Report of the
Comptroller and Auditor General
of India

for the year ended March 2001

Union Government

(Indirect Taxes - Central Excise & Service Tax)

No.11 of 2002

Laid on the Table of the Lok Sabha and Rajya Sabha on .....

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PREFATORY REMARKS

This Report for the year ended 31 March 2001 has been prepared for submission to the President under Article 151 of the Constitution.

The report presents the observations noticed in test audit of Indirect Taxes (Central Excise and Service Tax) of the Union Government. Section I of the report covers matters relating to "Central Excise" and section II covers "Service Tax".

The cases mentioned in the Report are among those which came to notice in the course of audit during the year 2000-01and early part of the year 2001-02, as well as those which came to notice in earlier years but were not reported.

OVERVIEW

This report is presented in two sections :

Section I	**Chapters 1 to 11**	**Central Excise**
Section II	**Chapter 12**	**Service Tax**

Some of the significant findings are highlighted below :-

SECTION I - CENTRAL EXCISE

This section contains 138 paragraphs featured individually or grouped together and one review with a financial implication of Rs.1972.10 crore. Some of the significant findings included in this section are mentioned below :-

A. General

Net receipts from excise duty continued to fall short of budgeted estimates. The collections stood at Rs.68,282 crore during 2000-01 as against the budget estimates of Rs.70,967 crore.

(Paragraph 1.2)

While Central Excise receipts had grown by 2.79 times during the decade 1990-91 to 2000-01, the increase in Modvat availed was 6.92 times. Consequently the percentage of Modvat availed to duty paid by cash had been increasing consistently from 26.50 per cent to 76.35 per cent till 1996-97 with marginal declines thereafter. The overall increasing trend in availing Modvat/Cenvat credit can be attributed to the expansion/liberalisation of the scheme. To a certain degree, it is also indicative of the misuse of Modvat/Cenvat credit facility as brought out in audit.

(Paragraph 1.4)

Expenditure on collection of excise duty has shown a rising trend. It went up from Rs.354.74 crore in 1996-97 to Rs.615.84 crore in 2000-01. The growth in cost of collection averaged 15.32 per cent during the previous five years whereas revenue growth had averaged around 11.33 per cent during the same period.

(Paragraph 1.5)

50464 cases involving Rs.22,909.04 crore of central excise duty were pending decision with different authorities on 31 March 2001.

(Paragraph 1.6)

B. Review

Levy of duty on the basis of capacity of production on processed fabrics

- **While the scheme was intended to plug leakage of revenue, audit scrutiny revealed that it resulted in not only a 55 per cent reduction in the incidence of duty but also a fall in revenue collections. Consequent reduction in revenue in 394 units is estimated at Rs.1132.14 crore in two years, which was more than the amount actually collected from these units.**

(Paragraph 2.5)

- **The capacity determined by the Government initially in value terms and later in quantity terms was on an average 25 to 47 per cent lower than the actual production.**

(Paragraph 2.6.1)

- **While access to records relating to determination of capacity was not provided to audit, scrutiny of other records revealed that the capacity was determined on the basis of minimum tax paying capacity projected by the Industry Association to the Central Board of Excise and Customs.**

(Paragraph 2.6.2)

- **Even though the adverse impact of the scheme was evident in the last quarter of 1998-99, the Government did not take any remedial action till March 2000. The increase in levy from March 2000 was insufficient to plug revenue leakage.**

(Paragraph 2.6.3)

- **The Government failed to tax extra production of fabric using stentors other than hot air stentors/float dryers. The resultant duty foregone in 60 units was Rs.163.46 crore.**

(Paragraphs 2.7.1 & 2.7.2)

- **Processors with proprietary interest in spinning/weaving mills were also allowed to pay duty under the scheme, which resulted in loss of revenue of Rs.21.41 crore in 4 units.**

(Paragraph 2.8.1)

C. Non-levy/short levy of duty

Short levy/under assessment of Central Excise duty amounting to Rs.604.45 crore were noticed. The more significant of these findings are as follows :

- **Inappropriate provisions in the Rules led to grant of Modvat credit on inputs (molasses) more than the duty recoverable on finished goods (rectified spirit). This enabled the assessees to utilise the surplus credit for payment of duty on sugar eventhough molasses was not an input for manufacture of sugar. Unintended benefit derived by 38 assessees amounted to Rs.31.35 crore.**

(Paragraph 3.1)

- **Issue of ambiguous notifications enabled hundred per cent export oriented units to avail exemption from additional duties of excise on goods exported as well as cleared in the domestic tariff area though the exemption was intended only for goods exported. Exemption availed by 85 export oriented units caused revenue loss of Rs.17.25 crore.**

(Paragraph 3.2)

- **Failure to amend the Rubber Act, 1947 to provide for interest on belated payments for two decades of being pointed out in audit, enabled assessees to defer indefinitely payment of cess and interest amounting to Rs.4.48 crore.**

(Paragraph 3.3)

- **91 processors of fabrics took undue financial benefit to the tune of Rs.54.26 crore by taking deemed credit on inputs, in excess of the duty suffered.**

(Paragraph 3.4)

- **Incorrect grant of refund/rebate of duty or delay in grant of refund of duty, resulted in loss of revenue of Rs.129.67 crore**

(Paragraph 4)

- **Assessees wrongly availed exemption notifications pertaining to intermediate goods, finished goods, goods manufactured on job work basis and goods produced by small scale industry. Duty of Rs.113.77 crore was short collected as a consequence.**

(Paragaraph 5)

- **There were instances of non-levy of Central Excise duty on additive mixture, bricks, hot rolled products and also non-levy of cess on textiles and rubber to the tune of Rs.60.56 crore.**

(Paragraph 6)

- **Instances of misclassification by assessees manufacturing cosmetics, motor vehicle's parts and bodies, stiffened fabrics etc., were noticed in test audit with a consequent short realisation of Rs.45.09 crore.**

(Paragraph 7)

- **Incorrect availment of Modvat/Cenvat credit in excess of prescribed limit or on ineligible goods or in violation of the Rules caused the Government to be deprived of Rs.40.92 crore.**

(Paragraph 8)

- **Cases of incorrect valuation were detected pertaining to goods sold at buyer's destination, goods transferred to sister units, goods sold through depots, etc. This resulted in short levy of duty of Rs.30.58 crore.**

(Paragraph 9)

- **Non-adjudication of demands, non-raising of demands and delay in raising demands caused a revenue of Rs.30.42 crore being lost to the Government.**

(Paragraph 10)

SECTION II - SERVICE TAX

This section contains 16 paragraphs with revenue implication of Rs.32.55 crore. The significant findings of Audit included in this section are indicated below :-

- **Service tax of Rs.21.85 crore was not levied on services provided by consulting engineers, transport operators, management consultants and consignments agents.**

(Paragraph 12.1)

- **Short collection of service tax amounted to Rs.8.77 crore.**

(Paragraphs 12.2 & 12.5)

- **Interest of Rs.1.53 crore was not recovered on delayed payment of service tax.**

(Paragraph 12.3)

- **Penalties amounting to Rs.40.10 lakh was not levied for late submission of returns or for belated payment of tax.**

(Paragraph 12.4)

SECTION I - CENTRAL EXCISE

CHAPTER 1 : CENTRAL EXCISE RECEIPTS

1.1 Contents of Report

This section contains a review of the scheme for levy of duty on the basis of capacity of production on processed fabrics and highlights revenue implication of Rs.1,367.65 crore. Besides, there are 138 paragraphs featured individually or grouped together, arising from important findings from test check in audit pointing out leakage of revenue aggregating Rs.604.45 crore. Of this concerned Ministries had (till January 2002) accepted audit observations in 95 paragraphs involving Rs.389.90 crore and recovered Rs.42.89 crore.

1.2 Budget estimates, revised budget estimates and actual receipts

(a) Budget estimates and actual collections *

The budget estimates, revised budget estimates and actual receipts of Central Excise duties during the year 1996-97 to 2000-2001 are exhibited in the table below:-

(Amount in crore of rupees)

Year	Budget estimates	Revised budget estimates	Actual receipts	Difference between actual receipts and budget estimates	Percentage variation
1996-97	46,883	46,190	44,818	(-) 2065	(-) 4.40
1997-98	52,200	47,700	47,763	(-) 4437	(-) 8.50
1998-99	57,690	53,200	53,053	(-) 4637	(-) 8.04
1999-2000	63,565	60,731	61,672	(-) 1893	(-) 2.98
2000-2001	70,967	70,399	68,282	(-) 2685	(-) 3.78

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

Shortfalls ranged between Rs.1,893 crore and Rs.4,637 crore during these years. Reasons for the shortfall were awaited from the Ministry of Finance (January 2002).

(b) Commodity wise break-up *

Details of collection vis-à-vis budget estimates in respect of commodities (as per budget heads) which yielded revenue of more than Rs.1000 crore during 2000-2001 alongwith corresponding figure for 1999-2000 are as follows :

(Amount in crore of rupees)

Sl. No.	Budget Head	Description	1999-2000 (Actual)	2000-2001 (Budget estimates#)	2000-2001 (Actual)	Percentage variation of actual over budget	Percentage share in total collection
1.	36	Refined diesel oil	6769.43	7385.75	8145.52	10.29	11.92
2.	34	Motor spirit	5000.67	6002.22	5425.27	(-) 9.61	7.94
3.	27	Cigarettes, cigarillos or tobacco substitutes	4862.58	3695.72	5180.47	40.17	7.58
4.	102	Iron & steel	4476.07	4999.48	4756.20	(-) 4.87	6.97
5.	40	All other goods falling under chapter 27 (minerals fuels, oils etc.)	2714.30	2806.75	3378.02	20.35	4.95
6.	31	Cement clinkers, cement all sorts	2932.18	3328.80	2945.12	(-) 11.53	4.31
7.	128	Motor cars & other vehicles for transport of persons	2595.19	2856.45	2867.08	0.37	4.20
8.	119	All other goods falling under chapter 84 (machinery, mechanical appliances etc.)	1800.62	1739.55	1733.74	(-) 0.33	2.54
9.	130	All other goods falling under chapter 87 (motor vehicles other than at Sl. No. 7)	1528.72	1631.76	1679.14	(-) 2.90	2.46
10.	61	Plastic & articles thereof	2096.84	2378.32	1456.41	(-) 38.76	2.13
11.	46	Pharmaceutical products	1181.15	1334.00	1415.35	6.10	2.07
12.	45	Organic chemicals	1109.00	1206.94	1344.49	11.40	1.97
13.	39	Petroleum gases and other gaseous hydrocarbons	358.57	384.44	1295.41	236.99	1.90
14.	79	Synthetic filament yarn and sewing thread including synthetic monofilament and waste	1114.85	959.08	1186.20	23.68	1.74
15.	62	Tyres, tubes and flaps	1255.02	1477.22	1158.05	(-) 21.61	1.70
16.	37	Diesel oil, NES	1234.29	1068.72	1104.03	3.30	1.62
17.	125	All other goods falling under chapter 85 (electrical machinery, equipments etc.)	1115.56	1147.06	1079.36	(-) 5.90	1.58
18.	71	Paper and paper board, articles of paper pulp	769.30	835.32	1016.92	21.74	1.49

* Figure furnished by Directorate of Audit, Customs and Central Excise, New Delhi.

\# Figure as depicted in Receipt Budget 2000-2001.

The above table shows that there were wide variations in the actual receipts which ranged from (-) 38.76 per cent in case of 'plastic and articles thereof' to 236.99 per cent in case of 'petroleum gases and other gaseous hydrocarbons'. The overall shortfall of 3.78 per cent between actual realisation of Central Excise revenue and budget estimates during 2000-2001

was mainly due to a shortfall in (i) plastics and articles thereof by 38.76 per cent, (ii) tyres, tubes and flaps by 21.61 per cent, (iii) cement clinkers, cement all sorts by 11.53 per cent etc.

1.3 Value of output* *vis-à-vis* Central Excise receipts

The value of output from the manufacturing sector vis-a-vis receipt of Central Excise duties through Personal Ledger Account (cash collection) during the years 1990-91 to 2000-2001 are given below:

(Amount in crore of rupees)

Year	Value of output	Central Excise	Percentage of Central Excise receipts to value of production
1990-91	274241	24514	8.94
1991-92	305293	28110	9.20
1992-93	345204	30614	8.87
1993-94	390561	31548	8.08
1994-95	479717	37208	7.76
1995-96	597354	40009	6.70
1996-97	661613	44818	6.77
1997-98	720410	47763	6.63
1998-99	794465	53053	6.68
1999-2000	861200	61672	7.16
2000-2001	909427	68282	7.50

* Includes value of all goods produced during the given period including net increase in work-in-progress and products for use on own account. Valuation is, at producers values, that is the market price at the establishment of the producers. As separate figure of value of production by Small Scale Industry Units and for export production were not available, these have not been excluded from the value of output indicated. Value of out put for the year 2000-2001 is based on estimates. Source : Central Statistical Organisation (Government of India).

The above table reveals that while value of output had increased by a factor of 3.32 during the period 1990-91 to 2000-2001, the corresponding increase in the Central Excise receipts was by a factor of 2.78 only.

1.4 Central Excise receipts vis-a-vis Modvat/Cenvat availed

A comparative statement showing the details of Central Excise duty paid through Personal Ledger Account (PLA), the amount of Modvat/Cenvat availed during the year 1990-91 to 2000-2001 is given in table as follows:

(Amount in crore of rupees)

Year	Central Excise duty paid through PLA		Modvat/Cenvat availed		Percentage of Modvat/Cenvat to duty paid through PLA
	Amount	Percentage increase	Amount	Percentage increase	
1990-91	24514	----	6469	23.04	26.50
1995-96	40009	7.53	29951	38.10	74.86
1996-97	44818	12.02	34222	14.25	76.35
1997-98	47763	6.57	35164	2.75	73.62
1998-99	53053	11.07	35489	0.92	66.89
1999-2000	61672	16.25	41230	16.18	66.85
2000-2001	68282	10.72	44986	9.11	65.88

The above table shows that while the Central Excise receipts had grown by 2.79 times during the decade 1990-91 to 2000-2001, the increase in Modvat/Cenvat availed during the relevant period had been 6.92 times. It would also be seen that the percentage of Modvat/Cenvat availed to duty paid by cash had increased from 26.50 per cent to 76.35 per cent between 1990-91 and 1996-97 with a marginal declines thereafter. The overall increasing trend in availing Modvat/Cenvat credit can be attributed to the expansion/liberalisation of the scheme and to a certain degree is also indicative of misuse of Modvat/Cenvat credit facility as also brought out in earlier Audit Reports and paragraphs 3.1, 3.4, 7.2, 8 and 10.1 (iii) of this Audit Report.

1.5 Cost of collection *

The expenditure incurred during the year 2000-2001 in collecting Central Excise duty alongwith the corresponding figures for the preceding four years is given below:-

(Amount in crore of rupees)

Year	Receipts from excise duty		Expenditure on collection		Cost of collection as percentage of receipts
	Amount	Percentage increase over previous year	Amount	Percentage increase over previous year	
1996-97	44818	12.02	354.74	15.12	0.79
1997-98	47763	6.57	479.59	35.19	1.00
1998-99	53053	11.07	547.23	14.10	1.03
1999-2000	61672	16.25	584.82	6.87	0.95
2000-2001	68282	10.72	615.84	5.30	0.90

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

Cost of collection as a percentage of the Central Excise collection has shown a rising trend with marginal decline in 1999-2000. Further, while growth in revenue averaged around 11.33 per cent, expenditure on collection had averaged at 15.32 per cent during the period 1996-97 to 2000-2001.

1.6 Outstanding demands *

The number of cases and amount involved in demands for excise duty outstanding for adjudication/recovery as on 31 March 2000 and 31 March 2001 are given below :

(Amount in crore of rupees)

		As on 31 March 2000				As on 31 March 2001			
		Number of cases		Amount		Number of cases		Amount	
		More than five years	Less than five years	More than five years	Less than five years	More than five years	Less than five years	More than five years	Less than five years
(a)	**Pending with** Adjudicating officers	1745	28491	682.24	5148.21	645	14627	45.13	12916.47
(b)	**Pending before**								
(i)	Appellate Commissioners	441	11896	246.58	1640.54	241	13726	213.25	2682.85
(ii)	Board	75	353	2.81	103.23	232	155	214.61	13.72
(iii)	Government	33	97	2.04	13.28	36	48	85.92	9.17
(iv)	Tribunals	1554	4455	499.44	2591.35	1130	4505	395.87	3562.79
(v)	High Courts	1032	815	573.59	715.14	688	866	988.78	667.73
(vi)	Supreme Court	308	342	314.85	434.22	199	323	240.71	204.58
(c)	**Pending for coercive recovery measures**	8484	6051	67.64	687.99	7466	5577	50.11	617.35
	Total	**13672**	**52500**	**2389.19**	**11333.96**	**10637**	**39827**	**2234.38**	**20674.66**

* Figure furnished by the Ministry of Finance and relates to 46 Commissionerates.

It may be seen that 50464 cases involving duty of Rs.22,909.04 crore were pending on 31 March 2001 with different authorities. While the number of cases pending for less than five years with adjudicating authorities decreased by 13864 over the previous year, duty involved increased from Rs.5,148.21 crore in 1999-2000 to Rs.12,916.47 crore in 2000-01.

1.7 Fraud/presumptive fraud cases *

The position of fraud/presumptive fraud cases alongwith the action taken by the department against the defaulting assessees during the period 1998-99 and 2000-2001 is depicted in the following table :

(Amount in crore of rupees)

Year	Cases detected		Demand of duty raised	Penalty imposed		Duty collected	Penalty collected	
	Number	Amount	Amount	Number	Amount	Amount	Number	Amount
1998-99	1030	1326.08	603.28	371	26.55	10.53	49	1.29
1999-2000	892	552.27	113.71	243	31.20	21.04	43	0.19
2000-2001	1047	493.37	228.31	239	35.19	45.06	51	0.17
Total	**2969**	**2371.72**	**945.30**	**853**	**92.94**	**76.63**	**143**	**1.65**

* Figure furnished by the Ministry of Finance and relates to 46 Commissionerates.

The above data reveals that while a total of 2,969 cases of fraud/presumptive fraud were detected during the years 1998-2001 by the department, involving a duty of Rs.2,371.72

crore, the department raised a demand of Rs.945.30 crore only and recovered Rs.76.63 crore (8.1 per cent) out of it. Similarly, out of penalty of Rs.92.94 crore imposed, the department recovered only Rs.1.65 crore.

1.8 Excise duty on the basis of capacity of production

Section 3A inserted with effect from 14 May 1997 in the Central Excise Act, empowers the Central Government to charge excise duty on the basis of capacity of production on the notified goods. The Government initially levied duty based on capacity on certain iron & steel products like ingots and billets and hot re-rolled products of non-alloy steel with effect from 1 September 1997. The negative impact of the new scheme on iron and steel products was highlighted in the Report of the Comptroller and Auditor General of India for the period ending 31 March 1999. The scheme was withdrawn from this sector with effect from 1 April 2000.

In December 1998, the Government notified certain processed textile fabrics, manufactured by independent textile processors, for levy of duty on the basis of capacity of production under section 3A. The negative impact of the scheme for certain processed textile fabrics is highlighted in chapter 2 of this report.

CHAPTER 2: REVIEW OF THE SCHEME FOR LEVY OF DUTY ON THE BASIS OF CAPACITY OF PRODUCTION ON PROCESSED FABRICS

2.1 Highlights

- **While the scheme was intended to plug leakage of revenue, audit scrutiny revealed that it resulted in not only a 55 per cent reduction in the incidence of duty but also a fall in revenue collections. Consequent reduction in revenue in 394 units is estimated at Rs.1132.14 crore in two years, which was more than the amount actually collected from these units.**

(Paragraph 2.5)

- **The capacity determined by the Government initially in value terms and later in quantity terms was on an average 25 to 47 per cent lower than the actual production.**

(Paragraph 2.6.1)

- **While access to records relating to determination of capacity was not provided to audit, scrutiny of other records revealed that the capacity was determined on the basis of minimum tax paying capacity projected by the Industry Association to the Central Board of Excise and Customs.**

(Paragraph 2.6.2)

- **Even though the adverse impact of the scheme was evident in the last quarter of 1998-99, the Government did not take any remedial action till March 2000. The increase in levy from March 2000 was insufficient to plug revenue leakage.**

(Paragraph 2.6.3)

- **The Government failed to tax extra production of fabric using stentors other than hot air stentors/float dryers. The resultant duty foregone in 60 units was Rs.163.46 crore.**

(Paragraphs 2.7.1 & 2.7.2)

- **Processors with proprietary interest in spinning/weaving mills were also allowed to pay duty under the scheme, which resulted in loss of revenue of Rs.21.41 crore in 4 units.**

(Paragraph 2.8.1)

- **Penalty of Rs.12.90 crore and inadmissible/irregular abatement from duty to the extent of Rs.26.99 crore had not been recovered from assessees.**

(Paragraphs 2.8.2 & 2.8.3)

2.2 Introduction

Section 3A was inserted in the Central Excise Act, 1944 with effect from 14 May 1997 by the Finance Act, 1997. This section provided for the levy of excise duty on the basis of capacity of production in respect of certain notified goods. The section stipulated that goods would be notified to safeguard the interest of revenue taking into account factors such as (a) nature of the process of manufacture and (b) the extent of evasion of duty. This section also empowered the Government to make rules to (i) lay down the manner for determination of annual capacity of production in a factory in which such goods are produced, (ii) specify the factors relevant to the production of such goods and (iii) decide the rate of duty.

The Government notified certain processed textile fabrics manufactured by independent textile processors (under Chapters 52, 54, 55, 58 and 60), for levy of duty on the basis of capacity of production with effect from 16 December 1998. For determination of annual capacity, the Government notified the Hot Air Stentor Independent Textile Processors Annual Capacity Determination (HASITPACD) Rules, 1998. Specific rule 96ZQ was framed prescribing the procedure to be followed by independent processors of textile fabrics.

Independent processors undertake the process of bleaching, dyeing, mercerising, stretching, drying, printing, water proofing, shrink-proofing, etc., by means of hot air stentors (comprising of a number of chambers), stentors other than hot air stentors and float dryers or drying machines. The installed capacity depends upon various factors such as the length of the chamber in a stentor, the number of other machines installed separately (float dryer or drying machine) to speed up the one process or the other, the number of processes to be carried out, etc. The value of the grey fabrics as well as the cost of the processing also vary widely depending upon the quality of the final fabric.

2.3 Duty rates fixed under the scheme

In terms of the notifications dated 10 December 1998, the rates of duty were originally fixed as follows: -

(i) For fabrics of an average value upto Rs.30 per square metre, the average value of production per chamber per month was fixed at 11.72 lakh and duty was to be paid at Rs.1.50 lakh per chamber per month.

(ii) For fabrics of an average value exceeding Rs.30 per square metre, the average value of production per chamber per month was fixed at Rs.15.63 lakh and duty was to be paid at the rate of Rs.2 lakh per chamber per month.

In March 2000, the production capacity was re-fixed in quantity terms at 1 lakh square metre per chamber per month. The rates of duty were fixed as under:

(i) For fabrics of average value upto Rs.30 per square metre, duty payable was fixed at Rs.2 lakh per chamber per month.

(ii) For fabrics of an average value exceeding Rs.30 per square metre, the duty payable was fixed at Rs.2.5 lakh per chamber per month.

2.4 Scope of Audit

Extent of evasion of duty being a principal consideration for its introduction, the impact of the scheme on revenue collections was reviewed in audit. For this purpose, records of 394 independent processors out of 871 in 25 Commissionerates of Central Excise for the period 16 December 1998 to 31 December 2000 were test checked during July 2000 to January 2001. Findings are contained in the succeeding paragraphs.

2.5 Impact on revenue

2.5.1 The impact of the scheme on revenue collections from the sample 394 units for the period 16 December 1998 to 31 December 2000 is presented below: -

	Pre scheme period (1.4.1998 to 15.12.1998)	**Scheme period (16.12.98 to 31.12.2000)**	**Percentage increase (+)/ decrease(-)**
Average quantity produced per month (in lakh sq. metres)	1904.46	3161.66	66.01 (+)
Average quantity cleared per month (in lakh sq. metres)	1881.19	3157.09	67.82 (+)
Average value of clearance per month (Rs. in lakh)	43807.04	78430.24	79.03 (+)
Average amount of duty paid per month (Rs. in lakh)	5607.30	4293.38	23.43 (-)
Percentage of duty paid to value	12.80	5.47	57.26 (-)
Amount of duty paid per sq. metre cleared (Rs.)	2.98	1.36	54.36 (-)

The above table reveals that: -

(i) Average duty paid per month by the sample units declined by 23.43 per cent, even though the average value of clearances per month was higher by 79.03 per cent in the period after the introduction of the scheme.

(ii) Duty paid as a percentage of the value of cloth cleared fell to 5.47 per cent from 12.8 per cent ad valorem prevailing during the pre-scheme period. Likewise, the average duty paid per square metre of cloth decreased from Rs.2.98 to Rs.1.36 after the introduction of the scheme. Thus both in value and in quantity terms, there was reduction in the incidence of duty to the extent of 57.26 and 54.36 per cent respectively.

2.5.2 It would, therefore, emerge that while the Parliament voted an amendment to the Central Excise Act to enable the Government to safeguard revenue, the capacity determination scheme for processed fabrics resulted in fall in revenue collection. Audit scrutiny reveals that this was due to more than 50 per cent reduction in the incidence of duty which was not envisaged in the enabling section 3A. This reduction in incidence of duty could, therefore, only be unintended. Audit estimated that this reduction in the incidence of duty resulted in short collection of revenue to the extent of Rs.1132.41 crore between 16 December 1998 and 31 December 2000 in respect of the sample units which is 112 per cent of the amount collected (Rs.1015.80 crore) from them. In other words there was leakage of revenue to the extent of 57 per cent.

2.6 Analysis of negative impact

In view of the significant adverse effect of the scheme on revenue collections, an effort was made in audit to determine: -

(a) Whether the under-realization of revenue was attributable to short determination of capacity,

(b) If so, what was the basis adopted by the Government for determination of capacity and whether the same was justified, and

(c) How responsive Government was to the trends of revenue collections and the need to protect revenue.

2.6.1 Determination of capacity

2.6.1.1 Value based

For the purpose of determination of annual capacity of production, the Government initially fixed the average value of production per chamber per month as Rs.11.72 lakh and Rs.15.63 lakh based on the average value of fabrics. Audit scrutiny of the relevant records of 358 units

revealed that there were wide variations in the actual average value of production per chamber per month as compared to the average value fixed by Government as per the table given below: -

(i) Where capacity fixed at Rs.11.72 lakh per chamber per month

(Amount in lakh of rupees)

Sl. No.	Chief Commissionerate	No. of Units	Actual average value of production per chamber per month	Determined value as a percentage of actual
1.	Chennai	07	26.02	45.04
2.	Delhi	37	12.73	92.06
3.	Hyderabad	19	10.16	115.35
4.	Jaipur	02	21.85	53.64
5.	Lucknow	07	17.42	67.27
6.	Mumbai	69	21.76	53.86
7.	Pune	12	13.70	85.55
8.	Vadodara	163	16.78	69.84
	Total	**316**	**15.27**	**76.75**

(ii) Where capacity fixed at Rs.15.63 lakh per chamber per month

(Amount in lakh of rupees)

Sl. No.	Chief Commissionerate	No. of Units	Actual average value of production per chamber per month	Determined value as a percentage of actual
1.	Delhi	07	32.59	47.96
2.	Jaipur	13	26.76	58.40
3.	Lucknow	01	35.60	43.90
4.	Mumbai	17	36.09	43.30
5.	Vadodara	04	23.68	66.00
	Total	**42**	**29.57**	**52.86**

The above tables reveal that: -

- The difference between the actual value of production and the value fixed by the Government was more pronounced in the units processing fabrics of superior quality (average value exceeding Rs.30 per square metre). The capacity of Rs.15.63 lakh fixed by the Government on processing of superior fabrics was much below the actual value of production in these units. In 42 units in five Commissionerates of Central Excise, the value fixed by the Government was almost half of the actual average value of production per chamber per month recorded by these units.

- As against value of Rs.15.63 lakh fixed by the Government, the actual value of clearance in the units under Mumbai Chief Commissionerate of Central Excise was 36.09 lakh per

chamber per month. In other words, the Government had determined capacity only to the extent of 43 per cent.

2.6.1.2 Quantity based

The scheme was modified with effect from 1 March 2000 determining capacity in quantity terms. The capacity of a hot air stenter was fixed in quantity terms at 1 lakh square metre per chamber per month. Audit scrutiny of the records of 366 assessees in 25 Commissionerates of Central Excise revealed that the actual average quantity of production per chamber per month varied from 0.92 lakh square metre to 2.12 lakh square metre in different Commissionerates as per table given below: -

Sl. No.	Chief Commissionerate	No. of Units	Actual average quantity of production per chamber per month (1999-2000) as against deemed quantity of production of 1 lakh square metre	Determined capacity as a percentage of actual production
1.	Chennai	04	1.35	74.07
2.	Delhi	44	0.96	104.17
3.	Hyderabad	19	0.92	108.69
4.	Jaipur	16	1.11	90.09
5.	Lucknow	09	1.30	76.92
6.	Mumbai	88	1.40	71.43
7.	Pune	12	2.12	47.17
8.	Vadodara	174	1.67	59.88
	Total	**366**	**1.32**	**75.76**

The above table also reveals that: -

- In Vadodara Chief Commissionerate of Central Excise which has the largest concentration of processing units, the deemed quantity fixed by the Government constituted only 60 per cent of the actual average quantity of production recorded by 174 units.

- Actual average quantity of production per chamber per month worked out to 1.32 lakh square metre in respect of 366 units which was higher by 32 per cent than the deemed quantity fixed by the Government.

It is, therefore, obvious that the Government's estimation of capacity of the units fell far short of the actuals both in terms of value and quantity.

2.6.2 Justification of the basis for capacity determination

2.6.2.1 Value based

In order to examine the reasonableness of the basis adopted by the Government in determining the capacity, they were requested, in January 2001, to provide access to the

relevant records to which no response was received. Audit scrutiny of correspondence between Central Board of Excise and Customs and the Commissionerates of Central Excise, however, revealed that a review by the Board during 1997 had shown that the revenue collected per chamber per month varied from Rs.25,000 to Rs.5,00,000 and above. In a meeting taken by the then Chairman of the Board, the representatives of the Independent Processor's Association assured him that revenue from a unit could not work out to less than Rs.1.50 lakh per month per working chamber. Since the same figure was adopted for notifying the duty rates in December 1998, it is inferred in audit that this formed the basis of capacity determined under the scheme. Thus, despite an apprehension of major evasion of duty in this industry, the Government relied on the minimum estimate of duty payable made by the Association's representatives rather than carry out an independent evaluation to gauge the extent of evasion and work out the reasonable amount of value of clearances and duty which could be realised per chamber. Reliance on this figure resulted in substantial percentage of production escaping levy as indicated in the preceding para.

2.6.2.2 Quantity based

In the absence of access to the basis adopted by the Government for determining the capacity of production of a chamber in a stenter introduced with effect from 1 March 2000, audit obtained technical opinion of the Government Textile Institute, Kanpur on whether the production of a stenter can at all be rationally and reasonably fixed in terms of value or in terms of quantity. They held that the capacity of a chamber/stenter is dependent on several variables such as length of chamber, speed of operation, nature of operation, mass of fabrics, the amount of water to be evaporated, the temperature, the sequence of processes decided to be carried out, etc. They suggested that in view of the large number of variables involved, the production capacity can be best decided by the charges levied by the processors for processing of the fabrics. It would, therefore emerge that the decision of the Government to fix production capacity in terms of value or quantity was technically unsound. As brought out in the preceding paragraphs the capacity fixed turned out to be only three fourth of the average actual production.

It can, therefore, be surmised that use of the enabling powers vested by section 3A was not preceded by any scientific or professional effort towards determining the capacity of the processing units. Not surprisingly, the new scheme failed in plugging revenue leakage. Instead it provided legitimacy to clearance of substantial quantities of fabrics without incidence of duty.

2.6.3 Response of the Government

The primary objective of the scheme being safeguarding of revenue and plugging of leakages, it was imperative that revenue trends be closely monitored to assess the efficacy of the scheme in realizing its objectives and to fine tune its parameters. Audit analysis of the trend of revenue for first two and half months (16 December 1998 to 29 February 1999) of the

operation of the scheme revealed that the negative impact of the scheme in respect of the 394 sample units located in 8 Commissionerates of Central Excise was quite apparent as under: -

	Pre scheme period (1.4.1998 to 15.12.1998)	**Scheme period (16.12.98 to 29.02.99)**	**Percentage increase (+)/ decrease(-)**
Average quantity cleared per month (in lakh sq. metres)	1881.19	2735.63	45.42(+)
Average value of clearance per month (Rs. in lakh)	43807.04	64438.33	47.09(+)
Average amount of duty paid per month (Rs. in lakh)	5607.30	4568.00	18.53(-)
Percentage of duty paid to value	12.80	7.09	44.61(-)

(a) Average monthly payment of duty fell from Rs.5607.30 lakh to Rs.4568.00 lakh i.e. fall of 18.53 per cent.

(b) Average value of clearance per month during this period rose from Rs.43,807.04 lakh to Rs.64,438.33 lakh indicating a steep fall in incidence of duty from 12.8 per cent to 7.09 per cent.

The existing system of information in the Central Excise Ranges/Commissionerates provides availability of revenue collections on a monthly basis. Therefore, this trend should also have been obvious to the Government. However, it was only in 2000-01 Budget that the Government took cognisance of the failure of the scheme, when the Finance Minister in his budget speech stated that 'this has not worked as well as expected and has led to leakages and revenue losses'. Rather than withdrawing the scheme, the Government took adhoc measures, which included revision of rates of duty from Rs.1.5 lakh to Rs.2 lakh and from Rs.2 lakh to Rs.2.5 lakh (depending upon the average value of fabrics) from March 2000, and fixation of the production capacity in quantity terms from March 2000, etc.

Audit scrutiny for the period from 1 March 2000 to 31 December 2000, however, revealed that the modifications, as announced by the Finance Minister in his Budget speech 'in order to plug loopholes', failed to arrest the downward trends in the collections of the revenue, as would be evident from the table as given below :

	Pre scheme period (1.4.1998 to 15.12.1998)	**Scheme period (01.03.2000 to 31.12.2000**	**Percentage increase (+)/ decrease(-)**
Average quantity cleared per month (in lakh sq. metres)	1881.19	3284.51	74.60(+)
Average value of clearance per month (Rs. in lakh)	43807.04	84787.71	93.55(+)
Average amount of duty paid per month (Rs. in lakh)	5607.30	4520.85	19.37(-)
Percentage of duty paid to value	12.80	5.33	58.34(-)

- While the average value of clearance per month in the period from 1 March 2000 to 31 December 2000 rose sharply by nearly 94 per cent, the average amount of duty collected during this period witnessed a decline of nearly 20 per cent as compared to the pre scheme period.

- The incidence of duty as percentage of value was lower by 58 per cent.

Thus, having ventured into determining capacity of a complex sector without adequate preparatory work, the Government did not react promptly to the adverse impact on revenue and when it did react, the response was insufficient to correct the trend.

2.7 Other lacunae in the scheme

2.7.1 Escapement of duty on fabrics processed by means of stenters other than hot air stenter

The Ministry of Finance, vide circular dated 16 July 1999 clarified that where there are no insulated chambers in the stenter, the determination of average value of production of any independent processor will not be possible and in such cases, compounded levy will not be applicable. This means that an independent processor having open stenter or other fabricated stenters, which perform the function of stretching, drying and LPG heating without blowers will have to pay duty on ad valorem basis. On the other hand, an independent processor who has open air stenters as well as hot air stenters will have to pay duty under the compounded levy scheme only on the fabrics processed through hot air stenter. With the aid of other stenters, such an independent processor will, hence produce more fabrics than a processor having only open air stenters or other fabricated stenters. But for the purpose of capacity determination under the scheme, no mechanism was devised to take care of the extra production of fabrics by means of other stenters.

Audit scrutiny revealed that 29 units, in four Commissionerates of Central Excise, had deployed open stenters for augmenting the production of processed fabrics. The duty escaped through this lacuna is estimated to be Rs.36.28 crore as per following details:

(Amount in crore of rupees)

Sl. No.	Commissionerate	No. of units	No. of stenters	No. of chambers	Duty involved
1.	Ahmedabad	24	37	111	31.78
2.	Hyderabad III	1	1	3	0.24
3.	Meerut I	2	2	6	2.13
4.	Meerut II	2	2	6	2.13
	Total	**29**	**42**	**126**	**36.28**

2.7.2 Fabrics processed with the aid of float dryers or drying machine separately installed escaped duty

As per explanation I of Hot Air Stenter Independent Textile Processors Annual Capacity Determination Rules, 1998, a float drying machine or any other equipment of length 3.05 metres installed in or attached to a stenter for aiding the process of heat-setting or drying of the fabrics shall be deemed to be one chamber of stenter. Further, explanation II of the said Rules also provides that the goods shall be deemed to have been manufactured or produced with the aid of a hot air stenter, if they are cleared from a factory where a hot air stenter is installed, irrespective of whether it is in use or in working condition or otherwise.

The Ministry of Finance, vide circular dated 27 February 1999 clarified that float dryers or any other equipment which is not installed in or attached to a stenter, for aiding the process of heat setting or drying of the fabrics shall not be taken into consideration for computing the number of chambers. It further clarified that in case such equipment, even though used in the processing factory, is not installed in or attached to a hot air stenter, the same shall not be relevant for computing the number of chambers.

Audit scrutiny revealed that float dryers or drying machine, whether attached to a hot air stenter or separately installed, perform the function of drying fabrics. On a reference made by Audit, the Government Central Textile Institute, Kanpur opined (on 26 April 2001) that 'higher speed of passing fabrics through stenter depends upon the mass of fabric and the amount of water to be evaporated at the time of heat setting. If the fabric is fed in wet condition, the first chamber is used for drying before subjecting the fabrics to the optimum heat setting temperature'. As the drying ranges are used for drying wet fabrics before passing it through stenter for heat setting, it naturally aids in processing and perform the function of first chamber. Thus, if drying and other processes are carried out in separate drying ranges then the stenter machine will be free for other jobs, which will result in more production in comparison to a situation where all these processes are carried out by stenter machine only. It is, therefore, clear that float dryers or drying machines would add to the capacity of the unit.

Ignoring the float drying machine or any other equipment, if not attached to the stenter, in computation of capacity determination, resulted in escapement of duty to the extent of Rs.127.18 crore as per the details as follows : -

(Amount in crore of rupees)

Sl. No.	Commissionerate	No. of Units	No. of chamber calculated on the basis of float dryers/drying machines	Compound duty involved
1.	Allahabad	01	2.00	0.88
2.	Jaipur II	18	154.21	69.11
3.	Kanpur I	01	25.00	10.44
4.	Meerut	05	64.00	28.43
5.	Meerut II	06	45.00	18.32
	Total	**31**	**290.21**	**127.18**

2.7.3 Safeguards to protect revenue in case of provisional determination of capacity of production not provided

As per rule 9B of the Central Excise Rules, 1944, where the assessee or the department is not in a position to determine the exact duty liability for want of further information or for any other reason, the assessment can be made provisional subject to the fulfillment of certain conditions as prescribed under the above said rule. One such condition is that the assesee should execute sufficient bond with bank guarantee covering the differential duty liability. However, similar provisions did not exist under the scheme to safeguard the Government revenue while determining capacity of production on provisional basis.

In the case of 29 assessees, in eight Commissionerates of Central Excise, the production capacity was determined on provisional basis between December 1998 and February 1999, which were finalised between July and May 2000 with higher duty liability. However, differential duty amounting to Rs.4.87 crore was still not recovered as the assessees did not execute bond or bank guarantee to cover the differential duty.

2.8 Lapses in implementation

2.8.1 Processors with proprietary interest in spinning/weaving mills allowed to pay duty under section 3A

As per Explanation III under rule 5 of Hot Air Stenter Independent Textile Processors Annual Capacity Determination Rules, 1998 as amended, if the processor of specified fabrics has proprietary interest in any other factory engaged in the spinning of yarn or weaving of fabrics, he cannot be treated as an independent processor for the purpose of levy of duty under section 3A of the Central Excise Act. Since the term 'Proprietary interest' has not been defined any where in the Central Excise Act, the related provisions in the Companies Act (Section 370 sub-section 1B) and in the Monopolies and Restrictive Trade Practices Act (Section 2(g) and explanation thereto) have to be applied for interpretation of this term. As per the clarification dated 28 June 2001 given by the Department of Legal Affairs, two firms having common persons as partners/directors can be considered as undertakings under the same management. It was further clarified that the word 'Proprietary interest' means any right, title etc. which one has by virtue of his being holder of any account of property or establishment. Where proprietary interest in spinning unit or weaving of fabric was proved such independent processors would discharge duty liability on processed fabrics at ad valorem rate.

A test check of commercial records revealed that four assessees, in four Commissionerates of Central Excise, had proprietary interest in other factories engaged in the spinning of yarn or weaving of fabrics in terms of the meaning of proprietary interest given by the Department of Legal Affairs. These four processors were, therefore, not eligible to be covered under section 3A. As a result of this, the Government suffered a loss of Rs.21.41 crore (computed with reference to the duty payable under section 3).

Two such cases are illustrated below: -

(i) In Jaipur II Commissionerate of Central Excise, it was noticed from the balance sheets for the years 1997-98 to 1999-2000 that the directors of M/s Ranjan Processors Limited, Bhilwara had interest in four other units namely M/s Ranjan Suitings (P) Limited, Bhilwara, M/s Ranjan Fabrics (P) Limited, Bhilwara, M/s Mega Syntex (P) Limited., Bhilwara and M/s Bhilwara Polyster (P) Limited, Bhilwara, which were engaged in weaving/spinning of yarn. As such, the unit did not fall within the definition of an independent processor under section 3A and was required to pay ad valorem duty. The payment of duty by the assessee under section 3A resulted in short payment of excise duty of Rs.11.39 crore during the period 16 December 1998 to 31 December 2000.

The department stated (May 2000) that the assessee had no relation with spinning units except one common director. The reply of the department is not tenable because of the meaning of the word proprietary interest, as interpreted by the Department of Legal Affairs. Moreover, the department have also acknowledged a relationship between these units in their adjudication orders (4 October 1999) issued in a different case.

(ii) In another case, in Hyderabad III Commissionerate of Central Excise, it was noticed that a processing unit (M/s. Sanghi Textiles Limited, Sanghinagar) has proprietary interest in the other unit engaged in spinning of yarn. A scrutiny of their annual accounts revealed that (i) the assessee company and the other unit had a common chairman, (ii) four out of five directors (including managing director) of the former unit were also the directors of the later unit during the years 1998-99 and 1999-2000, (iii) both the units were located in adjacent premises and were functioning as a group of companies under the same management, (iv) the units shared a common corporate office from where the administrative and marketing activities were carried out and (v) a common logo was being used on the products marketed from all the companies. The assessee was, therefore not eligible for coverage under section 3A and required to pay duty on ad valorem basis. The payment of duty under section 3A resulted in short payment of duty to the extent of Rs.8.53 crore during the period from 16 December 1998 to 31 December 2000.

The department stated (April 2001) that the assessee would not fall under the category of "composite mill" even though there were common directors. The reply of the department is not tenable in view of the fact that proprietary interest of the assessee in another unit was clearly established.

2.8.2 Non-levy of penalty on non/delayed recovery

As per rule 96ZQ(3), an independent textile processor was required to pay fifty per cent of amount of duty payable for a calendar month under sub-rule (1) of rule 96ZQ by 15 of the month and the balance amount by the end of the month. As per sub-rule (5) of rule 96ZQ, if he fails to pay the amount of duty or any part thereof by the date specified in sub-rule (3), he was liable to pay a penalty equal to an amount of duty outstanding from him at the end of such month or rupees five thousand whichever was greater. Beside, interest was payable at

the rate of 36 per cent upto 28 February 2000 and 24 per cent thereafter for delay in payment of duty beyond the due date.

Test check of records revealed that in 15 Commissionerates of Central Excise, 50 assessees engaged in manufacture of processed textile fabrics did not pay duty amounting to Rs.10.90 crore (till date of audit) and 17 assessees delayed payment of duty amounting to Rs.3.05crore by 1 day to 19 months during the periods between 16 December 1998 to February 2001.

The penalty leviable in respect of 67 cases worked out to Rs.12.90 crore. The department, however, levied penalty of Rs.10,000 only in two cases in Ahmedabad Commissionerate of Central Excise. Two units under Pune Commissionerate of Central Excise were closed and assessee's whereabout not known.

On this being pointed out (April 2001), the department accepted (May 2001) the objection in three cases. Recovery particulars were awaited as on 30 June 2001.

2.8.3 Inadmissible/irregular abatement from duty in case of closure

As per provisions of sub-rule (7) of rule 96ZQ of the Central Excise Rules, 1944 where an independent processor does not produce or manufacture processed fabrics for any continuous period of not less than seven days during the period upto 31 March 2000 and for not less than fifteen days during the period from 1 April 2000 onwards and wishes to claim abatement under sub-section (3) of section 3A, the abatement will be allowed by an order passed by the Commissioner of Central Excise for such amount as may be specified subject to fulfillment of conditions laid down under the said sub-rule.

A test check of records 78 units revealed inadmissible/irregular abatement from duty to the extent of Rs.26.99 crore due to non-fulfillment of the conditions stipulated in the rules.

A few cases are illustrated below:-

(i) In Mumbai IV Commissionerate of Central Excise, M/s. Vishnu Dying and Printing Mills, did not pay duty to the extent of Rs.2.12 crore for the periods when his stenters were closed for more than one month, even though no abatement was allowed by the department as per the procedure laid down under the rules.

(ii) In Mumbai III Commissionerate of Central Excise, M/s. Rotex Textile Mills availed abatement of duty to the extent of Rs.1.82 crore without the same being allowed by the department as per the rules.

(iii) Similarly, in Jaipur II Commissionerate of Central Excise, M/s. Siddharth Processors (P) Limited, Bhilwara availed abatements irregularly to the extent of Rs.1.24 crore for the period when the stentors were closed without the department having allowed the abatements.

2.8.4 Short levy of duty due to increase in the average value of fabrics above Rs.30 per square metre

The rate of duty under Hot Air Stenter Independent Textile Processor Annual Capacity Determination (HASITPACD) Rules, 2000, was fixed at the rate of Rs.2.00 per square metre for fabrics of average value of upto Rs.30 per square metre and Rs.2.50 per square metre for fabrics of average value exceeding Rs.30 per square metre.

M/s. Bronze Processor, Faridabad, in Delhi-II Commissionerate of Central Excise was clearing the goods with the average value below Rs.30 per square metre upto 1998-99. During 1999-2000, the average value of fabrics exceeded Rs.30 per square metre. On the enhancement of average value, the duty liability was to be re-determined at the rate of Rs.2.50 lakh per chamber per month for one stenter having five chambers from 1 April to 30 June 2000 and for three chambers from 1 July to 30 November 2000, but the assessee continued to pay duty at the rate of Rs.2.00 lakh per chamber per month. This resulted in short levy of duty of Rs.15.00 lakh during the period from April to November 2000 besides levy of interest of Rs.1.96 lakh and penalty of Rs.15.00 lakh.

On this being pointed out (October 2000), the department intimated (April 2001) recovery of duty of Rs.15.00 lakh and issue of a show cause notice for the recovery of interest and penalty.

2.8.5 Change in the installed capacity resulting in short payment of duty

As per provisions of rule 5 of the HASITPACD Rules, 1998, in case an independent processors proposes to make any change in the installed machinery or any part thereof which tends to change any of the parameters specified in clause (3) of rule 3, he shall intimate the proposed changes to the Commissioner of Central Excise (C.C.E.) in writing with a copy to the Assistant Commissioner of Central Excise one month in advance and obtain the written permission of the C.C.E. before making such changes, whereafter the C.C.E. shall determine the date from which the changes in the annual capacity shall be deemed to be effective.

In the case of M/s. Bronze Processor, Faridabad, engaged in processing of fabrics with the aid of two stenters having ten chambers in Delhi-II Commissionerate of Central Excise, monthly duty was fixed at the rate of Rs.19.77 lakh from 1 January 1999 and Rs.16.62 lakh from 16 June 1999 onwards. The second stenter installed in the factory was sealed/dismantled by the assessee on 4 February 1999 without any permission of the Commissioner and without following the procedure prescribed under the Rules. The duty was also reduced by the assessee on his own. This resulted in short payment of duty of Rs.24.69 lakh for the period from 16 December 1998 to 29 February 2000.

On this being pointed out (May 2000), the department stated (June 2001) that demand of Rs.24.01 lakh alongwith penalty of equivalent amount and interest at the prevailing rates had been confirmed (March 2001).

2.8.6 Incorrect computation of annual capacity of production

The Annual capacity of production of an independent textile processor has to be determined by the appropriate authority as stipulated in Hot Air Stenter Independent Textile Processors Annual Capacity Determination Rules, 1998. One of the factors for deciding the annual capacity of production is the number of chambers installed in the stenter. Rule 4 to the said Rules provides that the capacity of production for any part of the year or any change in the total number of chambers, shall be calculated pro rata on the basis of annual capacity of production determined in the manner stated in rule 3. Further, Explanation I to the said Rules provides that any equipment attached to stenter aiding the process of heat setting or drying has to be treated as one chamber. A detailed procedure for the removal of a chamber from the stenter machine has been prescribed in Trade Notice dated 22 February 1999 of Chandigarh II Commissionerate of Central Excise.

M/s. Jupiter Textile Processors, in Chennai I Commissionerate of Central Excise, sealed the oil nozzle of one chamber of the stenter machine and applied for refixation of annual capacity of production without removing the side panels of the chamber. Department refixed the annual capacity of production by reducing one chamber. As the chambers were not fully dismantled as prescribed in the trade notice stated above, the enclosed portion between the side panels will retain heat and will aid the process of heat setting or drying. The incorrect redetermination of annual capacity of production resulted in short payment of duty of Rs.21.57 lakh.

On this being pointed out (May 2001), the department while accepting that the chambers were not completely removed stated (July 2001) that the nozzle and radiators were removed as per experts opinion only. The department had, however, issued show cause notice demanding duty for the period from November 1999 to February 2000 (November 2000).

2.8.7 Audit findings on the functioning of the scheme for the period from 16 December 1998 to 31 December 2000 on the basis of test check of the records of only 215 units in the Commissionerates of Central Excise located in Gujarat and Maharashtra was sent to the Government on 12 April 2001 for their comments. The audit had analysed that the capacity fixed by the Government both in terms of value and quantity was much below the actual capacity recorded in these units and that the scheme had adversely affected the revenue. The reply of the Ministry had not been received (January 2002).

2.9 Postscript

After withdrawing the scheme with effect from 1 March 2001, the Government re-introduced a truncated revised scheme in May 2001. This revised scheme was optional and applicable to processors whose original value of the investment in plant and machinery did not exceed rupees three crore. The rate of compounded levy was also increased by Rs.50,000 per stentor. A quick test check of 41 units in 8 Commissionerates of Central Excise revealed that even

under the revised scheme, the duty realised was only 74 per cent of the duty recoverable on ad valorem basis as per the table given below: -

(Amount in lakh of rupees)

Sl. No.	Chief Commissionerate	No. of units	Value of clearances (May & June 2001)	Duty paid	Duty payable (@ 8.8%)	Difference
1.	Chennai	1	408.65	18.75	35.96	17.21
2.	Delhi	4	1446.20	92.00	127.27	35.27
3.	Jaipur	1	1338.22	90.00	117.76	27.76
4.	Mumbai	30	15826.25	1070.00	1392.71	322.71
5.	Pune	5	2247.15	115.00	197.75	82.75
	Total	**41**	**21266.47**	**1385.75**	**1871.45**	**485.70**

In respect of these 41 units alone, the loss of revenue during 2 months was Rs.5 crore. Since reasonable fixation of capacity on notional basis was not technically feasible as pointed out in preceding paras, the continuation of this scheme would have adverse impact on the revenue, apart from providing legitimacy to the processors to clear substantial quantity of fabrics without payment of appropriate duty.

2.10 Conclusion

In sum, while powers were vested with the Government to levy duty based on capacity of production to plug revenue leakage, the scheme formulated for the processed fabrics industry had the opposite effect. Determination of capacity of stentors, dependent on several variables, was apparently done by the Government on an adhoc basis resulting in substantial under-determination of capacity and consequent clearance of large quantity of fabrics without payment of duty. Further, despite elaborate machinery for monitoring tax collections, the Government was not able to promptly respond to the falling revenue from this sector despite an increase in clearances. Even the optional scheme introduced as a part of the Budget 2001-02 is adverse to revenue and needs to be withdrawn.

The above observations were pointed out in October 2001; reply of the Ministry of Finance had not been received (January 2002).

CHAPTER 3 : TOPICS OF SPECIAL IMPORTANCE

3.1 Absence of appropriate provision in the Rules enabled assessees to get unintended benefit

Rule 57C of the Central Excise Rules, 1944, does not allow a manufacturer to take credit of duty paid on inputs used in the manufacture of final products which are exempt from whole of duty of excise or are chargeable to 'nil' rate of duty. Where a manufacturer takes credit on inputs which are used in manufacture of dutiable final product as well as in fully exempted final product or final product chargeable to 'nil' rate of duty, rule 57CC provides for payment of amount equal to 8 per cent of the price of the second category of final products. There is, however, no provision in the rule to ensure that if the credit taken for duty paid on inputs exceeds the duty payable on final products, the balance would be recovered or lapsed.

Test check of records of 38 assessees (sugar factories), in Aurangabad, Coimbatore, Madurai, Pune I, II and Trichy Commissionerates of Central Excise, revealed that these assessees used molasses in the manufacture of denatured spirit (dutiable) as well as in rectified spirit (non-dutiable) finished goods. Modvat credit of Rs.47.97 crore was availed by these assessees for duty paid on molasses used in manufacture of rectified spirit between April 1997 and March 2000. As against this, an amount of Rs.16.62 crore, representing 8 per cent of the value of the rectified spirit was paid on clearances of rectified spirit. Surplus credit balance of Rs.31.35 crore was utilised for payment of duty on sugar even though molasses was not an input into manufacture of sugar. This led to unintended benefit of credit of Rs.31.35 crore.

On being pointed out (between March 1999 and May 2000), the Ministry of Finance stated (December 2001) that inclusion of molasses used in the rectified spirit under rule 57CC was a policy matter.

The fact remains that absence of appropriate provision in rule led to passing on unintended benefit to the manufacturer. Necessary provisions have been made in rule 57CC and in the new Cenvat rules (1 April 2000) to mitigate such unintended benefits in respect of exempted goods like tyres and tubes for animal drawn vehicles/hand carts, black and white television sets, news prints etc. The rule requires payment of duty equivalent to credit availed instead of 8 per cent. Molasses used in rectified spirit has, however, not been covered and the manufacturers will continue to derive unintended benefit.

3.2 Ambiguous notifications led to non-levy of additional duties

Under the Export Oriented Units Scheme introduced by a Ministry of Commerce resolution dated 31 October 1980, Export Oriented Units (EOU) are permitted to sell upto 25 per cent of their finished goods in the Domestic Tariff Area (DTA) on payment of Central Excise duties

at the rates prescribed but only after achieving the prescribed value addition and fulfilment of export obligations.

By a notification dated 26 May 1984, all excisable goods produced or manufactured in a hundred per cent EOU are exempt from the whole of the duty of excise leviable provided that such goods are not allowed to be sold in India. In terms of a notification dated 4 January 1995, goods manufactured by a hundred per cent EOU and allowed to be sold in India are exempt from so much of the duty of excise leviable thereon under section 3 of the Central Excise Act as is in excess of the amount calculated at the rate of 50 per cent of the duties of customs leviable, provided that the amount of duty payable shall not be less than the duty of excise leviable on the goods produced or manufactured by non-hundred per cent EOUs. It is clear that the intention is to ensure that no excise duty benefit accrues to EOUs in respect of their DTA sales.

A check of records of 85 assessees (hundred per cent EOUs), in 22 Commissionerates of Central Excise, revealed that the units cleared textiles and textile articles for domestic consumption without payment of additional duties leviable under Additional Duties of Excise (Goods of Special Importance) Act, 1957 and Additional Duties of Excise (Textiles & Textile Articles) Act, 1978, claiming exemption under notifications dated 26 May 1984 and 25 July 1991. Audit observed that these notifications exempted goods produced in a hundred per cent EOU from additional duties of excise leviable under the said Acts of 1957 and 1978. These notifications did not specifically grant exemption to goods cleared for sale in domestic tariff area by hundred per cent EOU. Further, similar goods manufactured by non-EOU were leviable to these duties. Moreover, the levy of additional duty under Additional Duty of Excise (Goods of Special Importance) Act, 1957 was in lieu of sales tax imposed by the states declaring certain goods to be of special importance in the course of inter-state trade or commerce. Therefore, exemption availed was incorrect and resulted in non-levy of additional duties amounting to Rs.17.25 crore between April 1992 and March 2001.

On being pointed out between October 1996 and July 2001, the department recovered Rs.1.17 lakh from a unit in May 2001 and issued show cause notices for recovery of duty of Rs.96.69 lakh from six units in February 2001. In case of 47 units, the department contended (between January 1997 and June 2001) that notifications exempted goods produced in hundred per cent EOUs from additional duties irrespective of the fact whether the same was cleared for export or for home consumption (i.e. DTA).

The reply of the department is not tenable as the exemption under these notifications is intended only for goods exported by EOUs. Since 'domestic tariff area clearances' have not specifically been mentioned in these notifications, exemption in respect of goods cleared in DTA was not available. Further, the reply of the department creates partiality between the excisable goods cleared for sales in DTA by hundred per cent EOUs and non-hundred per cent EOUs.

The Ministry of Finance contended (November/December 2001) that the exemption notifications had been issued to avoid double levy of the additional duties of excise leviable

under both the Acts, ibid, as the goods cleared to the DTA were subjected to the additional duties of excise while computing the additional duty of customs in accordance with section 3 of the Customs Tariff Act.

The fact however, remains that the additional duties of excise leviable under both the Acts ibid, escaped levy because of exemption notifications.

3.3 Failure to amend Rubber Act - payment of cess and interest deferred indefinitely

In para 88(i) of the Audit Report for the year 1977-78, mention was made about the absence of provisions in the Rubber Act and Rubber Rules providing for levy of interest for belated payment of cess on rubber assessed by the Rubber Board. Ministry of Commerce stated in 1979 that the amendment to the Rubber Act would be carried out after necessary legislation. Later, the Rubber Board through its office note dated 10 June 1988 decided to levy interest at the rate of 12 per cent per annum on all arrears of excise duty (cess) on rubber, effective from April 1988.

A check of records of the Rubber Board (September 2000) disclosed that cess amounting to Rs.2.59 crore assessed upto 1998-99 was pending realisation as on 31 March 2000, of which Rs.95.01 lakh related to the period upto 1989-90. Interest at the rate of 12 per cent per annum was also recoverable on Rs.2.59 crore which amounted to Rs.1.89 crore till March 2000.

On the non-collection of cess with interest being pointed out (September 2000), the Rubber Board stated (July 2001) that in the absence of enabling provisions in the Rubber Act/Rules, Board was not in a position to collect the same effectively and that necessary proposals submitted by the Board were under consideration of the Ministry. The amendment of the Rubber Act for levy of penal interest promised by the Ministry of Commerce in 1979 has not yet been carried out. Failure to enact amendment in this regard enabled the assessees to defer payment of the cess indefinitely.

The Ministry of Commerce and Industry while confirming facts stated (October 2001) that many of the provisions of the Rubber Act had become redundant during the passage of time. Therefore, they had decided to carry out comprehensive amendments in the Act which also includes the amendment for levy of interest on belated payment.

3.4 Excessive and incorrect grant of deemed credit

Under rule 57A(2) {from 23 July 1996 and 57A(5) from 1 March 1997}, Government may declare inputs on which duties of excise or additional duty paid shall be deemed to have been paid at such rates or equivalent to such amounts as may be specified in the notification and

allow Modvat credit of such declared goods deemed to have been paid. The above wording in the rule makes it clear that duty on inputs should have been paid to make them eligible for deemed credit.

Further while interpreting a similar provision {rule 57G(2) prior to 23 July 1996}, the Tribunal, in the case of M/s. Machine Builders {1996 (83) ELT 576} ruled that "the intention is not to deem that the inputs which actually did not suffer duty are inputs which suffered duty. The purpose is to ensure the benefit to those who use inputs in the manufacture of which duty has actually been paid, but it might not be possible to produce duty paying documents".

Government issued two notifications dated 23 July 1996 and 3 September 1996 allowing deemed credit to fabric processors, to the extent of 50 to 70 per cent of duty paid on the final products. In the first notification dated 23 July 1996, dyes, chemicals, consumables and packing materials were not declared as eligible inputs, while in the second notification, dated 3 September 1996, the said inputs were so declared. 'Grey fabric' which is the main raw material for producing processed fabrics, has not been declared as eligible input in either of those notifications. In the case of composite mill, the provisions of notifications shall apply only to the processed fabrics manufactured from unprocessed fabrics not woven in the same composite mill.

(a) A test check of records of 67 assessees, in Ahmedabad I, Bangalore II and Surat I Commissionerates of Central Excise, engaged in the manufacture of processed fabrics using 'grey fabric' purchased from outside, and falling under sub-headings 5207.10, 5208.10 and 5209.10 and dyes, chemicals etc., falling under chapter 32, revealed that they were allowed deemed credit of Rs.73.40 crore between September 1996 and December 1998 despite the fact that 'grey fabrics' were not eligible inputs and exempt from duty. Allowing of deemed credit in these cases was accordingly not correct.

On being pointed out (between September 1999 and March 2001), the Ministry of Finance contended (October 2001) that the deemed credit was admissible even though the declared inputs were not directly used by the manufacturers of declared final products. It was further contended that the Tribunal's decision was not relevant to the case as it related to rule 57G.

Reply of the Ministry is not tenable as the declared inputs were not procured by the assessee, therefore direct or indirect use of declared inputs would not arise. The ratio of the Tribunal's judgement is also relevant as it relates to the allowance of deemed credit on inputs which did not suffer duty. It is of no relevance if such deemed credit is allowed under rule 57G or under rule 57A. Further the purpose of deemed credit would be to reimburse the duty paid on the inputs, major portion of which did not suffer duty and the amount of deemed credit allowed has far exceeded the amount of duty paid on the minor inputs. The duty paid on inputs was Rs.19.28 crore whereas deemed credit allowed was Rs.73.40 crore which resulted in undue financial benefit of Rs.54.12 crore to the processors.

(b) M/s. Arihant Industries Limited, Ludhiana, in Chandigarh I Commissionerate of Central Excise, availed deemed credit under the provisions of the notifications ibid. Records

of the assessee revealed that it was a public limited company falling under the definition of a composite mill having its other units engaged in the spinning of yarn from fibres and weaving of fabrics therefrom. The assessee was not entitled to the benefit of deemed credit. The credit availed incorrectly during the period June 1998 to March 1999 amounted to Rs.1.15 crore.

On being pointed (April 1999), the Ministry of Finance contended (November 2000) that the matter was in the knowledge of the department and a corrigendum to show cause notice dated 14 December 1998 was issued on 29 December 1998 denying the entire amount of deemed credit.

The reply of the Ministry is not tenable as show cause notice dated 14 December 1998 and its corrigendum dated 29 December 1998 clearly indicates that these related to the reduction of deemed credit from 60 per cent to 50 per cent and not to the denial of entire deemed credit.

CHAPTER 4 : REBATE AND REFUND OF DUTY

4.1 Incorrect grant of refund

(i) As per section 133 of the Finance Act, 1999, additional duty of excise at Re.one per litre is leviable with effect from 1 March 1999 on 'High speed diesel oil' (HSD) manufactured in India.

A test check of refund claims sanctioned by Shillong Commissionerate of Central Excise, revealed that M/s. Numaligarh Refinery, a joint sector oil refinery, was granted refund of additional duty of excise of Rs.107.13 crore which was paid on HSD oil during the period from April 2000 to April 2001. The refund was granted on the strength of a notification dated 8 July 1999 as amended on 9 February 2000 which exempted goods cleared from Numaligarh Refinery from duty of excise leviable under Central Excise Act, 1944 and additional duty of excise leviable under Additional Duty of Excise (Goods of Special Importance) Act, 1957. As the additional duty on HSD oil leviable under Finance Act, 1999, was neither covered by the said notification nor was exempted separately, refund of duty of Rs.107.13 crore was incorrect.

On being pointed out (July 2001), the Ministry of Finance, while admitting the objection, stated (January 2002) that an amount of Rs.10.75 crore had been realised and show cause notices for an amount of Rs.111.52 crore for the period from May 2000 to May 2001 had been issued in July 2001.

(ii) M/s. I.T.I. Limited, Bangalore, in Bangalore II Commissionerate of Central Excise, engaged in the manufacture of telecommunication equipment, had cleared goods during 1997-98 on payment of duty on a provisional basis. The assessment was finalised in February 1999 and an amount of Rs.64.08 lakh was refunded as duty paid in excess.

A check of the final assessment statement disclosed that the final assessment made by the department was not correct as in the case of some invoices value of goods and rate of duty adopted was lesser. Actually duty paid provisionally was short by Rs.4.16 lakh. Therefore, duty of Rs.64.24 lakh refunded was not correct and the assessee was liable to pay duty of Rs.68.40 lakh (Rs.64.24 lakh refunded plus Rs.4.16 lakh paid short).

On being pointed out (January 2000), the Ministry of Finance admitted the objection and stated (July 2001) that the entire amount of duty had been recovered.

4.2 Loss of revenue due to delay in refund

As per section 11BB of the Central Excise Act, 1944, if any duty ordered to be refunded under sub-section (2) of section 11B to any applicant is not refunded within three months from the date of receipt of application, there shall be paid to the applicant interest at fifteen per cent per annum on such duty from the date immediately after the expiry of three months from the date of receipt of such application till the date of refund of such duty.

M/s. Hindustan Motors, Hooghly, in Calcutta IV Commissionerate of Central Excise, manufacturing motor vehicles falling under chapter 87, cleared goods on payment of full rate of duty. Later such motor vehicles were got registered as 'taxi' and refund claimed for differential duty. Scrutiny of the refund claims revealed that they were submitted within the stipulated period but the department sanctioned the refund claims with delays ranging from 4 to 386 days counted after expiry of three months from the date of receipt of refund applications. Accordingly, assessee filed claims demanding interest of Rs.4.16 crore on delayed payment of refund as per section 11BB of the Act. The department had paid interest amounting to Rs.69.95 lakh till date of audit. Inaction on the part of the department to sanction the refund claims within the period of three months resulted in loss of revenue.

On being pointed out (December 1999), the Ministry of Finance admitted the delay and stated (December 2001) that out of the total claims of Rs.4.16 crore, amount of Rs.0.70 crore had been paid, claims for Rs.1.91 crore had been rejected and claims for the balance amount of Rs.1.55 crore were being processed.

4.3 Incorrect availment of rebate of duty

As per notification dated 22 September 1994 issued under rule 12 of the Central Excise Rules, 1944, rebate of duty paid in excess of Rs.24.94 per kilo litre on aviation turbine fuel (ATF) exported as stores for consumption on board an aircraft on foreign run is admissible subject to fulfilment of certain conditions. The benefit of the notification is not applicable to aircraft on foreign run to Nepal.

M/s. Bharat Petroleum Corporation Limited, in Delhi I Commissionerate of Central Excise, was allowed to export aviation turbine fuel (ATF) as stores for consumption on board an aircraft on foreign run to Nepal under bond under rule 13. Duty of Rs.24.94 per kilo litre only was paid by the assessee by self availing of the rebate under notification dated 22 September 1994 issued under rule 12. Since rebate under this notification was not applicable to ATF exported to Nepal, grant of rebate of duty of Rs.2.56 crore during April 1999 to March 2001 was incorrect.

On this being pointed out (November 2000 and June 2001), the department stated (March 2001) that the show cause notice for Rs.1.14 crore had been issued for recovery of duty for

the year 1999-2000. Action taken for recovery of duty for the period from April 2000 had not been intimated (June 2001).

The Ministry of Finance contended (December 2001) that the facility had been extended to air flights to Nepal by notification dated 26 June 2001 and during the period prior to 26 June 2001, facility was available under executive instructions of 1949 and 1950 which had the force of law.

Reply of the Ministry is not tenable as the executive instructions of 1949 and 1950 had lost validity after issue of statutory notification dated 22 September 1994 which specifically denied the benefit to air crafts on foreign run to Nepal. Therefore, rebate availed was in contravention of the notification which was in force during the relevant period.

CHAPTER 5 : EXEMPTIONS

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

5.1 Incorrect grant of exemption on intermediate goods

As per notification dated 16 March 1995 (as amended), specified inputs manufactured in a factory and used within the factory of production in or in relation to the manufacture of specified final products were exempt from duty provided that the final product was not exempt from whole of duty or chargeable to nil rate of duty. Petroleum goods falling under sub-heading 2710.19 (except natural gasoline liquid) were excluded from the specified inputs under this notification.

(a) M/s. Mishal Zinc Industries and M/s. Indo Deutsche Mettallo Chimique Limited, in Pune II Commissionerate of Central Excise, having factories adjacent to each other, were clearing excisable goods to each other without payment of excise duty claiming exemption under the notification ibid. The assessees were independent legal entities with separate excise and sales tax registrations. The goods were cleared outside the factory to one another after payment of sales tax, turnover tax etc. They cannot, therefore, be treated as captive consumption. Therefore, availment of exemption of Rs.83.17 crore during the period from August 1998 to November 1999 was incorrect. Besides the action of the assessees also attracted penal provisions under rule 173Q of the Central Excise Rules, 1944.

On this being pointed out (May 2000), the department admitted the objection (March 2001) and issued show cause cum demand notices for Rs.7.06 crore for the month of November 1999 on 30 November 2000. The demands for the earlier period were held as time barred. The fact remains that such blatant misuse of the exemption notification by two units located in the same range could have been detected by the Range officers while scrutinising the monthly returns. Responsibility for this may be fixed.

Reply of the Ministry of Finance had not been received (January 2002).

(b) M/s. Indian Oil Corporation, Haldia, in Kolkata II Commissionerate of Central Excise, manufactured V.B. gasoline (falling under sub-heading 2710.19) and cleared the same within the refinery for use in blending for manufacture of motor spirit. It also manufactured asphalt (heading 27.14), S.R. (sub-heading 2707.90) and extract (sub-heading 2707.90) and cleared

these within the refinery for manufacture of furnace oil (final product) which was cleared out side the refinery claiming exemption from duty under notification dated 23 July 1996. Duty on intermediate products was neither paid by the assessee nor demanded by the department even though exemption notification for captive consumption of 16 March 1995 was not applicable to input goods of sub-heading 2710.19 and input goods used in exempted final goods. This resulted in non-levy of duty of Rs.13.14 crore on the clearances between April 1997 and March 2000.

On being pointed out (July 2000), the department contended (January 2001) that duty was not levied on such intermediate products as the refinery was allowed to blend or treat their product or conduct further manufacturing process in terms of rule 139 read with rule 143A of the Central Excise Rules, 1944.

The contention of the department is not tenable. Rule 139 read with rule 143A deals with only movement of goods from one warehouse to another or from one tank to another tank within the refinery and not for the use of such products for blending, processing or other treatment for manufacture of final products. The latter would require a specific exemption notification. The audit contention finds support from the earlier notification dated 1 March 1989 (operative upto 28 February 1994) which granted specific exemption to such intermediate products.

Reply of the Ministry of Finance had not been received (January 2002).

(c) A public sector undertaking in Bhubaneswar II Commissionerate of Central Excise, manufactured spade plates (sub-heading 7225.30) and spade annealed plates (sub-heading 7225.90) and used them captively without payment of duty for manufacture of parts of main battle tanks to be used as original equipment part of such tanks and thus not dutiable under a notification of 28 February 1999. As the final product was cleared without payment of duty, grant of exemption on spade plates and spade annealed plates was incorrect. This resulted in short levy of duty of Rs.9.44 crore during the period from April 1998 to May 2000 after allowing adjustment of Rs.10.18 crore i.e. the amount of 8 per cent paid on spade plates under rule 57CC.

On being pointed out (February 2001), the Ministry of Finance admitted the objection (December 2001).

(d) M/s. Jay Cee Coach Builders Limited, Lalru, in Chandigarh I Commissionerate of Central Excise, manufactured seats falling under heading 94.01 and used these in manufacture of motor vehicle bodies without payment of duty availing exemption under said notification. Availment of exemption on seats was incorrect as duty was not paid on clearances of motor vehicles bodies. This resulted in short levy of duty of Rs.47.20 lakh between April 1997 and September 1998.

On being pointed out (October 1998), the department confirmed the demand of Rs.28.65 lakh for the period from May 1998 to November 1999 apart from interest payable under section 11AB and penalty of Rs.3 lakh under rule 173Q (February 2000). Report of the department/Ministry on recovery of confirmed demand and action taken to recover duty of Rs.34.26 lakh for the period prior to May 1998 had not been received (November 2001).

(e) M/s. Stassalit Limited, Baddi, in Chandigarh I Commissionerate of Central Excise, manufactured "Coils" (heading 85.04) and used them captively without payment of duty in repair of final products received under rule 173H. Since final products were not leviable to duty, this resulted in incorrect grant of exemption of Rs.40.78 lakh between 1 April 1996 and 2 June 1999.

On being pointed out (March 1999 and February 2000), the Ministry of Finance stated (December 2001) that show cause notice for Rs.31.49 lakh for the period from April 1996 to December 1998 had been issued in April 2001 and further developments would be intimated in due course.

5.2 Incorrect grant of small scale industry exemption

Notification dated 2 June 1998 provides SSI exemption for manufacturers with clearances of specified goods for home consumption not exceeding rupees three crore in the preceding financial year.

M/s. Sanjay Containers (P) Limited, Jaipur, in Jaipur I Commissionerate of Central Excise, engaged in manufacture of tin containers availed exemption under the said notification. The assessee cleared goods valuing Rs.2.96 crore upto the month of January 1999 and showed nil production during February and March 1999 so as to avail benefit under the notification ibid, during the next financial year (1999-2000). A scrutiny of electricity bills showed that the consumption of electricity was almost the same as compared to other months. This was indicative that production activities were going on in the unit and production was suppressed, thereby entailing liability to pay duty, penalty and interest amounting to Rs.2.40 crore.

On being pointed out (December 2000), the Ministry of Finance admitted the objection (July 2001).

5.3 Incorrect grant of exemption on goods manufactured on job work

As per notification dated 25 March 1986, as amended, specified goods manufactured in the factory on job work basis and used in or in relation to manufacture of final products (on which duty of excise was leviable whether in whole or in part) were exempt from the whole of the duty leviable thereon.

M/s. Bata India Limited, 24 Paraganas, in Kolkata I Commissionerate of Central Excise, was allowed to avail exemption under the said notification on footwear parts, viz., tongue, upper components etc., which were got manufactured on job work basis and were used in the manufacture of foot wears leviable to nil rate of duty. Since the final product was charged to nil rate of duty, exemption availed on footwear parts was incorrect. This resulted in non-levy of duty of Rs.1.41 crore during the period from 6 March 2000 to 21 August 2000.

On being pointed out (November 2000), the Ministry of Finance admitted the objection (October 2001).

5.4 Incorrect grant of exemption on final products

(i) As per notification dated 7 May 1977 and notification dated 16 March 1995 (as amended) goods supplied as stores for consumption on board a vessel of the Indian Navy are exempt from payment of the whole of the duty of excise leviable thereon. Tribunal in the case of M/s. Moosa Haji Patrawala {1999 (14) ELT 620} held that if the goods are not supplied as stores for consumption on board a vessel directly to Indian Navy then the benefit of exemption under the said notification is not applicable on such goods. The Supreme Court also upheld this judgement on 3 March 2000.

M/s. Indian Rayon Industries, Hooghly and M/s. ABB Limited, Budge Budge, in Kolkata I and IV Commissionerates of Central Excise, manufactured industrial fans, flax canvas, retardant fabrics, synthetic fabrics etc., and cleared them without payment of duty availing the exemption under the aforesaid notification. Test check of records revealed that these goods were not supplied to Indian Navy for consumption as stores on board a vessel but were cleared to a ship builder for construction of a new ship. Hence exemption availed was not correct and resulted in short levy of duty of Rs.84.02 lakh between 30 April 1995 and 31 August 2000.

On this being pointed out (March 2000), the Ministry of Finance had admitted the objection (November 2001).

(ii) As per notifications dated 16 March 1995 and 23 July 1996, excise duty on all goods of sub-headings 4811.30 and 4823.90, other than (a) products consisting of sheets of paper or paper board impregnated, coated or covered with plastic (including thermoset resins or mixture thereof or chemical formulations containing melamine, phenol, urea or formaldehyde with or without curing agents or catalysts), compressed together in one or more operations; or (b) products known commercially as 'decorative laminates' is 20 per cent ad valorem whereas tariff rate is 25 per cent ad valorem.

M/s. Polymer Papers, Faridabad, in Delhi II Commissionerate of Central Excise, manufactured impregnated filter paper and cleared it on payment of concessional rate of duty. The impregnated filter paper was made out of base paper impregnated with synthetic resin, solvent and other special adhesives. Synthetic resin used was manufactured by using phenol, formaldehydes and menthol. Therefore, the product was not covered under the said notification. This resulted in short levy of excise duty of Rs.29.87 lakh during April 1996 to March 1997.

On being pointed out (between April and December 1997), the department stated (December 2000) that a demand of Rs.1.44 crore for the period from October 1996 to February 2000 had

been confirmed and a penalty of Rs.10 lakh had been imposed. Duty for the earlier period had been held time barred (June 2001).

Reply of the Ministry of Finance had not been received (January 2002).

(iii) As per notification dated 30 April 1975 as amended, goods (other than rubberised coir mattresses, fixed vegetable oils of heading 15.03 and vegetable fats and oils of heading 15.04) manufactured in factories covered by coir industry, cashew industry, tanning industry, oil mill, solvent extraction industry and rice milling industry are exempt from the whole of the duty of excise leviable thereon.

M/s. Synthetic Industrial Chemicals Limited, Kolenchery, in Cochin Commissionerate of Central Excise, manufacturing spices oils, oleoresins and essential oils including sandalwood oil, cleared their goods on payment of duty till 31 July 1999. The assessee started clearing these goods without payment of duty from 1 August 1999, based on the above mentioned notification. Audit scrutiny revealed that sandalwood oil was being manufactured by the assessee by the steam distillation process and not in the solvent extraction plant. It was therefore not eligible for the concession. This resulted in incorrect availment of exemption of duty of Rs.38.35 lakh for the period from August 1999 to July 2000.

On being pointed out (May 2000), the department intimated (March 2001) confirmation of demand for Rs.76.70 lakh which included penalty of Rs.38.35 lakh.

The Ministry of Finance had admitted the objection (August 2001).

(iv) As per notifications dated 16 March 1995, 23 July 1996 and 1 March 1997, D.C. difibrilators for internal use were exempt from duty.

M/s. BPL Works, Palakkad, in Calicut Commissionerate of Central Excise, manufactured two models of difibrilators weighing more than 16 kilogram from January 1997 and cleared the items without payment of duty. As the heavy apparatus comprising different equipment was not capable of being used internally, it was not eligible for exemption from duty.

On being pointed out (February 1998), the department confirmed (November 1999) demand of Rs.56.42 lakh including duty of Rs.27.71 lakh for the period from January 1997 to March 1998, penalty of Rs.27.71 lakh under section 11 AC and another penalty of Rs.1 lakh under rule 173 Q. In addition to this, recovery of interest under section 11AB had also been ordered.

The Ministry of Finance had admitted the objection (October 2001).

5.5 Other cases

In 34 other cases of exemptions, the Ministry of Finance/department had accepted the objection involving duty of Rs.1.25 crore and reported recovery of Rs.0.27 crore in 29 cases till January 2002.

CHAPTER 6 : NON-LEVY OF DUTY AND CESS

Under rule 53 of the Central Excise Rules, 1944, every manufacturer is required to maintain daily stock account in a prescribed form (RG-1) indicating, inter-alia, the description of goods, quantity manufactured and quantity removed from the factory for various purposes. Rules 9 and 49 read with rule 173G ibid, further prescribe that excisable goods shall not be removed from the place of manufacture or storage unless the excise duty leviable thereon has been paid. If any manufacturer, producer or licencee of a warehouse, removes excisable goods in contravention of these rules or does not account for them, then besides such goods becoming liable for confiscation, a penalty not exceeding three times the value of goods or five thousand rupees, whichever is greater, is also leviable under rule 173Q. Duty not paid or short paid by suppressing facts, or by fraud/mis-statement etc., attracts penalty equal to the duty determined under section 11AC of the Central Excise Act, 1944. Some illustrative cases of non-levy of duty or cess are given in the following paragraphs :-

6.1 Central excise duty not levied

(i) Three assessees in Chandigarh I Commissionerate of Central Excise, engaged in the manufacture of chewing tobacco (sub-heading 2404.40 and 2404.49) cleared additive mixture valuing Rs.12.92 crore used in the manufacture of chewing tobacco in factories other than the factory where it was manufactured without paying duty of Rs.6.01 crore and without following the prescribed procedure. A penalty of Rs.38.76 crore (equal to three times the value of goods) was also leviable under rule 173Q for violation of rules 9, 49, 173G, 192 etc.

On being pointed out (October 1996), the department stated (December 2000) that cases booked by Delhi Commissionerate of Central Excise had been adjudicated in April 1998 demanding duty of Rs.16.06 crore. However, the assessees had gone in appeal and the Tribunal had remanded the matter back for re-adjudication which was pending decision.

Reply of the Ministry of Finance had not been received (January 2002).

(ii) M/s. Orissa Industries Limited, Lathikota, in Bhubaneswar II Commissionerate of Central Excise, was engaged in the manufacture of refractory bricks (fired and unfired), monolithic and DBM peas. A comparison of quantities of production as per RG-1/RT-12 return with those accounted for in the Annual Reports of the assessee for 1997-98 and 1998-99 in audit revealed short accountal of production of goods by 3838.62 tonne entailing levy of central excise duty of Rs.2.28 crore.

On being pointed out (February 1999 and December 2000), the department replied (July 1999) that the difference in production was due to adoption of production figure in RG-1 on

actual weightment basis whereas the weight in the EDP/Annual Report was taken from the contractual weight i.e. weight recorded in different work orders.

The contention of the department is not tenable as the department itself was not satisfied with the above differences even earlier. The adjudicating authority had confirmed the demand of Rs.2.46 crore with penalty of Rs.0.50 crore on 28 June 1994 for differences in quantities of production between those of EDP and those of RG-1 of the assessee for an earlier period (April 1988 to July 1989). The department had further issued four show cause notices to the assessee between November 1994 to March 1997 for Rs.2.98 crore in respect of similar discrepancies of short accountal of production during the period from August 1989 to March 1993 on which adjudication proceedings were pending.

Reply of the Ministry of Finance had not been received (January 2002).

(iii) As per notification dated 18 May 1995, waste, paring and scrap are exempted from duty only if it arises in the course of manufacture of exempted goods provided no other excisable goods other than exempted goods are manufactured in the factory.

Five assessees (cement units) in Chandigarh I, Jaipur I & II, Rajkot and Trichirapalli Commissionerates of Central Excise, cleared waste and scrap without payment of duty. Since such scrap and waste had arisen in the course of manufacture of excisable goods, the same could not be removed without payment of duty. This resulted in non-levy of duty of Rs.50.39 lakh on waste and scrap cleared between April 1994 and October 2000.

On being pointed out (between November 2000 and February 2001), the Ministry of Finance intimated (January 2002) recovery of Rs.36.09 lakh and issue of show cause notices for Rs.14.30 lakh.

(iv) M/s. Vijaya Steels Limited, Bangalore, in Bangalore II Commissionerate of Central Excise, engaged in manufacture of hot rolled products (sub-heading 7214.90), had been paying duty on annual production capacity basis. The assessee also received billets (input materials) from other manufacturers and converted them into hot rolled products (final products) on job work basis and cleared them without payment of duty. As the assessee was working under the compounded levy system for which job work exemption was not applicable, duty on those goods should have been paid. This resulted in non-payment of duty of Rs.24.32 lakh during January 1999 to December 1999.

On being pointed out (February 2000), the Ministry of Finance contended (June 2001) that since duty was paid at a compounded rate based on the annual capacity of production which was fixed taking into consideration the goods manufactured on job work, all goods cleared from the factory during the year would be considered as duty paid.

Reply of the Ministry is not tenable as the annual capacity of production fixed earlier which did not take into consideration the goods manufactured on job work, was re-fixed in March 2000 after the audit observation was communicated in February 2000 and demand of

differential duty of Rs.64.72 lakh for the period from September 1997 to March 2000 confirmed in March 2001.

6.2 Cess under Textile Committee Act not levied

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

A check of records of 325 assessees, engaged in the manufacture and processing of textile materials/articles, revealed that none of the said assessees had paid textile cess. It was also noticed that no action was taken by the Textile Committee to raise demand for collection of cess from these manufacturers in accordance with the provisions of the Textile Committee (Cess) Rules, 1975. The amount of cess not collected between the period April 1993 and March 2001 amounted to Rs.8.00 crore.

On this being pointed out (between November 1999 and May 2001), the Ministry of Textiles intimated (between August and November 2001) recovery of Rs.0.55 crore in 39 cases and issue of show cause notices for Rs.7.44 crore in 286 cases.

6.3 Cess under Rubber Act not levied

Under section 12 of the Rubber Act, 1947, cess at the rate notified by the Government of India from time to time is leviable on all rubber produced in India and is to be collected by the Rubber Board from the owner of the estate in which the rubber is produced or from the manufacturer by whom such rubber is used. There is no provision in the Act for granting exemption on rubber exported outside country.

Non-levy of cess on natural rubber exported had been pointed out in Audit Report 1977-78, 1981-82 and 1998-99. The Rubber Board had earlier stated (February 1994) that the cess could not be collected from the producers of rubber as the Rules made under the Rubber Act did not empower recovery of the cess from the producers of rubber and they could do so only from the manufacturers. On the failure to remove the inconsistency between the Act and the Rules being pointed out (Audit Report 1998-99), the Ministry of Commerce stated (October 1999) that the Board's proposal for amending the provisions of the Act to rectify the situation was under examination. Necessary amendment had not yet been made which resulted in further non-levy of cess of Rs.1.13 crore during 1998-2000.

On this again being pointed out (June 2001), the Ministry of Commerce and Industry confirmed the facts and stated (July 2001) that the proposal for amendment in the Act was under examination.

6.4 Penalty not levied

According to provisions contained in sub-rule 3 of rule 96ZO of the Central Excise Rules, 1944, a manufacturer having a total furnace capacity of 3 tonne can opt to pay duty a sum of rupees five lakh per month in two equal instalments. The first instalment is payable by 15th day of the month and the second instalment by the last day of each month. If the manufacturer fails to pay the duty on the due date, he shall be liable to pay interest at the rate of eighteen per cent and penalty equal to such outstanding amount of duty or five thousand rupees whichever is greater.

M/s. Silver Ispat Private Limited, Sinnar, in Aurangabad Commissionerate of Central Excise, engaged in the manufacture of M.S. ingots falling under chapter 72, had opted to pay duty on lumpsum basis under the provision of rule 96ZO(3) in two equal installments. The assessee paid duty of Rs.65.20 lakh during the period April 1999 to March 2000 after due dates. The delay in payment of duty ranged from 5 days to 111 days after the due dates. The assessee was therefore liable to pay penalty of Rs.65.20 lakh and interest of Rs.1.17 lakh as per the provisions of the above rules. No action was taken by the department to recover the penalty and interest.

On this being pointed out (March 2000), the Ministry of Finance stated (November 2001) that show cause notice demanding interest and penalty had been issued on 24 May 2000 and the assessee had already paid the interest of Rs.1.17 lakh. It further stated that adjudication could not be done in view of stay order given by the Supreme Court on 21 April 1998 in another case (M/s. Supreme Steels & General Mill).

Reply of the Ministry is not tenable as delay in payment of duties related to the period from April 1999 to March 2000 and no show cause notice for recovery of penalty and interest was issued to safeguard Government revenue prior to being pointed out in audit.

6.5 Other cases

In 236 other cases of non-levy, the Ministry of Finance/department had accepted the objection involving duty of Rs.2.57 crore and reported recovery of Rs.1.54 crore in 226 cases till January 2002.

CHAPTER 7 : CLASSIFICATION OF EXCISABLE GOODS

The rates of duty leviable on excisable goods are prescribed under various headings in the Central Excise Tariff. Some illustrative cases of incorrect classification of goods resulting in short levy of duty are given in the following paragraphs:

7.1 Preparation for the care of skin or hair

(i) Dabur lal tail

As per note 5 of chapter 33, heading 33.04 applies inter alia to skin foods, skin tonics, cuticle removers and other preparations for use in manicure or chiropody and barrier creams to give protection against skin irritants. The Supreme Court in the case of M/s. Baidyanath Ayurved Bhawan Limited {1996 (83) ELT 492 (SC)} had held that medicine is ordinarily prescribed by a medical practitioner and it is used for limited time and not every day unless it is so prescribed to deal with a specific disease like diabetes. The Tribunal in the case of M/s. Sunny Industries (P) Limited {1995 (75) ELT 677 (T)} held that 'Ad-vitamin massage oil fortex' being a massage oil intended for care of skin is classifiable under heading 33.04.

M/s. Dabur India Limited, Deoghar, in Jamshedpur Commissionerate of Central Excise, manufactured 'Dabur lal tail' - a baby massage oil for the care of skin and classified the product under sub-heading 3003.39 as other medicament. As per the product literature, it was a baby massage oil for the care of skin which strengthens muscles and nourishes the baby's tender skin keeping it soft and supple. It was, therefore, correctly classifiable under heading 33.04 in terms of note 5 of chapter 33 and judgments ibid. Incorrect classification of the product resulted in short levy of duty of Rs.6.08 crore during the period April 1995 to August 2000.

On being pointed out (January 1999), the Ministry of Finance admitted the objection and stated (November 2001) that demand of Rs.6.60 crore had been confirmed and penalty of Rs.6.60 crore had also been imposed. The assessee had filed an appeal and stay petition before Tribunal in June 2001.

(ii) Kesh nikhar soap

Preparations for use on hair are classifiable under sub-heading 3305.99 of the Central Excise Tariff. The Tribunal in the case of M/s. Henna Export Corporation {1993 (67) ELT 907 (T)} held that 'Herbal shikakai powder' sold in unit packing with labels indicating use for hair was classifiable under heading 33.05 and not as a bath preparation.

M/s. Peshawar Soap & Chemicals Limited, Gurgaon, in Delhi II Commissionerate of Central Excise, manufactured 'Kesh nikhar soap' and cleared it under sub-heading 3401.10 as toilet soap. From the printed wrapper of the product, audit observed that the product was meant for conditioning/beautifying hair. The product was, therefore classifiable under sub-heading 3305.99 as preparations for use on the hair. The incorrect classification resulted in short levy of duty of Rs.4.55 crore during the period from April 1996 to June 1998.

On being pointed out (January/February 1999), the Ministry of Finance admitted the objection as technically correct and stated (May 2001) that two show cause notices demanding duty of Rs.27.41 crore were issued out of which demand of Rs.8.42 crore had been confirmed in November 2000 and the demand for the remaining amount was pending adjudication.

(iii) Masala pudies

As per Tribunal's decision in 1993 in the case of M/s. Henna Export Corporation {1993 (67) ELT 907} henna powder made out of natural henna leaves if cleared in bulk would fall under heading 14.01 and if cleared in unit packs with indication of its use as a hair dye would fall under heading 33.05.

M/s. M.M. Khambatwala, in Ahmedabad I Commissionerate of Central Excise, manufactured masala pudies in the name of amla ki pudi, brahmi ki pudi, dhudhi ki pudi, bhrungraj ki pudi, mehdi ki pudi, and dhupel ki pudi and cleared them in unit packs at nil rate of duty after classifying the products under chapter 14 as vegetable products. These products were known as masala pudies in common parlance. The cartons indicated that the powder of amla, brahmi, mehdi leaves, kapoor kachli, nagar moth, spices etc. were meant to prepare perfumed hair oil after mixing and boiling with coconut oil, ground nut oil or any other oil. These products contained concentrate in the form of powders for making perfumed oil. In view of Tribunal's decision cited above, the products would fall under heading 33.05. The incorrect classification resulted in short levy of duty of Rs.1.36 crore for the period from 1990-91 to 1996-97.

On being pointed out (September 1998), the Ministry of Finance admitted the objection (January 2002).

7.2 Painting system

Mechanical appliances for dispersing or spraying liquids or powders are classifiable under heading 84.24 of the Central Excise Tariff.

M/s. Thermax Surface Coatings Limited, Chinchwad, in Pune I Commissionerate of Central Excise, manufactured 'Painting system' and cleared it under heading 84.79 instead of 84.24. During the period from April 1997 to February 1999, goods worth Rs.36.52 crore were cleared on which duty amounting to Rs.4.75 crore was paid. Though there was no short payment of duty at the producer's (assessee) end because duty leviable under both the headings was the same, incorrect classification enabled the purchasers of the product to avail

Modvat credit which was other wise not admissible as the goods falling under heading 84.24 were not covered under rule 57Q. A sample verification of three sales invoices issued by the assessee on 31 January 1998, 20 March 1998 and 10 July 1998 in audit revealed that the duty amounting to Rs.3.53 lakh paid on these invoices was taken as Modvat credit by the purchasers of the goods.

On being pointed out (February 1999), the Ministry of Finance contended (December 2001) that the painting system comprised of various sections of the paint shop and hence it was a machine to be classified under sub-heading 8479.19.

Reply of the Ministry is not tenable as sub-heading 8479.19 is a residuary heading. As per note 2 and 3 of section XVI of the Tariff, this heading comes into picture only when the goods do not find place in any other heading precedent to it. Since heading 84.24 specifically covers goods meant for projecting, dispersing or spraying liquids or powders, the painting system is correctly classifiable under heading 84.24. Further, the Ministry has also admitted (October 2000 and October 2001) classification of spray painting booth and spray painting equipment under heading 84.24 manufactured by M/s. Bullows Paint Equipment (P) Limited, Thane (Para 6.3 of Audit Report 1999-2000).

7.3 Motor vehicle parts and bodies

Heading 87.07 of the Central Excise Tariff specifically covers 'Bodies' for motor vehicles. The Punjab and Haryana High Court in the case of Darshan Singh Pavitar Singh {1988 (34) ELT 631} held that 'Motor vehicle bodies', built by independent body builders on the duty paid chassis supplied by customers, are to be classified under heading 87.07, even though the goods emerging from body builder's premises is a complete motor vehicle falling under heading 87.01 to 87.05. In the case of Kamal Auto Industries {1996 (82) ELT 558}, Tribunal also decided that 'Motor vehicle bodies' built by independent body builders is rightly classifiable under heading 87.07. The Supreme Court has also upheld these decisions {1997 (94) ELT 442}.

M/s. Sita Singh Engineers & Sons (P) Limited, Faridabad, in Delhi II Commissionerate of Central Excise, manufactured bodies on duty paid chassis of motor vehicles for the transport of passengers and goods (heading 87.02 to 87.05) and classified these 'Motor vehicle bodies' built on chassis under heading 87.02 to 87.04 as 'Motor vehicles' instead of under heading 87.07 as 'Bodies'. The incorrect classification resulted in short levy of duty of Rs.2.01 crore during November 1995 to March 1999.

On being pointed out (November 1999), the Ministry of Finance stated (December 2001) that the amendments had been carried out to heading 87.07 and note 3 of chapter 87 with effect from 1 March 2001 and for the period prior to 1 March 2001, the matter was being examined for issue of notification under section 11C.

7.4 Stiffened fabrics

Heading 59.01 of the Central Excise Tariff, covers textile fabrics coated with gum or amylaceous substances, of a kind used for the outer covers of books or the like; tracing cloth; prepared painting canvas, buckram and similar stiffened textile fabrics. As per explanatory notes to HSN, heading 59.01 covers buckram and similar stiffened textile fabrics made by impregnating light weight open textile fabrics with adhesives and fillers e.g. with glue or amylaceous substances (starch) mixed with kaolin, whereas textile fabrics, impregnated, coated, covered or laminated with plastics are classifiable under heading 59.03.

As per chapter note 2(a)(3) of chapter 59, products in which the textile fabric is either completely embedded in plastics or entirely coated or covered on both sides with such material, provided that such coating or covering can be seen with naked eyes, are not covered under heading 59.03. Such fabrics are classifiable under chapter 39.

M/s. A.P.L. Poly Fab (P) Limited, Kolkata, in Kolkata I Commissionerate of Central Excise, manufactured stiffened fabrics for use in the manufacture of footwear was allowed to clear them after classifying it under heading 59.01. Scrutiny of the manufacturing process revealed that the assessee manufactured a paste out of polystyrene granules (plastic material) and coated it with uniform thickness on both the sides of cotton fabrics of running length. The coating on cotton fabrics was visible with the naked eyes. Therefore, the product was classifiable under sub-heading 3920.39 in terms of chapter note 2(a)(3) ibid. Incorrect classification resulted in short levy of duty of Rs.1.70 crore during the period from April 1995 to March 2000.

On being pointed out (July 1999 and April 2001), the department contended (February 2000) that the paste manufactured by the assessee was rightly classifiable as prepared adhesive under heading 35.06 and not under 3903.10 as polymers of styrene. Such adhesive when coated in the fabric satisfied the tariff description of heading 59.01.

The department's contention is not tenable as paste is not an adhesive since it is used as a coating material on both sides of the fabric. To classify the paste as adhesive it would have to be used as a pasting material on one side only which is not so in this case. The fabrics was coated with plastics and such coated fabrics have been excluded from chapter 59, therefore, it is classifiable under chapter 39.

Reply of the Ministry of Finance had not been received (January 2002).

7.5 Other cases

In 83 other cases of incorrect classification, the Ministry of Finance/department had accepted the objection involving duty of Rs.1.78 crore and reported recovery of Rs.0.70 crore in 78 cases till January 2002.

CHAPTER 8 : GRANT OF MODVAT/CENVAT CREDIT

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

8.1 Availment of credit in excess of the prescribed limit

(i) Under rule 57AC(2)(a) and (b) of Central Excise Rules, 1944, introduced with effect from 1 April 2000, Cenvat credit in respect of capital goods received in a factory at any point of time in a given financial year shall be taken only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year. Balance of credit may be taken in any subsequent financial year. Rule 57AC(2)(c) provides that Cenvat credit may also be taken in respect of such capital goods as have been received in the factory, but have not been installed, before 1st day of April 2000 subject to the condition that during the financial year 2000-01, credit shall be taken for an amount not exceeding fifty per cent of duty paid on such capital goods.

(a) M/s. Hindustan Petroleum Corporation Limited, Visakhapatnam, in Visakhapatnam Commissionerate of Central Excise, procured certain capital goods during the years 1996 to 1999 for establishing a 'Diesel Hydro De-sulpharisation Project' and did not avail Modvat credit as the same was not installed till 31 March 2000. The assessee availed the entire credit of Rs.24.52 crore between April and October 2000 rather than fifty per cent of the duty paid. This resulted in excess availment of credit of Rs.12.26 crore. Further, the assessee utilised the credit for payment of duty on final products which led to financial accomodation to the extent of Rs.12.26 crore involving interest liability of Rs.1.56 crore.

On being pointed out (February 2001), the department issued show cause notice to the assessee but stated (May 2001) that as per Central Board of Excise and Customs clarification of 29 August 2000, full amount of credit was allowable where credit was not taken for any reasons on capital goods received and installed prior to 1 April 2000.

Contention of the department is not tenable since Board's clarification is applicable only in cases where capital goods received prior to 1 April 2000 were installed but credit was not taken for any reason whereas in the instant case capital goods were not installed by the assessee before 1 April 2000.

The Ministry of Finance contended (November 2001) that the irregularity was noticed much earlier and action initiated by Range Officer.

Reply of the Ministry is not tenable as the show cause notice pertaining to April 2000 has been issued only on 26 April 2001 after being pointed out by Audit in February 2001.

(b) Eight assessees, in seven Commissionerates of Central Excise, availed full credit of the excise duty paid on capital goods between April 2000 and March 2001 instead of availing fifty per cent of the duty paid. This resulted in excess availment of Cenvat credit of Rs.54.21 lakh.

On being pointed out (between July 2000 and January 2001), the Ministry of Finance admitted the objection and intimated (August and September 2001) recovery of Rs.54.21 lakh.

(ii) As per sub-rule 3 and 5 of rule 57Q, as effective from 1 March 1997, credit of additional duty leviable under section 3 of the Customs Tariff Act, 1975, on goods falling under heading 98.01 of the Customs Tariff was admissible to the extent of 75 per cent of the additional duty paid.

M/s. Steel Authority of India Limited, Bokaro, in Jamshedpur Commissionerate of Central Excise, imported capital goods like plant and equipment, drill machine, hydrogen analyzer, hydraulic cylinder etc., under project import (heading 98.01 of the Customs Tariff) and availed Modvat credit for the entire amount of Rs.2.49 crore of the countervailing duty paid on these items during the period May to June 1999 as against the admissible amount of 75 per cent. Credit of Rs.62.26 lakh was therefore, availed in excess of the prescribed limit.

On being pointed out (November 1999), the Ministry of Finance accepted the objection and stated (September 2001) that amount of Rs.62.26 lakh had been recovered.

8.2 Modvat credit availed but duty not paid on finished products

According to rule 57CC of the Central Excise Rules, 1944, where a manufacturer is engaged in the manufacture of any final product which is chargeable to duty as well as any other final product which is exempt or is chargeable to 'nil' rate of duty and the manufacturer takes credit of specified duty on any input which is used in relation to the manufacture of both the categories of final products, whether contained in the said final product or not, the manufacturer shall pay an amount equal to 8 per cent of price of second category of final product charged by the manufacturer for the sale of such goods, at the time of clearance from the factory.

Eight assessees, in eight Commissionerates of Central Excise, manufacturing both dutiable and exempted products, availed Modvat credit on inputs and utilised the same towards payment of duty on dutiable final products. Since the assessees did not maintain separate

accounts of inputs used for manufacture of exempted products, they were liable to pay an amount equivalent to eight per cent of the value of such exempted final products which was neither paid nor demanded by the department. This resulted in non-payment of duty of Rs.7.57 crore between October 1994 and December 2000.

On being pointed out between November 1997 and February 2001, the Ministry of Finance, while admitting the objection in seven cases, reported (between August 2001 and January 2002) recovery of Rs.46.66 lakh and issue of show cause notices for Rs.76.69 lakh. In one case, it contended that the goods were manufactured on job work basis and no sale of such goods was effected by the assessee, therefore, rule 57CC was not to be enforced even if such goods were cleared without paying duty.

Reply of the Ministry is not tenable as separate inventory has not been kept for the inputs used in the manufacture of finished goods cleared without payment of duty and hence 8 per cent amount was recoverable in terms of rule 57CC irrespective of the fact that the goods were sold at the factory gate or from any other premises.

8.3 Incorrect availment of Cenvat credit

(i) The Cenvat rules, effective from 1 April 2000, did not contain provisions for allowing credit of duty debited under the erstwhile rule 57F of the Central Excise Rules, 1944, on inputs or partially processed inputs received back from job worker after processing. By notification dated 3 May 2000, sub-rule (4) was inserted under rule 57AG providing for taking Cenvat credit of the amount debited under rule 57F on receipt back of the inputs or partially processed inputs, on or after 1 April 2000. Thus, there was no provision during the intervening period from 1 April 2000 to 2 May 2000 to avail Cenvat credit of the duty debited under the erstwhile rule 57F.

Thirteen assessees, in Aurangabad, Bangalore II, Mumbai II to VI and Pune I Commissionerates of Central Excise, had availed Cenvat credit during the period 1 April 2000 to 2 May 2000 of the duty debited under the erstwhile rule 57F even though during the said period, there was no provision in the Rules allowing such credit. This resulted in incorrect availment of Cenvat credit of Rs.2.76 crore.

On being pointed out (between June 2000 and April 2001), the Ministry of Finance confirmed (July 2001) recovery of duty of Rs.0.33 crore in a case and in the remaining cases, it stated that the objection was technically correct (August and November 2001).

(ii) As per rule 57AE of the Central Excise Rules, 1944, effective from 1 April 2000, Cenvat credit shall be taken by the manufacturer on the basis of any of the documents mentioned thereunder. Certificate A, issued by the department, which was a valid document under erstwhile rule 57G (3) (l) upto 31 March 2000 was not considered so in the new rule 57AE. Accordingly, no Cenvat credit would be allowed on such certificates.

Two assessees, in Chennai I and Vadodara Commissionerates of Central Excise, availed Cenvat credit of Rs.88.54 lakh between April 2000 and August 2000 on the basis of 'Certificate A' which was in violation of provisions cited above. This resulted in incorrect availment of Cenvat credit of Rs.88.54 lakh.

On being pointed out (November 2000 and March 2001), the Ministry of Finance stated (August and September 2001) that the issue was merely procedural in nature as instead of taking credit on the basis of supplementary invoices, credit was taken on the basis of a certificate. Nevertheless, demand for Rs.18.73 lakh had been confirmed in one case in May 2001.

The fact remained that 'Certificate A' has not been covered as an eligible document for taking Cenvat credit under the Rules.

8.4 Modvat credit not reversed on raw materials written off

Rule 57A of the Central Excise Rules, 1944 allows credit of duty paid on inputs used in or in relation to manufacture of final products. Central Board of Excise and Customs clarified on 14 February 1995 that where inputs are written off in the stock accounts of the assessee because of any reason, credit of duty paid on such inputs is not available for utilisation by the assessee and Modvat credit so taken should be reversed.

Four assessees, in Bangalore III, Hyderabad I & III and Visakhapatnam Commissionerates of Central Excise, engaged in the manufacture of various excisable goods, availed Modvat credit on different inputs received in their factories from time to time. During the years 1997-98 to 1999-2000, the assessees had written off some of these raw materials and components valued at Rs.17.78 crore in their annual accounts declaring them as written off or obsolete or as surplus/redundant due to non-movement of inventory. The corresponding credit of duty of Rs.2.73 crore on such inputs was, however, not reversed from their Modvat accounts notwithstanding the fact that the items became unfit for use for the specified purposes and thus ceased to be inputs under rule 57A ibid.

On being pointed out (between December 1999 and February 2001), the Ministry of Finance admitted the objection in one case and intimated (July 2001) recovery of Rs.18.04 lakh. In the remaining cases, it contended (November 2001) that only the value of inputs was reduced and the quantity of inputs was not written off from the records for which provisions to restrict credit did not exist in the rules.

Reply of the Ministry is not tenable as rules allow credit of duty only on those inputs which are used in the manufacture of the final products. Inputs, the value of which had been written off, are obviously unfit for use and cease to be inputs under rule 57A.

8.5 Availment of Modvat credit without declaration

The Tribunal in the case of M/s. P.G. Conductors {1996 (81) ELT 336} decided that the requirement of rule 57G relating to declaration "is not just a technical formality or procedural requirement but the use of words in the rule clearly brings out that the Modvat credit can be taken only after filing the declaration and obtaining acknowledgement thereof". Thus the requirement of the rule is substantive in nature.

M/s. Ranbaxy Laboratories Ltd., Dewas, in Indore Commissionerate of Central Excise, engaged in the manufacture of patent or proprietary medicaments was allowed to avail and utilise Modvat credit of duty paid on inputs, notwithstanding the fact that the declarations indicating the description of inputs or the outputs were not filed. The utilisation of credit of Rs.1.67 crore between July 1999 and February 2000 was, therefore, incorrect.

On being pointed out (April 2000), the Ministry of Finance stated (July 2001) that the assessee should have submitted the revised declaration after the changes in potency/nomenclature of the products but this lapse could be considered as a technical lapse which had to be condoned.

Reply of the Ministry is not tenable as in terms of the provisions of rule 57G(11), condonation could be done only after recording the reasons for not denying the credit by the proper officer which has not been done as a show cause cum demand notice has been issued denying the credit by the proper officer in April 2000.

8.6 Modvat credit availed on ineligible goods

(i) As per notification dated 1 March 1994 (as amended), issued under rule 57A of the Central Excise Rules, 1944, high speed diesel oil (HSDO) falling under heading 27.10 was excluded from specified input for availing Modvat credit.

Seven assessees, in Chennai II, Indore and Mumbai II Commissionerates of Central Excise, manufacturing rubber, PVC profiles, dumpers, loaders, lubricant oils etc., availed Modvat credit of duty paid on high speed diesel oil between March 1995 and March 2000 which was incorrect. This resulted in incorrect availment of credit of Rs.1.16 crore.

On being pointed out (between November 1997 and February 2001), the Ministry of Finance admitted the objection in all cases and reported (August and September 2001) recovery of duty of Rs.75.83 lakh in five cases.

(ii) Four assessees, in Meerut I, Mumbai VII and Surat II Commissionerates of Central Excise, engaged in the production of various excisable goods, incorrectly availed Modvat credit of Rs.64.45 lakh on unspecified/ineligible capital goods like water cooler, refrigerators,

freezer, thermotracers, spin finish oil, sapcostate, uniperol etc., during the period October 1997 to January 2000.

On being pointed out (April/May 2000), the Ministry of Finance admitted the objection in two cases and reported (July 2001) recovery of Rs.14.25 lakh and issue of show cause notice for Rs.31.35 lakh. In the third case, it stated (July 2001) that the demand for Rs.4.32 lakh was confirmed but the same had been set aside in order-in-appeal. In the fourth case, it contended (November 2001) that the spin finish oil, sapcostate, uniperol etc. also performed functions of lubricants, therefore, these could be treated as lubricating oils for eligibility of Modvat credit under rule 57Q.

Ministry's contention is not tenable as 'lubricating oils' covered under rule 57Q, fall under heading 34.03 whereas the products in question have been classified under heading 34.02 as organic surface active agents and duty thereon has also been paid under this heading. Therefore, differential treatment of the same product for different purposes is not justifiable.

8.7 Other cases

In 853 other cases of incorrect availment of Modvat/Cenvat credit, the Ministry of Finance/ department had accepted the objection involving duty of Rs.11.75 crore and reported recovery of Rs.8.89 crore in 843 cases till January 2002.

CHAPTER 9 : VALUATION OF EXCISABLE GOODS

Ad valorem rates of duty are charged on a wide range of excisable commodities. The valuation of such goods is governed by section 4 of the Central Excise Act, 1944, read with the Central Excise (Valuation) Rules, 1975. Some illustrative cases of short levy due to incorrect valuation are mentioned in the following paragraphs :

9.1 Valuation of goods sold at buyer's destination

In the case of M/s. Escorts JCB Limited, the Tribunal, while interpreting the scope of the term 'place of removal' under section 4(4)(b)(iii) of the Central Excise Act, 1944, held that where the property in goods passes from the seller to the buyer only after the goods reached the destination of the buyers, the goods are assessable to duty with reference to value at buyer's destination since the seller continues to be the owner of the goods during transit period {2000 (118) ELT 650}.

Thirteen assessees, in four Commissionerates of Central Excise, engaged in the manufacture of different excisable goods entered into agreements for supply of goods at the destinations specified by the buyers. As per the terms and conditions stipulated in the purchase orders/delivery instructions of the buyers, the prices quoted by the assessees were composite prices which included the cost of freight, insurance, forwarding, loading and unloading charges, etc. The goods were transported under the cover of transit insurance the cost of which was borne by the assessees and the title to the goods in all these cases passed on to the buyers only after the goods reached the destination specified by the buyers. Therefore, the freight and insurance charges incurred upto the point of sale were to be included in the assessable value of the goods. Exclusion of such charges from the assessable value resulted in short levy of duty of Rs.6.32 crore between October 1996 and September 2000.

On being pointed out (between November 1999 and May 2001), the Ministry of Finance admitted objection in all cases and stated (between September and December 2001) that the show cause notices demanding duty of Rs.10.47 crore were being proposed to issue.

9.2 Valuation of goods on cost basis

(i) Where excisable goods are wholly consumed within the factory of production or in any other factory of the same manufacturer, their assessable value is to be determined on the

basis of value of comparable goods or the cost of production, including a reasonable margin of profit, if the value of comparable goods is not ascertainable.

The Central Board of Excise and Customs also clarified on 30 October 1996 that the cost of production of goods captively consumed was to be determined taking into account certain elements of costs including (i) administrative cost, (ii) interest, (iii) depreciation and (iv) margin of profit.

(a) M/s. Hindustan Zinc Limited, Rajpura, in Jaipur II Commissionerate of Central Excise, manufactured 'Zinc concentrates' and transferred them to its zinc smelter plants on payment of duty on provisional basis. The provisional assessment was finalised adopting assessable value as the cost of production of the previous year plus 10 per cent notional profit instead of cost of production and profit of the current year. This resulted in short levy of duty of Rs.3.49 crore for the period April 1997 to March 2000.

On being pointed out (November 1999), the Ministry of Finance, while admitting the objection as technically correct, stated (January 2002) that the differential amount worked out to Rs.2.33 crore on the basis of current year's cost and previous year's profit where earned. It added that a show cause notice for Rs.1.24 crore covering the period from June 1999 to March 2000 had been issued but the demand for the earlier period could not be raised due to time bar.

Reply of the Ministry is not tenable as the differential amount should be worked out on the basis of current year's cost and current year's profit which is available.

(b) M/s. B.O.C. India Limited and M/s. Alstom Limited, Kolkata, in Kolkata I and II Commissionerates of Central Excise, manufactured 'Gyogenic vessels', 'Vacuum interrupter and vacuum circuit breaker' and cleared them to its other unit on payment of duty on the basis of cost of production. Scrutiny of the cost statements revealed that the assessee did not include elements like administrative cost, depreciation, interest and profit margin as per balance sheet in the cost of such goods. This resulted in short levy of duty of Rs.2.42 crore between August 1997 and June 2000.

On being pointed out (August 2000), the Ministry of Finance admitted the objection (December 2001).

(c) M/s. Whirlpool of India, Faridabad and M/s. Kalyani Brakes Limited, Nanekarwadi, in Delhi III and Pune I Commissionerates of Central Excise, manufactured refrigerator parts and booster assembly and cleared them for captive consumption to their other units after payment of duty on cost data basis. The assessable value at which the goods were cleared was lower than the comparable price at which the goods were sold to independent buyers in the course of wholesale trade. This resulted in short levy of duty of Rs.2.11 crore between April 1996 and March 2000.

On being pointed out (April 1999 and May 2000), the Ministry of Finance, while admitting the objection, reported (July 2001 and January 2002) recovery of Rs.1.55 crore and issue of show cause notice for Rs.0.56 crore.

(ii) As per rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 effective from 1 July 2000, where 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 fifteen per cent of the cost of production or manufacture of such goods.

Two assessees, in Coimbatore and Mumbai III Commissionerates of Central Excise, engaged in the manufacture of M.S. ingots and cold rolled coils, cleared the products to their sister concerns by paying duty on an assessable value which was not arrived at on the basis of cost of production plus 15 per cent profit margin as provided for in the Rules. Non-adoption of correct assessable value resulted in short levy of duty of Rs.1.31 crore during the period from July 2000 to December 2000.

On being pointed out (between November 2000 and February 2001), the Ministry of Finance admitted the objection and reported (August and September 2001) recovery of Rs.1.28 crore.

9.3 Non-adoption of price fixed by the Government

As per section 4(1)(a)(ii) of the Act, where goods are sold by the assessee in the course of wholesale trade for delivery at the time and place of removal at a price fixed under any law for the time being in force or at a price, being the maximum fixed under any such law, then the price so fixed shall be deemed to be the normal price. The Supreme Court in the case of Pyrites Phosphates and Chemicals Limited, upheld the Tribunal's decision that where a price is fixed under a Control Order, the assessable value shall be determined on the basis of the price so fixed under such order {1996 (88) ELT A131}.

The Tribunal, while interpreting the provisions of section 4(1)(a)(ii), in the case of M/s. Soyabean & Vanaspathi Industries {1999 (105) ELT 238} further held that the maximum price fixed under the law shall be deemed to be the normal price and in such a case the argument that the goods were actually sold at a price lower than the controlled price will have no relevance in view of the clear provisions of the Law.

Five assessees in Guntur, Hyderabad I and III Commissionerates of Central Excise, cleared certain bulk drug preparations and formulations between November 1996 and June 2000 at prices lower than those fixed under the Drugs (Price Control) Order, 1995. Duty was also paid on these lower prices. The department admitted these lower prices as assessable value for levy of duty instead of adopting the maximum prices fixed under Price Control Order. This resulted in short levy of duty of Rs.2.14 crore between November 1996 and June 2000.

On being pointed out (between April 1999 and April 2001), the Ministry of Finance contended (October 2001) that the Drugs (Price Control) Order does not prohibit an assessee from selling drugs at prices lower than maximum indicated. It would therefore, be improper to penalise an assessee and charge duty on the basis of the maximum price, when the law permits him to sell goods at a lower rate. The Ministry further contended that a distinction had to be made between a law fixing price of any goods and a law indicating only the maximum price of goods beyond which the goods can not be sold.

Reply of the Ministry is not tenable in view of specific provision of section 4(1)(a)(ii) and the Tribunal's rulings of 1999 on this section cited supra.

9.4 Inadmissible deduction allowed from assessable value

(i) Freight charges/transportation charges

The Supreme Court in the case of M/s. Bombay Tyre International {1983 ECR 1627 D} held that expenses incurred on account of the several factors which have contributed to the value of the product upto the date of sale, which apparently would be the date of delivery, are liable to be included in the assessable value of the product.

(a) M/s. Indian Oil Corporation, Haldia, in Kolkata II Commissionerate of Central Excise, engaged in the manufacture/procurement of various petroleum products, had incurred certain expenses such as notional railway freight, railway siding/shunting charges, FDZ (free delivery zone) charges between the place of procurement and the place of clearances of final product for sale. While clearing the goods for sale, the assessee recovered these charges from the purchaser but did not include them in the assessable value of the product. This resulted in undervaluation of the products and consequential short levy of duty of Rs.1.63 crore during the period from April 1994 to March 1999.

On being pointed out (June 1999), the Ministry of Finance admitted the objection and reported (November/December 2001) issue of show cause notice for Rs.1.63 crore.

(b) M/s. Hindustan Petroleum Corporation, Budge Budge, in Kolkata I Commissionerate of Central Excise, manufactured blended lubricating oils out of lubricating base oil obtained without payment of duty under bond from a refinery. The assessee paid duty on the administered price when cleared within the factory for manufacture of final products. A scrutiny of the price structure of the base oil received from refinery revealed that the assessee while paying duty did not include the cost of transportation from refinery to its warehouse though the same ought to have been included. This resulted in short levy of duty of Rs.35.87 lakh during the period from October 1996 to March 2000.

On being pointed out (August 2000), the Ministry of Finance, while admitting the objection as technically correct, contended (December 2001) that there was no loss of revenue since the duty paid on this account would be taken by the assessee as Modvat credit.

The reply of the Ministry is not relevant. The product was required to be assessed correctly notwithstanding its modvatability.

(ii) Discount

As per section 4(4)(d)(ii) of the Central Excise Act, 1944, value in relation to any excisable goods does not include trade discount allowed in accordance with the normal practice of the wholesale trade provided that such discount is not refundable on any account whatsoever.

Three assessees, in Kolkata I and II Commissionerates of Central Excise, manufacturing paints and varnishes, thinners and synthetic resins, claimed trade discount, cash discount and other discounts from the declared wholesale price to arrive at the assessable value. Scrutiny of the depot sales invoices revealed that such discounts in the declared percentage were not actually passed on to the buyers. Either full or a portion of discount was retained by the assessees. This resulted in short levy of duty of Rs.1.33 crore between April 1998 and November 2000.

On being pointed out (between May 2000 and January 2001), the Ministry of Finance admitted the objection (November/December 2001).

9.5 Additional consideration not included in the assessable value

As per the provisions of section 4(1)(a) of the Central Excise Act, 1944, read with rule 5 of the Central Excise (Valuation) Rules, 1975, where the price charged for the excisable goods sold in wholesale trade is not the sole consideration for the sale, the assessable value of such goods shall be determined based on the aggregate of the price and money value of additional consideration flowing directly or indirectly from the buyer to the assessee. In the case of Bombay Tyre International {1983 (14) ELT (1896)}, the Supreme Court held that the value of the article for the purpose of levy of excise duty shall include all costs and expenses which have given the article its marketability.

(a) M/s. Vijay Tanks and Vessels Limited, Haldia, in Kolkata II Commissionerate of Central Excise, manufactured metal containers on job work basis out of raw materials supplied free of cost by the customers. Waste and scrap generated during the process of manufacture of finished goods was not returnable to the customer and was in fact sold by the assessee in the market. The sale value of such waste and scrap was not added but deducted from the assessable value of metal containers. The benefit thus reaped by the assessee as profit was in the nature of an additional consideration flowing indirectly from the customers and was liable to be included in the assessable value. This resulted in short levy of duty of Rs.86.55 lakh during the period from April 1996 to March 1999.

On this being pointed out (October 2000), the Ministry of Finance admitted the objection and reported (September 2001) issue of show cause notice for Rs.1.46 crore for the period from April 1998 to January 2001.

(b) M/s. India Containers Limited, Waluj, in Aurangabad Commissionerate of Central Excise, engaged in the manufacture of metal containers, excluded the value of caps supplied free of cost by the buyer while determining the assessable value of the metal containers. Non-inclusion of cost of 'caps' in the assessable value resulted in short levy of duty of Rs.86.69 lakh during the period from April 1995 to March 2000.

On being pointed out (September 1998 and April 2000), the Ministry of Finance admitted the objection and reported (August 2001) issue of show cause notices for Rs.51.64 lakh for the period from July 1998 to January 2001. Action taken to recover duty for the period prior to July 1998 had not been intimated (January 2002).

9.6 Valuation of goods sold through depots

The Tribunal in the case of Colgate Palmolive India Limited {1995 (76) ELT 186 (T)} held that where there is no ex-factory sales and entire production is transferred to depots, assessable value is to be determined on the basis of depot sale price.

M/s. Eureka Forbs Limited, Nainital, in Meerut Commissionerate of Central Excise, manufactured turbo clean and transferred to various depots after payment of duty on transfer invoice value of Rs.4.32 crore during 1997-98. Sales invoices of the depots were not made available to audit. Dealers turn over of turbo clean was shown as Rs.7.46 crore. Thus it was clear that turbo clean transferred from factory valuing Rs.4.32 crore were sold for Rs.7.46 crore. Therefore, there was undervaluation of Rs.3.14 crore on which duty of Rs.56.51 lakh was leviable in terms of judicial pronouncement cited above.

On being pointed out (June 1999), the Ministry of Finance contended (November 2001) that the dealer's turnover as indicated in the balance sheet was inclusive of sale of other products which were not manufactured by the assessee but were procured from open market. Therefore such sale was not liable to duty.

Reply of the Ministry is not tenable as other purchases by the assessee are not available in his relevant balance sheet.

9.7 Others

In 95 cases of valuation of excisable goods, the Ministry of Finance/department had accepted the objection involving duty of Rs.8.03 crore and reported recovery of Rs.4.55 crore in 85 cases till January 2002.

CHAPTER 10 : DEMANDS DELAYED OR NOT RAISED

Short payment or non-payment of duty on any excisable goods is to be recovered by issuing a show cause notice under section 11A to be followed up with its adjudication and recovery proceedings. The period of limitation for issue of show cause notice is six months (one year from 12 May 2000) in normal cases of non-levy/short levy of duty. However in case of short levy/non-levy due to fraud, collusion etc., the limitation period stands extended to five years. Some illustrative cases of demand not raised or raised with delay or not adjudicated are given in the following paragraphs :-

10.1 Non-adjudication of demands

(i) M/s. Indian Oil Corporation Limited, Jelpaiguri, in Bolpur Commissionerate of Central Excise, was allowed to clear petroleum products from the warehouse without payment of duty under bond through AR3A applications. Scrutiny of demand registers maintained by the department revealed that the show cause notices demanding duty on the quantity of petroleum products not re-warehoused or warehoused short were issued since 1994 but not adjudicated for a long time. It was also seen that the assessee had been receiving claims from the railways on the short quantity of petroleum products but duty was not paid on such quantities. This resulted in blockage of revenue of Rs.8.73 crore during the period from 1994-95 to 1996-97.

On being pointed out (April 2000), the department stated (April 2001) that the assessee would pay duty after settlement of the matter with their marketing companies.

The fact, remained that the department did not take any positive action even after expiry of six years to realise the Government dues. Allowing the assessee to withhold Government money because of its inability to settle the issue with their marketing companies was not justified.

The Ministry of Finance admitted the objection and stated (November 2001) that the relevant re-warehousing certificates had been obtained except in cases involving duty of Rs.71.93 lakh for which show cause notices had been issued to safeguard to Government revenue.

(ii) A test check of Central Excise records of Bhubaneswar I Commissionerate of Central Excise, revealed that a case of suppression of production and clandestine removal of Vanaspati by M/s. IPINIT Vanaspati Limited, Cuttack, was detected on 15 September 1995. Show cause notice demanding duty of Rs.2.52 crore for the period from August 1991 to August 1995 was issued only on 27 September 1996 i.e. after 1 year. It also emerged that the assessee had stopped production and surrendered their Central Excise Registration on 1 October 1996. The first hearing in the case was scheduled as late as on 29 October 1997.

Three more hearings were also held till 17 June 1998. Thereafter there was no indication of action being taken till the date of audit (November 1999).

On the unjustified and inordinate delay in the issue of show cause notice and its adjudication being pointed out (November 1999), the department adjudicated the case in December 1999 confirming demand of Rs.2.47 crore and imposing penalty of Rs.35.35 lakh.

The Ministry of Finance admitted the delay and stated (November 2001) that the case could not be adjudicated in time due to the absence of statutory time limit in the Act and large number of cases pending for adjudication.

The fact remains that lack of timely action in the case resulted in blockage of Government revenue of Rs.2.47 crore. Further, interest of Rs.3.06 crore (till June 2001) leviable under section 11AB remained unrecovered.

(iii) M/s. Asian Paints (I) Limited, in Mumbai II Commissionerate of Central Excise, was served with a show cause cum demand notice in August 1996 for Rs.1.40 crore for reversal of Modvat credit of raw material, capital goods etc., destroyed/burnt in fire which took place on 21 February 1996. The show cause cum demand notice was not adjudicated, resulting in financial accommodation to the assessee to the extent of Rs.1.40 crore and notional loss of interest to the extent of Rs.1.35 crore.

On being pointed out (June 2001), the Ministry of Finance admitted the objection and intimated (November 2001) that the show cause notice had been adjudicated in August 2001 confirming demand for Rs.1.40 crore with penalty of Rs.0.25 crore.

10.2 Demands for duty not raised

The Supreme Court in the case of Madhumilan Syntex Private Limited and others {1988 (35) ELT 349 (SC)}, held that unless a show cause notice was issued under section 11A of the Central Excise Act, 1944, the department was not entitled to recover any dues.

(i) M/s. Pearls Polymers Limited, Mahad, in Mumbai VII Commissionerate of Central Excise, engaged in the manufacture of plastic goods, simultaneously availed the benefit of exemption under notification dated 1 March 1997 as well as Modvat credit during the period from March 1997 to May 1998 which was not correct. The department issued show cause notice for the period July 1997 to May 1998 but no show cause notice was issued for the period from March 1997 to June 1997. This resulted in loss of revenue to the extent of Rs.3.61 crore.

On being pointed out (November 1999), the Ministry of Finance contended (September 2001) that the show cause notice was not issued as the recovery of duty had become time barred by December 1997 when the Board issued a clarification in this regard.

The reply of the Ministry is not tenable as irregularity could have been detected by the department at the time of scrutiny of the classification, declaration and RT 12 return. The notification dated 1 March 1997 clearly restricts simultaneous availment of both the benefits.

(ii) Prices of the various petroleum products were revised from 3 July 1996 and the rates of Central Excise duty were increased from 10 to 20 per cent ad valorem with effect from 23 July 1996.

Test check of records of the distribution outlets of the Indian Oil Corporation situated in Uttar Pradesh revealed that petroleum products like high speed diesel, motor spirit, aviation turbine fuel, liquified petroleum gas, furnace oil were sold at the enhanced price and duty was also recovered at the enhanced rates from the customers. However, differential duty of Rs.3.58 crore recovered as a result of increase in price and duty rates which was payable on 1 August 1996 was not paid to the Government. Department also did not take any action for recovery of differential duty and also for recovery of interest on delayed payment. The amount of duty was, however, paid by the assessee with a delay of more than four years between August 2000 and June 2001. This resulted in blockage of Government revenue of Rs.3.58 crore for more than four years entailing notional loss of interest of Rs.3.47 crore.

This was pointed out in July 2001; reply of the department/Ministry of Finance had not been received (January 2002).

(iii) M/s. Hitkari Fibres Limited, Mahad, in Mumbai VII Commissionerate of Central Excise, manufactured jute backed sheet and used it without payment of duty, in the manufacture of jute backed carpet which had leviable to nil rate of duty. As the final product was cleared without payment of duty, duty was payable on jute backed sheet. Though the show cause cum demand notices were issued for the period from July 1998 to March 1999, no show cause notice was issued for the period from March 1997 to June 1998 involving duty of Rs.28.38 lakh.

On being pointed out (November 1999), the Ministry of Finance admitted the objection and stated (November 2001) that the show cause notice was under preparation.

10.3 Delay in raising demand

The Central Board of Excise and Customs, through its letter dated 18 August 1988, issued instructions directing field officers to take recourse to section 11A only and issue legal notices wherever required in order that the department did not suffer due to show cause notice becoming time barred or on account of faulty show cause notice.

M/s. Indian Oil Corporation Limited, Bangalore, in Bangalore I Commissionerate of Central Excise, engaged in marketing of petroleum products collected notional railway freight charges on sales invoices but such charges were not included in the assessable value. Thus, there was

short payment of duty of Rs.1.54 crore from September 1994 to September 1996. No demand was raised by the department even though there was a decision of the Supreme Court of October 1983 (Bombay Tyre International) to this effect. Board's clarification of 21 June 1996 also stipulates inclusion of such charges in the assessable value. Demand raised by the department on 30 November 1999 was dropped by Commissioner of Central Excise (Appeals), Chennai on 31 March 2000 on the grounds that the demands were time barred. It was seen that the reason for the short levy was well known to the department all the while through mandatory returns and invoices. The demand could therefore have been issued within time and revenue loss of Rs.1.54 crore could have been avoided.

On being pointed out (May 2000), the Ministry of Finance contended (August 2001) that the department was not at fault for not issuing demand within six months as freight was not includible in the assessable value prior to the amendment made in section 4 of the Act on 28 September 1996.

Reply of the Ministry is not tenable as the expenses incurred by the assessee on railway freight to bring the goods from refineries were inward expenses which were includible in the assessable value in terms of Supreme Court rulings in the case of Bombay Tyre International Limited {1983 (14) ELT 1896} and Madras Rubber Factory {1995 (77) ELT 433} upholding that all costs incurred to make the goods complete and marketable is to be included in the assessable value. Further, the amendment of 28 September 1996 was clarificatory in nature as it elaborated the definition of 'place of removal' under section 4 so as to include therein 'a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearances from the factory'. Inward expenses were to be included in the assessable value in terms of aforesaid rulings of the Supreme Court even prior to the amendment ibid.

10.4 Other cases

In 4 other cases of delay in raising demands, the Ministry of Finance/department had accepted the objection involving duty of Rs.0.93 crore till January 2002.

CHAPTER 11 : MISCELLANEOUS TOPICS OF INTEREST

11.1 Duty collected but not paid to Government

According to Section 11D of the Central Excise Act, 1944, "notwithstanding anything to the contrary contained in any order or direction of the Appellate Tribunal or in any Court or in any other provision of this Act or the rules made thereunder, every person who is liable to pay duty under this Act or the rules made thereunder, and has collected any amount in excess of the duty assessed or determined and paid on any excisable goods under this Act or the rules made thereunder from the buyer of such goods in any manner as representing duty of excise, shall forthwith pay the amount so collected to the credit of Central Government".

(a) Thirteen depots/terminals of M/s. Indian Oil Corporation Limited, M/s. Bharat Petroleum Corporation Limited, M/s. Hindustan Petroleum Corporation Limited and M/s. Indo Burma Petroleum Company Limited, in six Commissionerates of Central Excise, were engaged in storage and distribution of petroleum products like motor spirit, diesel oil, aviation turbine fuel, superior kerosene oil, furnace oil etc., to various distribution outlets on payment of appropriate duty. Test check of records revealed that the prices of petroleum products were enhanced on 3 July 1996 and 2 September 1997. The rates of central excise duty were also increased on 23 July 1996. Duty on these products was collected at the enhanced prices and rates at the time of final clearance for sale from the depots/distribution outlets. However, differential duty collected in excess of the amount already paid was not remitted to Government. This resulted in non-remittance of duty of Rs.3.52 crore in thirteen cases alone. Similar retention of duty in all cases was required to be ascertained and recovered.

On being pointed out (between February 1997 and July 2001), the Ministry of Finance admitted the objection in two cases and intimated (June and November 2001) recovery of Rs.2.51 crore. Reply in the remaining cases had not been received (January 2002).

(b) As per rule 57CC of the Central Excise Rules, 1944, an assessee not maintaining separate accounts for dutiable and exempted products and availing Modvat credit on common inputs, is required to pay an amount equal to 8 per cent of the price of the exempted goods cleared.

M/s. P.T. Steel Industries, Odhav, M/s. Unison Metals Limited, Vatwa and M/s. Calcutta Rolls Manufacturing Company, Howrah, in Ahmedabad I and Kolkata II Commissionerates of Central Excise, manufacturing both dutiable and exempted excisable goods availed Modvat credit on common inputs but did not maintain any separate accounts. While clearing the exempted goods the assessee paid an amount equal to 8 per cent of the price of the exempted goods from Modvat account. Scrutiny of the invoices revealed that the assessee at the same time collected such amount through the invoices from the customers. Since there was no provision to collect such amount from the customer, total amount so collected ought to have

been paid to the Government as per section 11D of the Act. Instead of doing so the amount was retained by the assessee. This resulted in an incorrect collection and retention of amount of Rs.2.01 crore between April 1997 and June 2000.

On being pointed out (between December 1997 and September 2000), the Ministry of Finance admitted (December 2001) the objection in two cases. Though the reply of the Ministry in the third case had not been received, the department had admitted the objection (August 2001).

11.2 Revenue foregone due to absence of provision in the Tariff

As per notes in chapters 28, 29, 30 and 38 of the Central Excise Tariff, labelling or re-labelling of containers and repacking from bulk pack to retail packs or adoption of any other treatment to render the product marketable to the consumer, shall amount to 'manufacture'. By Budget 1998-99, similar provisions have been added in chapters 4,9,16 of the Tariff and by Budget 2000-01 in chapter 27 for lubricating oils and lubricating preparations.

Corn flour, glucose and shaving gel are classifiable under chapters 11, 17 and 33 of the Central Excise Tariff respectively. There is no provision in these chapters to treat the activity of labelling or re-labelling of containers and repacking from bulk pack to retail packs as amounting to manufacture.

Six assessees, in Aurangabad, Bangalore II, Mumbai III, VI and Pune I Commissionerates of Central Excise, procured corn flour, glucose and shaving gel in bulk packs and repacked them in retail packs. These retail packs were sold at a higher price. In five cases, prices ranged from 80 to 370 per cent higher than the cost of bulk pack. In the absence of provisions to treat the activity of repacking from bulk packs to retail packs of goods under chapters 11, 17 and 33 amounting to manufacture, duty of Rs.4.39 crore could not be levied on the value addition of goods after repacking in retail packs between April 1996 and September 2000.

On being pointed out (between November 1999 and April 2001), the Ministry of Finance contended (between September and December 2001) that not treating re-packing from bulk packs to retail packs as manufacture under chapters 11, 17 and 33 was a policy decision.

The absence of provisions has resulted in forgone of Government revenue of Rs.4.39 crore.

11.3 Clearance of excisable goods without credit balance in PLA

Rule 173G(1) requires that in cases where maintenance of account current has been permitted, sufficient amount shall be credited therein periodically so as to cover the duty due on the goods intended to be removed. The Central Board of Excise and Customs while prescribing the procedure for depositing central excise duties during strike, prolonged holidays or sudden

closure of banks etc., clarified on 23 August 1999 that payment of duty or other dues through cheques should not be permitted in case of declared bank holidays because such holidays are known well in advance.

(a) M/s. Videocon International and M/s. Videocon Appliances Limited, Aurangabad, in Aurangabad Commissionerate of Central Excise, deposited cheques of Rs.5.60 crore in March 1998 and Rs.1.70 crore in March 1999 with the department and took credit in the PLA immediately against which duties payable on clearances was debited. Records of the assessee and the department revealed that there was no credit balance in PLA of the assessee, as the cheques were submitted with the department after business hours of the bank and the department took 8 to 30 days to deposit them with the bank. Thus, the assessee was able to clear goods even though duty had not been credited to Government account. This resulted in financial accomodation to the assessee to the extent of Rs.7.30 crore and loss of interest of Rs.8.61 lakh.

On being pointed out (October 1999), the Ministry of Finance admitted (December 2001) the objection and intimated that the matter was being enquired.

(b) M/s. Raasi Cement Limited, Nalgonda, in Hyderabad III Commissionerate of Central Excise, deposited two cheques for Rs.57.75 lakh and Rs.42 lakh towards remittance in PLA on 10 September 1999 and 16 October 1999 respectively declaring that he had sufficient balances in his bank account and sought permission for clearance of 28,500 tonne of cement on the plea that the banks would not function on three immediate succeeding public holidays in each case. Though payment of duty through cheques was not permissible in cases where the holidays were known in advance, the department permitted the clearance on the basis of the cheque payments which amounted to clearance of excisable goods without requisite balances in Personal Ledger Account.

On being pointed out (December 1999), the Ministry of Finance admitted the objection and stated (August 2001) that the show cause notice for Rs.1.35 crore was pending adjudication.

11.4 Delay in finalisation of provisional assessments resulting in blocking of revenueof excisable goods without credit balance in PLA

As per provisions contained in rule 9B of the Central Excise Rules, 1944, excisable goods can be assessed to duty provisionally where the assessee is unable to produce any document necessary for the assessment of duty or where the assessee is unable to determine the correct classification of the goods or on a written request made by the assessee or when the proper officer deems it necessary to make further enquiry for assessment of duty. Under rule 9B (3), assessee had to enter into general bond in proper form with such surety or sufficient security in such amount or under such conditions as approved for assessment of any goods provisionally from time to time.

M/s. Jain Spinners Limited, in Aurangabad Commissionerate of Central Excise, manufacturing cotton yarn and synthetic blended yarn, filed the price declaration for the goods sold through their depots which was approved provisionally on 23 November 1994. Records of the assessee revealed (July 1996) that the price charged through depots were higher than those declared by the assessee. The department was, therefore required to assess the goods on those higher prices. However, the provisional assessment was not finalised till July 1998. The relevant information required by the department was made available by the assessee in February 1997 and the unit was locked out from April 1998. The provisional assessment was finalised in July 1998/September 1998 confirming demand of Rs.1.55 crore. Delay in finalisation of assessment resulted in financial accommodation by way of interest of Rs.46.71 lakh upto July/September 1998. Further the department did not take bank guarantee and hence confirmed demands of Rs.1.55 crore alongwith interest of Rs.51.91 lakh for the period from October/December 1998 to August 2000 remained un-realised.

On being pointed out (September 2000), the Ministry of Finance admitted the objection (September 2001).

11.5 Impermissible reduction in duty

Sub-rule (3) to rule 96ZO of the Central Excise Rules, 1944, provided for payment of duty at a concessional rate in respect of manufacturers of non-alloy steel ingots and billets having a total furnace capacity of 3 tonne. However, if a manufacturer opts for this variant, he is barred from seeking any reduction in duty liability on account of production being lesser than the determined capacity.

Commissionerate of Central Excise, Kolkata IV fixed the monthly duty liability of Rs.6.66 lakh on M/s. Hoogly Ispat Limited, Hooghly, manufacturing non-alloy steel products from 1 September 1997 under sub-rule (3) of rule 96ZO ibid. Subsequently, the assessee sought (February 1998) permission to switch over from payment of duty on production capacity based to actual production based on the plea that he would manufacture only 20 to 10 per cent non-alloy products and the rest of alloy products. The department granted permission in March 1999. The assessee paid duty at the rate of Rs.33,330 per month from 1 February 1998 on non-alloy products instead of Rs.6.66 lakh per month fixed on 1 September 1997. Since such reduction was not permissible under the rule, this resulted in short levy of duty of Rs.1.37 crore between February 1998 to October 1999.

On being pointed out (September 2000), the Ministry of Finance admitted the objection and stated (September 2001) that eight show cause notices demanding duty of Rs.1.37 crore had been issued.

11.6 Incorrect application of rate of duty on sugar

Duty on levy sugar is levied at the rate of Rs.17 per quintal (basic) plus Rs.21 per quintal (additional) and on free sale sugar at Rs.34 per quintal (basic) plus Rs.37 per quintal (additional).

Seventeen assessees, in Aurangabad, Pune I and II Commissionerates of Central Excise, had initially cleared levy sugar for public distribution system paying duty as applicable to levy sugar. Subsequently, the levy sugar was converted into free sale sugar and the assessees also realised the differential price applicable to free sale sugar. However, the assessees did not pay the differential duty applicable to free sale sugar. This resulted in short levy of duty of Rs.1.28 crore during 1996-97 and 1997-98.

On being pointed out (between September and November 2000), the Ministry of Finance admitted the objection (November 2001) and reported recovery of Rs.1.24 crore. The balance amount of Rs.0.04 crore was under process of recovery.

11.7 Other cases

In 335 cases of short levy of duty, the Ministry of Finance/department had accepted the objection involving duty of Rs.3.04 crore and reported recovery of Rs.2.60 crore in 333 cases till January 2002.

SECTION II - SERVICE TAX

CHAPTER 12 : SERVICE TAX

Service tax was introduced from 1 July 1994 through the Finance Act, 1994. Administration of service tax has been vested with the Central Excise department under the Ministry of Finance. Commissioners of Central Excise have been authorised to collect service tax within their jurisdiction. This section contains 16 paragraphs featured individually or grouped together and has a revenue implication of Rs.32.55 crore. The Ministry of Finance/Department had (till January 2002) accepted audit observations in 8 paragraphs involving Rs.10.77 crore and recovered Rs.1.49 crore. The significant findings of Audit included in this section are mentioned in the following paragraphs :-

12.1 Non-levy of service tax

(i) Consulting engineers

As per section 65 of the Finance Act, 1994, as amended with effect from 7 July 1997, services rendered by a consulting engineer are liable to service tax. The term consulting engineer has been defined as "any professionally qualified engineer or an engineering firm, who either directly or indirectly, renders any advice, consultancy or technical assistance in any manner to a client in one or more disciplines of engineering".

As per notification dated 9 April 1999, service tax is exempt if payment for taxable services is received in India in convertible foreign exchange which is not repatriated or sent outside India.

(a) M/s. Schlumberger Asia Services, in Mumbai V Commissionerate of Central Excise, rendered oilwell logging, perforation and auxiliary services to M/s. ONGC and M/s. Enron Oil and Gas India Limited. Oil well logging services included surveying the oil wells by qualified engineers. Logging tools were used to measure technical aspects like magnetism, resistivity and radioactive emission of the formation and the data generated were correlated to infer various parameters such as thickness, porosity and components of the formations. These were submitted to the clients in the form of technical log records. The assessee also provided technical interpretation to the client in order to give the client a clear picture of the downhole formation contents at various levels of the oilwell. Thus the logging service was a technical assistance provided by the assessee in the capacity of consulting engineer to the client to gauge the potential of the oilwell. Therefore, the gross amount charged from the clients was liable to service tax at the rate of 5 per cent.

Annual accounts of M/s. ONGC and M/s. Enron Oil and Gas India Limited showed that a payment of Rs.389.53 crore was made towards services rendered by the said firm during the period 1997-98 to 2000-01. Relevant invoices also indicated that the taxable value received in convertible foreign exchange was repatriated outside India and it was not exempt from service tax. Service tax of Rs.19.48 crore was, therefore, recoverable.

This was pointed out in July 2001; reply of the department/Ministry of Finance had not been received (January 2002).

(b) Records of M/s. Washle Ideal Limited, M/s. Motherson Auto Computers Engineering Limited and M/s. Matsushita Televisions and Audio India Limited, Noida, in Meerut II Commissionerate of Central Excise, revealed that an amount of Rs.7.36 crore was paid to their foreign collaborators during 1997-98 to 1998-99 for providing technical assistance/know-how in the capacity of consulting engineers. However, service tax amounting to Rs.37.33 lakh liable to be paid, was not paid by the service providers.

On being pointed out (February/April 2000), the department stated (October 2000) that Rs.2.94 lakh had been recovered from one of the assessees. Reply in other two cases had not been received (March 2001).

Reply of the Ministry of Finance had not been received (January 2002).

(c) M/s. D.O. Industrial Plant Services Limited, 24 parganas in Kolkata III Commissionerate of Central Excise, collected an amount of Rs.3.35 crore from the customers on account of designing and engineering services provided during the period from July 1997 to March 2000. Though such services were liable to tax under heading 'Consulting Engineers', service tax of Rs.16.74 lakh due thereon was neither paid by the assessee nor was demanded by the department.

This was pointed out in May 2000; reply of the department/Ministry of Finance had not been received (January 2002).

(d) M/s. Transparent Energy Systems Private Limited and M/s. SKF Bearings Limited, in Pune I and II Commissionerates of Central Excise, rendered services as consulting engineer but did not pay the service tax due on the taxable value recovered from the buyers. This resulted in non-levy of service tax of Rs.15.89 lakh during the period from 7 July 1997 to April 2000 on which interest of Rs.4.08 lakh was also due.

On this being pointed out (March and September 2000), the Ministry of Finance accepted the objection and intimated (October 2001) recovery of Rs.23.54 lakh and issue of show cause cum demand notice for Rs.4.23 lakh.

(ii) Transport operators

As per sub-rule (xvii) of rule 2(d) of Service Tax Rules, 1994, effective from 16 November 1997, recipients of services of goods transport operators were liable to pay service tax at the rate of 5 per cent of the freight charges paid to goods transport operators.

Twenty two assessees, in Aurangabad, Mumbai VII, Pune I and II Commissionerates of Central Excise, had not paid service tax on the freight charges paid to goods transport operators during the period 16 November 1997 to 1 June 1998. This resulted in non-levy of service tax to the extent of Rs.1.13 crore.

On being pointed out (between August 1999 and November 2000), the Ministry of Finance admitted the objection (December 2001) and intimated recovery of Rs.35.51 lakh from six assessees. In the remaining cases, it stated that the necessary action for recovery of tax had either been initiated or was being initiated.

(iii) Management consultants

Service tax was levied on service provided by a management consultant with effect from 16 October 1998 vide notification dated 7 October 1998.

M/s. DSP Merrill Lynch Limited, in Mumbai I Commissionerate of Central Excise, received Rs.6.35 crore during the period 16 October 1998 to 31 March 1999 for providing consultancy services in regard to merger and acquisition of companies. However, service tax of Rs.31.73 lakh payable thereon was not paid.

On being pointed out (October 1999), the Ministry of Finance admitted the objection (July 2001).

(iv) Consignment agents

As per notification dated 11 July 1997, recipients of service of consignment agent are liable to pay service tax on remuneration paid to consignment agent.

M/s. Koparan Limited, M/s. Bhupendra Industries Limited and M/s. Ruby Mills Limited in Mumbai VII Commissionerate of Central Excise, had not paid service tax on the remuneration paid to consignment agents during the period July 1997 to August 1999. This resulted in non-recovery of service tax of Rs.18.42 lakh.

On being pointed out (July 2000), the Ministry of Finance admitted the objection and intimated (January 2002) that show cause notices for Rs.18.42 lakh had been issued.

12.2 Short collection of service tax

(i) According to rule 6 of the Service Tax Rules, 1994, as amended from 16 October 1998, the service tax on telephone service is payable on the value of taxable services received during any calendar month.

A test check of S.T. 3 returns filed by Chennai Telephones, Chennai, providing telephone services, in Chennai I Commissionerate of Central Excise, revealed that in respect of half yearly period from October 1998 to March 1999, the value of taxable services charged or billed was less than the value of services realised. Service tax was paid on the billed or charged amount instead of the amount realised. There was short payment of service tax of Rs.8.23 crore during the period from July 1994 to March 2000.

On being pointed out (July 2000), the Ministry of Finance confirmed the facts and stated (October 2001) that the assessee had preferred an appeal before Commissioner (Appeals) which was pending decision.

(ii) As per sub-rule (xvii) of rule 2(d) of Service Tax Rules, 1994, which came into effect from 16 November 1997, recipients of service of goods transport operators were liable to pay service tax at the rate of 5 per cent of the freight charges paid to goods transport operators.

M/s. Float Glass India Limited, Taloja, in Mumbai VII Commissionerate of Central Excise, paid an amount of Rs.6.94 crore towards freight charges to goods transport operators during the period 16 November 1997 to 1 June 1998. The service tax payable thereon worked out to Rs.34.70 lakh. However, an amount of Rs.23.19 lakh only was paid. This resulted in short levy of service tax of Rs.11.51 lakh.

On being pointed out (November 2000), the Ministry of Finance admitted the objection (October 2001).

12.3 Non-recovery of interest on delayed payment of service tax

In terms of section 75 of the Finance Act, 1994, every person liable to pay tax in accordance with provisions of section 68, or rules made thereunder, who fails to credit the tax or any part thereof to the account of Central Government within the prescribed period, shall pay simple interest at the rate of one and a half per cent, for every month or part of the month by which such crediting of tax or any part thereof is delayed and penalty for failure to pay service tax can be imposed.

For the purpose of calculation of interest and penalty under service tax on telephones, the Ministry of Finance clarified on 15 October 1996, that the first date on which book transfer is made in the cash section of Secondary Switching Area (SSA) may be taken as the date of credit of service tax to Central Government account.

(a) Scrutiny of service tax records of two secondary switching areas of Chennai Telephones and Coimbatore Telephones, in Chennai I and Coimbatore Commissionerates of Central Excise, revealed that there was delay ranging from one month to five months in effecting book transfer for remittance of service tax collected. Interest amounting to Rs.1.49 crore was leviable between August 1994 and October 1998.

On being pointed out (between November 1998 and April 1999), the department stated (March 1999) that the actual amount of interest to be paid could be ascertained only at the time of assessment of ST-3 returns filed by the assessee and that the assessees had been issued show cause notices to submit their accounts for assessment.

Reply of the Ministry of Finance had not been received (January 2002).

(b) M/s. Lucent Technologies Hindustan Limited, in Delhi I Commissionerate of Central Excise, engaged in providing services of supervision/commissioning of telecom projects, charged service tax from clients but did not deposit it with the Government on due dates. Service tax of Rs.57.85 lakh charged between August 1997 and March 1998 was deposited on different dates with delay ranged from 1 to 27 months. Interest of Rs.3.49 lakh recoverable for delayed payment was not realised.

On being pointed out (December 2000), the Ministry of Finance admitted the objection and intimated (June 2001) recovery of Rs.3.78 lakh.

12.4 Non-levy of penalty

(i) Penalty for late filing of returns of service tax

According to section 77 of the Finance Act, 1994, if a person fails to furnish in due time, the return which he is required to furnish, he shall pay by way of penalty, a sum which shall not be less than one hundred rupees but which may extend to two hundred rupees for every day (for every week or part thereof with effect from 16 October 1998) during which such failure continues. As per Finance Act, 1999, effective from 11 May 1999, the penalty leviable may extend to an amount not exceeding two thousand rupees irrespective of the period of delay.

A check of service tax returns filed by 78 assessees, in Raipur Commissionerate of Central Excise, revealed that returns due between the period October 1994 and December 1999 were not filed within the prescribed time limit and no action was initiated for recovery of penalty which amounted to Rs.29.85 lakh.

On being pointed out (January 2000), the Ministry of Finance stated (August 2001) that show cause notices had been issued in all the cases.

(ii) Penalty for delayed payment of tax

As per section 76 of the Finance Act, 1994, any person liable to pay service tax in accordance with the provisions of section 68 or the rules made thereunder, who fails to pay such tax shall pay in addition to paying such tax, and interest, a penalty which shall not be less than rupees one hundred but which may extend to two hundred rupees for every day during which such failure continues, however, such penalty shall not exceed the amount of service tax that he failed to pay.

A check of service tax records maintained by Assistant Commissioner (S.T.) Division I, Surat Commissionerate of Central Excise, revealed that 24 assessees made payment of service tax after due dates. Though interest was levied on them but penalty under section 76 which was mandatory and leviable in addition to service tax and interest, was not levied. This resulted in non-levy of penalty amounting to Rs.8.07 lakh.

On being pointed out (January 2001), the Ministry of Finance admitted the objection and intimated (July 2001) that show cause notices amounting to Rs.10.25 lakh had been issued.

12.5 Other cases

In 20 other cases of non-levy of service tax, the Ministry of Finance/department had accepted the objection involving tax of Rs.0.42 crore and reported recovery of Rs.0.06 crore in 18 cases till January 2002.

New Delhi
Dated :15 February 2002

(S.K. BAHRI)
Principal Director (Indirect Taxes)

Countersigned

New Delhi
Dated : 15 February 2002

(V.K. SHUNGLU)
Comptroller and Auditor General of India