The Tribunal in the case of Ispat Industries Limited Vs Commissioner of Central Excise, Raigarh, {2007 (209) ELT 185 (TriLB)} and Hon'ble Supreme Court in the case of Aquamall Water Solutions limited Vs Commissioner of Central Excise, [{006 (193) ELT A 197 (S.C.)} have also upheld that where goods are sold to a related person and partly to independent third parties, assessment should be on the basis of sale made to third party.

Rule 9 has been revised w.e.f. 1 April 2012 inserting 'where whole or part of excisable goods are sold by the assessee to or through a person who is related'.

M/s G R Multiflex Packaging Pvt Ltd. in Kolkata V Commissionerate, engaged in the manufacture of Plain Plastic Film etc. under Chapter 39 of Central Excise Tariff Act 1985, cleared Plain Plastic Fill to related party M/s G R Poly Film Pvt Ltd., both having a common Managing Director during the period 2011-12 and 2012-13. Further verification revealed that in some cases the price of the products transferred to related units, was lower than the price at which it was sold to other parties. This resulted in undervaluation of the products cleared to their related units and consequent short-levy of duty of ₹ 46.05 lakh (including cess) for the period 2011-12 and 2012-13 which was recoverable along with applicable interest.

Though the unit was a mandatory unit for internal audit, it was not audited since December 2010. Hence the assessee's lapse remained undetected until pointed out by us.

When we pointed this out (August 2013), the Assistant Commissioner (October 2014) intimated that Show Cause cum Demand Notice for ₹ 46.05 lakh covering the period of 2011-12 to 2012-13 along with applicable interest and penalty had been issued to the assessee.

Reply of the Ministry was awaited (December 2015).

### 7.3.2 Lapses not detected by Internal Audit

We detected 23 cases where audit of the assessee was conducted by the department but it failed to detect the defaults committed by the assessees. In 10 cases, Ministry admitted the lapses of internal audit and stated that instructions are being issued to the department to sensitise the audit parties. These cases are detailed in appendix III. Remaining 13 cases are illustrated in following paragraphs.

#### 7.3.2.1 Non-detection of irregular availing of Cenvat credit on Works Contract

As per Rule 2(l) of Cenvat Credit Rules 2004 "input service" means any services used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products up to the place of removal but excludes services as specified in Rule 2(l)(ii)(A),(B) and (C) viz. construction or execution of works contract of a building or a civil structure or a part thereof with effect from 1 April 2011.

M/s Fresenius KABI Oncology Ltd. under Kolkata III Commissionerate, engaged in the manufacture of Bulk drug viz. Irinotecan, aclitaxel, etc. under

chapter 29 of Central Excise Tariff Act 1985, availed input service credit of ₹ 23.26 lakh (including cess) for service tax paid on civil construction services rendered by M/s Power Max (India) Pvt. Ltd., Kolkata during the period 2011-12 and 2012-13 for civil structural and infrastructural works at Kalyani. Out of this total irregularly availed service credit, the assessee had already reversed ₹ 5.63 lakh (including cess) in February 2013, though such reversal was not shown in the ER-1 of the respective month. Thus, the remaining irregularly availed input service credit of ₹ 17.63 lakh (including cess) during the period 2011-12 and 2012-13 was recoverable from the assessee.

Though internal audit was carried out by the department in November 2013 covering the period August 2012 to July 2013, the lapse remained undetected until pointed out by CAG.

When we pointed this out (March 2014), Ministry stated (September 2015) that the assessee has reversed the amount of ₹ 17.63 lakh from their Cenvat account. On lapse of internal audit, Ministry stated that the issue was detected by internal audit in November 2013 and amount of ₹ 4.26 lakh was realised from the assessee.

Department, though detected lapse committed during August 2012 to July 2013 but failed to detect lapse for the prior period.

### 7.3.2.2 Non-detection of non-reversal of Cenvat credit on account of trading

According to Rule 6 (2) of Cenvat Credit Rules 2004, manufacturers or providers of output service availing Cenvat credit of any inputs or input services, and manufactures such final products or providing such output services which are chargeable to duty or tax as well as exempted goods or services, shall maintain separate accounts for receipt, consumption and inventory of inputs and input services and take Cenvat credit only on that quantity of input or input service which are intended for use in the manufacture of dutiable goods or in providing output service on which service tax is payable. Rule 6(3) states that the manufacturer or provider of output service, opting not to maintain separate accounts shall either pay an amount equal to five per cent (6 per cent up to 6 July 2009) of value of exempted goods and services; or pay an amount as determined under sub-rule (3A). As per explanation under Clause 2(iii) of Notification No.3/2011/CE dated 1 March 2011, exempted services include trading.

M/s Delphi Connection Systems Pvt. Ltd. Mulanthuruthy, in Cochin Commissionerate, was engaged in trading of goods in addition to manufacturing activity. The assessee had trading income of ₹ 7.14 crore and ₹ 17.93 crore during the years 2011-12 and 2012-13 respectively. The

assessee availed credit of inputs and input services but separate accounts were not maintained for receipt, issue and inventory of inputs and input services relating to exempted services. The assessee was liable to pay an amount of ₹ 34.69 lakh payable as per Rule 6(3).

Internal audit of the assessee was carried out in July 2013 covering the period up to June 2013, but the lapse detected by us was not pointed out.

When we pointed this out (January 2014), department replied (February 2015) that the assessee reversed amount of ₹ 34.73 lakh for the period April 2011 to March 2014 with interest of ₹ 16.35 lakh and penalty of ₹ 8.03 lakh.

Ministry also confirmed (October 2015) that assessee had reversed the credit. On lapse of internal audit, it stated that during preliminary walk through of the unit, the audit team understood that trading and manufacturing activities were dealt by the unit separately and the team centered on manufacturing activity only.

The reply is not tenable, as no verification of assessee's wrong claim was done by internal audit which resulted in non-detection of the lapse.

### 7.3.2.3 Non-detection of incorrect adoption of assessable value resulting in short payment of duty

Central Excise (Valuation) Rules, 2000 vide Rule 10 read with rule 8 and 9 stipulates that where excisable goods are sold by an assessee to an inter-connected undertaking for use or consumption of such goods in the production or manufacture of articles, the value shall be hundred and ten percent of the cost of production or manufacture of such goods as calculated in CAS-4 certificate. On belated payments if any, interest is payable as per section 11AA of Central Excise Act 1944.

M/s Lucas Indian Service Ltd., falling under Chennai II Commissionerate had adopted Purchase Order rate on the clearance of goods made during the years 2011-2014 to its holding company M/s Lucas TVS Ltd. The purchase order rate was less than one hundred and ten percent of the cost of production or manufacture of such goods. The non-adoption of correct assessable value on the clearances made to another inter-connected undertaking resulted in short payment of duty.

The internal audit of the unit was conducted in September 2013 but this aspect was not pointed out by them.

When we pointed this out (May 2014), the department replied (December 2014) that the assessee had paid the differential duty for the three years amounting to ₹ 17.55 lakh with interest of ₹ 5.90 lakh.

Ministry also confirmed (November 2015) the payment made by the assessee. It further stated that CAS-4 was not prepared for three years by the assessee at the time of internal audit and therefore, it could not calculate the differential duty.

The reply is not tenable as, even if CAS-4 certificate was not prepared by the assessee, the issue of non-preparation of CAS-4 certificate should have been raised by internal audit.

### 7.3.2.4 Non-detection of short payment of duty in respect of clearance made to related party

Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 stipulates that where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

Further, Rule 9 stipulates that "When the assessee so arranges that the excisable goods are not sold by an assessee except to or through a person who is related in the manner specified in either of sub clause (ii), (iii) or (iv) of clause (b) of sub section (3) of section 4 of the Act, the value of the goods shall be normal transaction value at which these are sold by the related person at the time of removal, to buyers (not being related); or where such goods are not sold to such buyers, to buyers (being related person) who sells such goods in retail, provided that in a case where the related person does not sell the goods but use or consumes such goods in the production or manufacture of articles, the value shall be determined in the manner specified in Rule 8 ibid, that is one hundred ten per cent of the cost of production of such goods.

M/s Sunshine Steel Industries, Jodhpur in Jodhpur Commissionerate (erstwhile Commissionerate Jaipur II), engaged in manufacture of SS Utensils and SS Cold Rolled Patta/Patti, cleared manufactured quantity 18.36 lakh Kgs of SS cold rolled Patta/Patti having assessable value of ₹ 12.24 crore to a related party M/s Ramdev Stainless Strips Pvt. Ltd., Jodhpur during 2012-13 and this manufactured product was not sold to any other party. The value of SS cold rolled Patta/Patti should have been determined at 110 per cent of the cost of production in terms of rules ibid. Since the assessee did not provide the cost of production i.e. CAS-4 certificate in respect of clearance made to sister concerned/related person Audit worked out the Short payment considering the invoice values to related party as cost of production amounted to ₹ 15.13 lakh which was required to be recovered along with interest.

Internal audit of the assessee was carried out by the department in October 2012 covering the period upto September 2012 but the lapse was not detected by it.

When we pointed this out (October 2014), the Commissionerate admitted the objection and stated (June 2015) that a Show Cause Notice was under process of issuance.

Ministry stated (December 2015) that the fact of partners being related to other firms/companies could not be ascertained from the documents provided to internal audit party. However, officials of audit party had been warned to be more cautious to examine this aspect.

### 7.3.2.5 Non-detection of irregular utilization of Cenvat credit on old capital goods

As per Rule 3(5A) (b) of Cenvat credit Rules (CCR) 2004, if capital goods on which Cenvat credit have been taken are removed after being used, whether as capital goods or as scrap or waste, the manufacturer or provider of output service shall pay an amount equal to the Cenvat credit taken on the said capital goods reduced by 2.5 per cent calculated by straight line method for each quarter or part thereof from the date of taking the Cenvat credit. Rule 14 of CCR 2004 states that where Cenvat credit has been taken and utilized wrongly, the same along with interest shall be recovered from the manufacturer or provider of output service.

M/s OEN India Ltd., Mulanthuruthy, in Cochin Commissionerate transferred its Capital goods procured in 1995, 1997 and 2000 to Tripunithura unit in January 2005. These goods were again transferred back to Mulanthuruthy unit in March 2013 and the Mulanthuruthy unit availed the credit which was reversed at the time of transferring the said capital goods to Tripunithura unit during January 2005, on the basis of old invoices. Since the original invoices pertained to 1995, 1997 and 2000, on transfer of these capital goods to Mulanthututhy unit in March 2013, there was no credit left to be availed applying the formula for proportionate reduction at the rate of 2.5 per cent per quarter, as per sub-rule 3 (5A)(b). However, the transfer of the capital goods was made on the basis of the old original invoices without making the proportionate reduction as stipulated in sub-rule 3(5A)(b) and full Cenvat credit ₹ 8.25 lakh was availed and utilized by Mulanthuruthy unit in March 2013, which was irregular and required to be reversed with interest from the assessee.

Internal audit of the assessee covering the period upto March 2013 was conducted in December 2013, but the irregular utilization of credit was not detected.

When we pointed this out (January 2014), the department replied (November 2014) that Show Cause Notice demanding Cenvat credit of ₹ 8.25 lakh, with interest and equal penalty had been issued to the assessee.

Ministry stated (November 2015) that credit reversal at time of transferring capital goods to other unit and credit taken again at the time of receiving back the capital goods was in order.

Reply is not tenable as rule 3(5A) cited supra, specifically require reversal of credit at reduced rate according to depreciated value of capital goods.

### 7.3.2.6 Short payment of duty due to misclassification

According to Rule 4 (1) of Central Excise Rules, 2002, every person manufacturing excisable goods shall pay duty in the manner provided in Rule 8 and Rule 6 states that, the assessee shall himself assess the duty payable on excisable goods. Chapter 90 of Central Excise Tariff Act 1985 covers medical or surgical instruments and apparatus. General Exemption No. 50 provides for payment of reduced rate of duty at the rate of 4 per cent upto February 2011 and at the rate of 5 per cent from March 2011 for goods covered under Chapter heading 9018. As per Harmonised System of Nomenclature (HSN) 2002 and 2012, chapter heading 9018 does not cover instruments and appliances used in laboratories to test blood, tissue, urine, fluid etc. and should be classified under Chapter heading 9027. Chapter heading 9027 is for instruments and apparatus for physical or chemical analysis, instruments or apparatus for measuring or checking viscosity, porosity, expansion, surface tension or the like, instruments and apparatus for measuring or checking quantities of heat, sound or light (including exposure meters), microtomes etc.

M/s Agappe Diagnostics Ltd, in Cochin Commissionerate, manufacturing diagnostic equipments, incorrectly classified medical diagnostic equipments viz. MISPA Plus Analyzer, MISPA-1 and MISPA Uno which were clinical chemistry analyzers, under chapter heading 90189019 instead of under Chapter heading 9027. The assessee paid duty for the equipments at reduced rate of 4 per cent/ 5 per cent under General Exemption No. 50 during the period April 2010 to May 2011. The assessee reclassified the equipments correctly under Chapter heading 90278090 and paid duty at normal rate of 10 per cent from June 2011, since Customs authorities issued demand notice in June 2011 classifying similar equipments imported by the assessee under heading 90278090 on the basis of HSN notes. However, assessee did not rectify the mistake for period prior to June 2011. Misclassification of diagnostic equipments during the period April 2010 to May 2011 resulted in short payment of duty of ₹ 22.21 lakh.

Internal audit carried out in July 2011 covering the period upto June 2011 had not pointed out the lapse detected by us.

When we pointed this out (September 2012), the Commissionerate stated (July 2013) that the demand of duty of ₹ 24.07 lakh was issued to the assessee which was confirmed in adjudication (December 2014) alongwith interest and equivalent penalty.

Ministry also confirmed (November 2015) that SCN issued to the assessee was adjudicated, confirming the demand. On lapse of internal audit, it stated that classification of goods was changed by the assessee on the basis of demand notice issued by the Customs authority and the fact was not brought to their notice by the assessee, therefore internal audit was not able to detect it.

Reply is not tenable as not only the department failed to detect the wrong classification, as detected by Customs authorities, internal audit also failed to take cognizance of the demand notice of Customs authority and incorrect classification by the assessee.

Audit is also of the view that Board needs to devise a mechanism for exchange of information in such cases between different wings of the Board i.e. Customs, Central Excise and Service Tax.

### 7.3.2.7 Non-detection of irregular availing of Cenvat credit on civil construction service

Rule 2(1) (A) of Central Credit Rules, 2004 provides that service portion in the execution of a works contract and construction services in so far as they are used for construction or execution of works contract of a building or a civil structure or a part thereof or laying of foundation or making of structures for support of capital goods, except for the provision of one or more of the specified services that are not included in input services for availment of Cenvat credit.

M/s Kudos Chemie Ltd., Derabassi in Chandigarh II Commissionerate, engaged in manufacturing of bulk drugs under chapter 29 of Central Excise Tariff Act, 1985, availed Cenvat credit amounting to ₹ 92.50 lakh on civil construction during the period 2011-12 to 2013-14 in contravention of the Rules ibid. This resulted into irregular availment of Cenvat credit amounting to ₹ 92.50 lakh which was recoverable alongwith interest.

The Internal Audit of the assessee was carried out by the department upto April, 2014, but the irregularity was not pointed out.

When we pointed this out (August 2014), the department intimated (November 2014) that an amount of ₹ 92.50 lakh had been reversed by the assessee and interest of ₹ 0.68 Lakh was also paid.

Ministry also confirmed the credit reversal by the assessee (September 2015). On lapse of internal audit, it stated that the matter was under examination.

### 7.3.2.8 Non-detection of wrong availing of credit on same invoice and utilization of the same

Rule 4 (2)(a) of Cenvat Credit Rules, 2004 stipulates that the Cenvat credit in respect of capital goods received in a factory at any point of time in a given financial year shall be taken only for an amount not exceeding 50 per cent of the duty paid on such capital goods in the same financial year. Rule 14 of the said rules stipulates that irregularly availed and utilized Cenvat credit shall be recovered along with interest.

Audit of M/s Shri Badrinarain Alloys and Steel Ltd. in Haldia Commissionerate, engaged in manufacturing of TMT bars, revealed that the assessee purchased three capital goods from M/s Shailja Engineering Works in the month of October 2013 and availed Cenvat credit of ₹ 28.43 lakh (including Cess) being 50 per cent of the total duty paid on Capital Goods. Subsequently, the remaining 50 per cent credit of ₹ 28.43 lakh was availed in April 2014. Further verification revealed that the assessee in the month of November 2013 had also availed Cenvat credit of ₹ 28.43 lakh based on same sets of invoices. Thus, assessee availed 150 per cent credit out of which 100 per cent was availed in the same year. The credit availed by the assessee in the month of November 2013 was irregular. The assessee had also utilised whole of irregularly availed credit. This resulted in irregular availing and utilization of Cenvat credit of ₹ 28.43 lakh during the period 2013-14 which was recoverable along with interest.

The unit was audited by Internal Audit (May 2013) but it didn't detect the lapse pointed out by us.

When we pointed this out (August 2014), department intimated (October 2014) that the assessee had reversed the credit of ₹ 28.43 lakh along with interest of ₹ 10.58 lakh.

Ministry also confirmed the reversal of credit by the assessee (December 2015). On lapse of internal audit, it stated that audit for the period of 2011-12 was completed in January 2014, hence there was no lapse by the internal audit in 2013-14.

Reply is not tenable, as provision of Central Excise Audit Manual 2008 stipulates that audit should extend upto one completed month preceding the date of current audit. Thus, even if audit was completed in January 2014, it should have covered the period upto December 2013.

### 7.3.2.9 Non-detection of non-payment of duty on additional consideration as Sales Tax remission

As per Section 4(1)(a) of the Central Excise Act, 1944, when the duty of excise is chargeable on any excisable goods with reference to their value, then such value shall be the transaction value. Transaction value means the price actually paid or payable for the goods when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to or on behalf of, the assessee, by reason of, or in connection with the sale whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing etc or any other matter, but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

The Government of Maharashtra introduced the Package Incentive Scheme for deferred payment of Sales Tax whereby the assessee was allowed to collect Sales Tax from the buyer and retain 75 per cent and repay it after prescribed period. The Government of Maharashtra thereupon amended the provisions of Sales Tax Act and issued a Notification in November 2002 providing further incentive for premature repayment of Sales Tax liability.

Supreme Court in its judgment in case of M/s Super Synotex India dated 28 February 2014 (2014-TIOL-19-SC-CX) on similar issue made it clear that the 75 per cent of Sales Tax retained by the assessee would form part of Assessable value and Excise duty is payable. Further Board has also issued a circular vide F.No.6/8/2014-CX.1 dated 17 September 2014 on similar lines in light of above judgment and instructed that similar cases may be finalized on this ground.

M/s Perfect Circle India Ltd in Nashik Commissionerate, engaged in the manufacture of the goods (chapter 84) had prepaid the amount of deferred taxes (Sales Tax) at Net Present Value (NPV) on 29 June 2013 under Package Scheme of incentive. Thus benefit availed by the assessee for ₹ 1.34 crore was includible in the assessable value. Non-inclusion of Sales Tax amount in the assessable value resulted in short levy of duty of ₹ 16.58 lakh with interest of ₹ 2.68 lakh (upto 23 May 2014).

Internal Audit of the assessee was conducted in November 2013 but the lapse was not detected by them.

When we pointed this out (May 2014), department admitted the objection (June 2015) and stated that show cause notice was being issued.

Ministry stated (December 2015) that SCN was issued to the assessee. On lapse of internal audit, it stated that the fact of deferred sales tax payment was not informed to the audit officer and the assessee suppressed the facts from the department.

Reply is not tenable as if the facts are not reported by the assessee, internal audit should be able to detect such evasion and in the instant case, internal audit failed to detect the lapse.

### 7.3.2.10 Non-detection of irregular availing of Cenvat credit

Rule 3 (1) of Cenvat Credit Rules, 2004 provides that a manufacturer of final products shall be allowed to take credit of specified duties paid on any input or capital goods received in factory of manufacturer of final products on or after 10 September 2004.

Govt. of India vide notification numbers 13/2012-Customs and 14/2012-Customs dated 17 March 2012 exempted the imported goods from payment of Education cess and Secondary and Higher education cess leviable under sub-section (1) of section 3 of the Customs Tariff Act, 1975.

M/s Somi Conveyer Belting Ltd and M/s Prem Cables Pvt. Ltd in Jodhpur Commissionerate availed Cenvat credit of Education cess and Secondary and Higher Education cess on imported goods during 2012-13 and 2013-14 which was not levied in Bill of Entries as the same was exempted vide notifications ibid. This resulted in irregular availing of Cenvat credit of ₹ 11.67 lakh which is recoverable from the assessee alongwith applicable interest of ₹ 3.65 lakh.

Though internal audit of the assessee was conducted for the period included in the para, the irregularity was not pointed out until detected by us.

We pointed this out in December 2014. Reply from the Ministry/Commissionerate was awaited (December 2015).

## 7.4 Other Lapses

### 7.4.1 Non-conducting of detailed scrutiny resulted in non-detection of irregular availing of Cenvat credit

Rule 2(l) of Cenvat Credit Rules, 2004, specifically excluded architect services, construction services and works contract services from the definition of 'input service', if these services are utilized for construction of a building or civil structure or for laying foundation or making structures for support of capital goods and Cenvat credit of the same is not admissible.

Audit of the records pertaining to Nippani II Range under Belgaum Commissionerate, for the period 2009-10 to 2011-12 revealed that no detailed scrutiny was conducted by the Range. Audit selected a few assessees for detailed assessment to verify the impact of not conducting of detailed scrutiny of returns and observed that, M/s Shivshakti Sugars Ltd., Soudatti had availed Cenvat credit of ₹ 11.39 lakh on architect services, construction services and works contract services utilized for construction of factory building and M/s Krishna SSKN, Athani had availed Cenvat credit of ₹ 3.66 lakh on works contract services and club membership services during 2011-12. These services were not eligible input services for the manufacturers for availing Cenvat credit. The Cenvat credit availed was irregular and had to be reversed, along with interest and penalty, as applicable.

When we pointed this out (January 2013), the department replied (April 2015) that scrutiny of returns were not conducted initially due to various operational issues faced during the implementation of ACES and that scrutiny was being conducted regularly after these problems have been solved. The department further replied (October 2013) that M/s Shivshakti Sugars Ltd. had paid (April 2013) ₹ 11.39 lakh and M/s Krishna SSKN had paid ₹ 3.24 lakh for ineligible Cenvat credit. Department also replied (June 2014) that the assessee had not reversed Cenvat credit of ₹ 0.42 lakh, hence, a Show Cause Notice (SCN) was issued to M/s Krishna SSKN on the grounds that the same was not an eligible credit as it pertained to membership of Federation of Co-operative Sugar Mills.

Ministry also confirmed (December 2015) the payment made by both the assessees. On departmental lapse, it also stated that department could not conduct scrutiny due to operation issues in ACES.

Though Commissionerate stated that detailed scrutiny is being conducted now, however, during performance audit on Cenvat credit, it has been noticed that out of 41 test checked Commissionerates, no detailed scrutiny was being conducted in 21 Commissionerates and reply of 20 Commissionerates was awaited. Ministry need to ascertain the claim of Belgaum Commissionerate for conducting detailed scrutiny.

### 7.4.2 Delay in issuing SCNs by the department

CBEC circular No. 5/83-CX.6 dated 10 March 1983 as amended vide instruction F No. 206/2/2010-CX.6 dated 03 February provided that instructions should be issued to issue show cause notice immediately on receipt of an audit objection from CAG, even if the objection is not admitted.

Section 11A of Central Excise Act, 1944 stipulated that a show cause notice shall be issued within one year (for Service Tax, 18 months, with effect from

28 May 2012) in normal course and in case of fraud, collusion, wilful misstatement, suppression of facts etc. with intent to evade duty, within a period of five years from the relevant date. Further as per section 73(6)(b) of the Act, relevant date inter alia means where no periodical returns as aforesaid filed, the last date on which such returns to be filed under the said rules.

Supreme Court in the case of M/s Nizam Sugar Ltd. Vs Commissioner of Central Excise {2006(197) ELT 465(SC)} has held that the extended period of five years was not available to the department for the subsequent show cause notice which was issued based on the same set of facts of the earlier show cause notice as the full facts were known to the department and hence suppression cannot be alleged.

Audit pointed out five cases relating to four assessees under the Allahabad Commissionerate, during June 2010 to March 2011. However, department took action by issuing SCN in January 2013 (one case) and April 2014 (four cases). Thus, department took action after more than four years, resulting in realisation of revenue to the tune of ₹ 1.29 crore doubtful, as these cases may have become time-barred.

When we pointed this out (May 2015), Ministry did not admit the objection stating that there was no violation of Board's instruction as protective SCNs were issued in all these cases.

Reply is not tenable as CBEC instruction dated 3 February 2010 clearly states that show cause notices should be issued immediately on receipt of an Audit observation of CAG, even if the objection is not admitted. The audit observations were issued during 2010-11 (June 2010 to April 2011) but the department did not furnish any reply to these paras till the year 2014. The department intimated Audit in the Audit Committee Meeting held with the department in 2014 about issuance of SCNs in respect of these cases during January 2013 and April 2014 respectively i.e. after more than four years.

Further, an SCN can be issued after one year only in cases where there is suppression of facts or fraud by the assessee. However, department in all delayed cases use the suppression of facts clause which many times are not admitted by tribunal/courts and SCN are time barred.

### 7.4.3 Non–issuance of show cause notice to recover Central Excise duty

Rule-6(3) of Cenvat Credit Rules, 2004 provides that if Cenvat credit is availed on common inputs/input services which are used in manufacture of exempted goods as well as in dutiable goods and separate accounts for inputs are not maintained, then the manufacturer shall either pay an amount equivalent to six per cent (five percent upto 31.03.2012) of value of the

exempted goods or pay an amount equivalent to the Cenvat credit attributable to inputs and input services used in or in relation to the manufacture of exempted goods or provision of exempted services.

Section 11A of Central Excise Act, 1944, provides that when any duty of excise has not been levied or has been short-levied or short-paid or erroneously refunded, Central excise officer may, within one year from the relevant date, serve notice on the person. The period of one year stands extended to five years where duty has been short-paid due to fraud, collusion, willful mis-statement or suppression of facts with the intention to evade duty.

M/s Canton Laboratories Ltd. in Vadodara-II Commissionerate cleared the exempted goods – Sodium chloride (NaCl) amounting to ₹ 524.18 lakh during April 2009 to June 2012 using common inputs and input services for the manufacture of said exempted goods. However, the assessee neither maintained separate accounts for inputs and/or input services nor paid amount equivalent to six/five per cent of the value of the exempted goods.

Audit further noticed that internal audit raised this issue in March 2014 and the assessee paid amount equivalent to six percent of value of exempted goods for the period July 2012 to February 2014. However, department did not initiate any action to recover the amount for the period April 2009 to June 2012 from the assessee. This resulted in non-recovery of Central Excise duty of ₹ 28.24 lakh.

When we pointed this out (May 2014), the Commissionerate stated (March 2015) that objection was acceptable and Show cause notice for ₹ 25.45 lakh had been issued to the assessee covering the period from July 2009 to June 2012.

Ministry stated (October 2015) that SCN was adjudicated, confirming the demand. Reply was silent on departmental lapse.

### 7.4.4 Ineffective Review of Call Book

As per CBEC Circular No.162/73/95-CX dated 14.12.1995, the Show Cause Notices (SCNs) which has reached a stage when no action can or need to be taken to expedite its disposal for at least 6 months might be transferred to the Call Book with the approval of the Competent Authority. Cases held up in law courts, cases in which the department has gone in appeal to the appropriate authority, cases where injunction has been issued by Supreme Court/High Court/CESTAT etc., cases where audit objections are contested and cases where the Board has specifically ordered the same to be kept pending and to be entered into the Call Book, can be transferred to the Call Book. Further, extant instructions to the Commissionerates require monthly review of pending Call Book items.

During the verification of cases pending in the Call Book at Belgaum Commissionerate, we noticed that 28 SCNs in respect of 13 cases/assessees were kept pending in the Call Book even though the cases were fit for adjudication. In one such case SCN dated 26 July 2010 issued to M/s JSW Cement Ltd., Bellary, demanding ₹ 97.06 lakh of irregular Cenvat credit availed on MS Plates, TMT Bars, Angles etc. as capital goods. Though the SCN was liable to be adjudicated in February 2011, as similar cases were adjudicated by the department, it took more than three years to adjudicate the case.

When we pointed this out (April 2013), the department intimated (November 2013) that 22 SCNs, including SCN issued to M/s JSW, were taken out of call book. Department further intimated (March 2015) that 22 cases were adjudicated and three more cases were to be taken out, and continued to keep the remaining two SCNs in Call Book.

Retaining the two cases in Call Book was not accepted by Audit as the reasons furnished by the department were not correct.

Ministry stated (December 2015), that remaining two cases had also been taken out from call book and adjudication was underway.

**New Delhi** **(SANJEEV GOYAL)**
**Dated: 10 February 2016** **Principal Director (Central Excise)**

**Countersigned**

**New Delhi** **(SHASHI KANT SHARMA)**
**Dated: 10 February 2016** **Comptroller and Auditor General of India**