# Report of the Comptroller and Auditor General of India

for the year ended March 2008

## Union Government

(Indirect Taxes – Central Excise, Service Tax and Customs)

(Compliance Audit)

No. CA 20 of 2009-10

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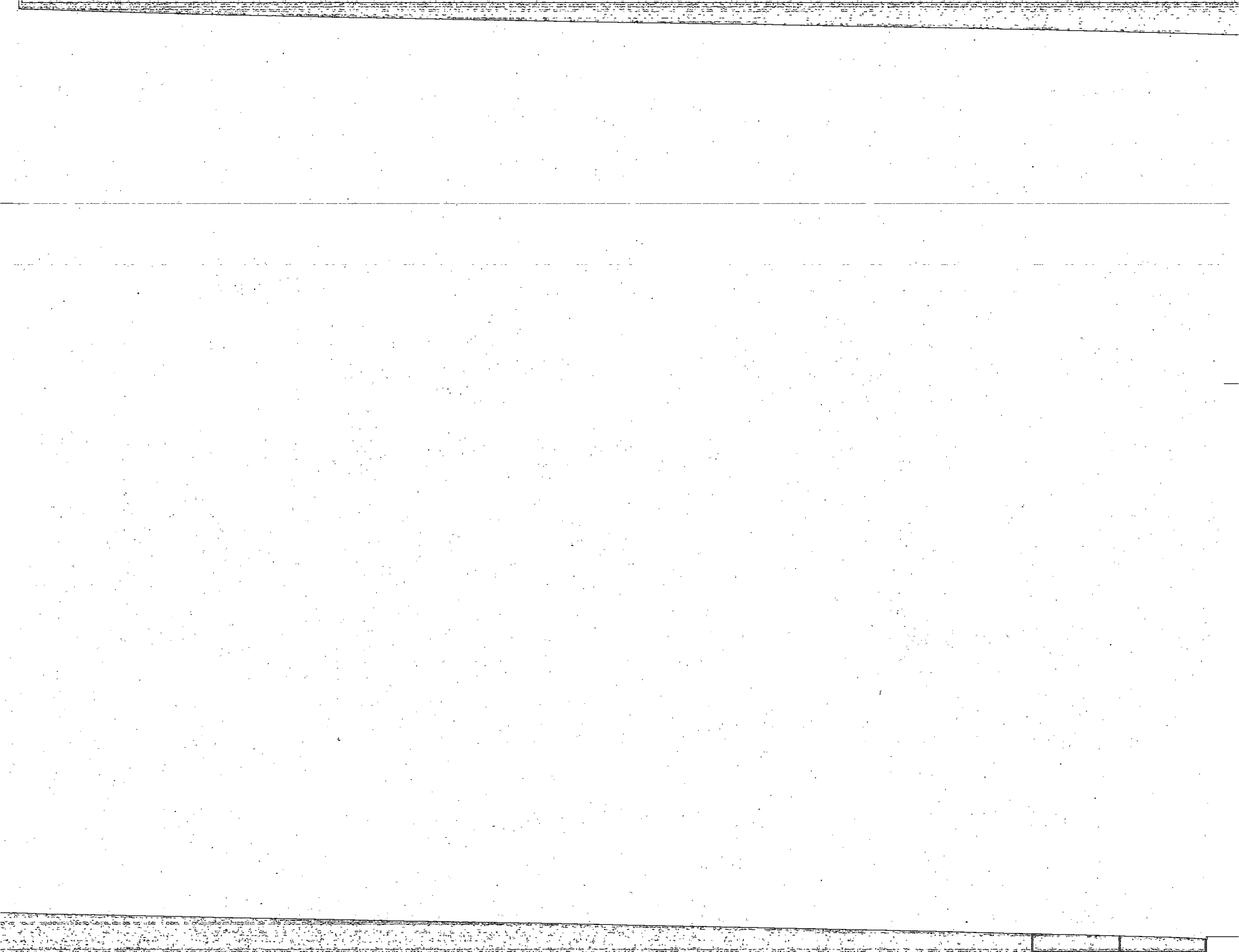


# PREFACE

This Report for the year ended March 2008 has been prepared for submission to the President of India under the Article 151 of the Constitution of India.

Audit of Revenue Receipts – Indirect Taxes of the Union Government is conducted under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

The report presents the results of audit of receipts under indirect taxes comprising of central excise duties, service tax, customs duties etc., and is arranged in the following order:-

(i) Section 1 depicts issues arising out of the test check of assessments of central excise duties

(ii) Section 2 deals with the results of test check of service tax assessments

(iii) Section 3 comprises issues arising out of the test check of assessments of customs duties

The observations included in this report have been selected from the findings of the test check conducted during 2007-08, as well as those which came to notice in earlier years but were not included in the previous reports.

# OVERVIEW

**This report is presented in three sections:**

| | | |
|---|---|---|
| **Section 1** | **Chapters I to VIII** | **Central excise** |
| **Section 2** | **Chapters IX to XII** | **Service tax** |
| **Section 3** | **Chapters XIII to XVIII** | **Customs** |

**The report has a total revenue implication of Rs. 1,090.71 crore flagged through 503 paragraphs. The Ministry/department had accepted, till December 2008, the audit observations in 353 paragraphs with a money value of Rs. 241.53 crore, of which Rs. 76.20 crore had been recovered. The audit contentions had, accordingly, been accepted in 70 per cent of the paragraphs.**

# SECTION 1 - CENTRAL EXCISE

This section contains 163 paragraphs with a revenue implication totalling Rs. 717.49 crore. The Ministry/department had, till December 2008, accepted the audit observations in 104 paragraphs involving revenue of Rs. 156.27 crore and reported recovery of Rs. 43.13 crore. Some of the significant findings included under the section are mentioned in the following paragraphs:-

## Chapter I: Central excise receipts

- The actual collections fell short of the budget estimates year after year. Despite this, the Government continued to make optimistic projections during presentation of the annual budget. The budget estimate 2007-08 was pitched at Rs.1,30,220 crore, an increase of 9.43 per cent over budget estimates, 11.05 per cent over revised estimate and 10.72 per cent over actual receipts of 2006-07. However, the collections in 2007-08 fell short of the budget estimates by Rs.6,609 crore or 5.07 per cent.

***{Paragraph 1.1}***

- While central excise receipts had grown by 36 per cent during the years 2003-04 to 2007-08, the growth in cenvat availed during the relevant period was much more at 129 per cent. Percentage of cenvat availed of, to duty paid by cash, increased constantly during the years 2003-04 to 2007-08. Cenvat credit availed of during 2006-07 and

2007-08 was more than the duty paid through PLA. One of the reasons for the excessive use of cenvat credit compared to duty payment by cash could be the misuse of the cenvat credit scheme. The incorrect use of this facility has been reported in chapter III of this report, in addition to similar chapter in each year's audit report.

***{Paragraph 1.3}***

- The Government had amended Act/Rules addressing the concerns raised through audit reports. Some of these important changes effected between May 2006 and March 2008 have been indicated in Table no.10 under Chapter I of this report.

***{Paragraph 1.10.2}***

## Chapter II: Non-levy/short levy of duty

- Duty and interest of Rs. 121.64 crore on account of duty refunded earlier but made recoverable by amendment to the Act, was not realised from M/s North Eastern Tobacco Company Ltd.

***{Paragraph 2.1}***

- Duty of Rs. 77.25 crore was not recovered from M/s NALCO on failure to export finished products against the duty free procurement of imported and indigenous goods.

***{Paragraph 2.2}***

- Duty totalling Rs. 99.29 crore was not paid on excisable goods consumed captively or was not paid on due dates or was not paid by classifying goods incorrectly or duty was levied short by adopting lower assessable value etc.

***{Paragraphs 2.3 to 2.8}***

## Chapter III: Cenvat credit

- Cases of availing of cenvat credit in violation of prescribed conditions, availing of credit in excess of permissible limits, re-taking of disallowed credit, availing of credit on exempted goods/non-excisable goods, availing of dual benefit by taking credit and collecting duty on exempted goods, removal of capital goods/inputs without payment of duty despite availing cenvat, excess transfer of cenvat credit to sister units, non-recovery of credit on materials written off/found short etc., were noticed in audit. Duty involved in these cases was Rs. 187.54 crore.

***{Paragraphs 3.1 to 3.18}***

## Chapter IV: Exemptions

- Duty of Rs. 136.17 crore was levied short due to incorrect grant of exemptions.

***{Paragraphs 4.1 to 4.7}***

## Chapter V: Demands not raised or adjudicated

- Revenue of Rs. 49.25 crore remained unrealised as demands for duty were either not raised or were not adjudicated.

***{Paragraphs 5.1 to 5.3}***

## Chapter VI: Valuation of excisable goods

- Instances of undervaluation due to non-inclusion of additional consideration in the assessable value, incorrect allowance of deduction from assessable value, incorrect determination of cost of excisable goods, incorrect valuation of samples meant for free distribution etc., were noticed. Duty levied short in these cases amounted to Rs. 40.03 crore.

***{Paragraphs 6.1 to 6.5}***

## Chapter VII: Cess not levied or demanded

- Cess amounting to Rs. 4.39 crore was not levied or demanded on textile articles, textile machinery, petroleum products and cement.

***{Paragraphs 7.1 to 7.4}***

## Chapter VIII: Non-levy of interest and penalty

- Interest and penalty totalling Rs. 1.93 crore was not recovered in a few cases of delayed payment or non-payment of duty.

***{Paragraphs 8.1 to 8.3}***

# SECTION 2 - SERVICE TAX

This section contains 158 paragraphs with a revenue implication totalling Rs. 276.72 crore. The Ministry/department had accepted, till December 2008, the audit observations in 112 paragraphs involving revenue of Rs. 47.43 crore and reported recovery of Rs. 23.22 crore. Significant findings of audit included under the section are summarised in the following paragraphs:-

## Chapter IX: Service tax receipts

- A total of 99,900 cases involving tax of Rs. 6,364.02 crore were pending as on 31 March 2008 with different authorities, of which 77 per cent in terms of number were with the adjudicating officers of the department. Pendency with these adjudicating officers had been increased from 63,703 in 2006-07 to 76,816 in 2007-08 i.e. an increase of 20.58 per cent and pendency for recovery of demands had increased from 18,396 cases in 2006-07 to 19,470 cases in 2007-08 i.e. an increase of 5.84 per cent.

*{Paragraph 9.3}*

- The Government had amended Act/Rules addressing the concerns raised through audit reports. Two of these important changes effected through the Budget 2008-09 have been indicated in Table no.6 under Chapter IX of this report.

*{Paragraph 9.6.2}*

## Chapter X: Grant of cenvat credit of service tax

- Instances of utilisation of cenvat credit without restricting it to prescribed limits or for payment of tax on input services, availing of credit on inputs used in non-taxable output services, non-recovery of credit on input services contained in written off output services, availing of credit of ineligible services or tax relating to other units etc., were noticed, in a few cases test checked. Service tax involved in these cases was Rs. 177.55 crore.

*{Paragraphs 10.1 to 10.12}*

## Chapter XI: Non-levy/non-payment of service tax

- Service tax totaling Rs. 79.28 crore was not levied or was not paid by the service providers or recipient of services from foreign service providers.

*{Paragraphs 11.1 to 11.3}*

## Chapter XII: Miscellaneous topics of interest

- Cases of non-payment of interest on delayed payment of service tax or on wrong availing of cenvat credit, incorrect availing of exemption from tax, avoidance of tax by splitting value of services into components, non-inclusion of 'tax deducted at source (TDS)' in the value of services, incorrect classification of services etc., were noticed in audit. Tax implication in these cases was Rs. 19.89 crore.

*{Paragraphs 12.1 to 12.7}*

# SECTION 3 - CUSTOMS

This section contains 182 paragraphs featured individually or grouped together with a revenue implication of Rs. 96.50 crore. The Ministry/department had accepted, till December 2008, the audit observations in 137 paragraphs involving revenue of Rs. 37.83 crore and reported recovery of Rs. 9.85 crore. Some of the important findings included in the section are highlighted in the following paragraphs:-

## Chapter XIII: Customs receipts

- Budget estimate for 2007-08 was pitched at Rs. 98,770 crore and revised estimate at Rs. 1,00,766 crore. Actual collections of Rs. 1,04,119 crore, however, were more than both, mainly due to increase in collection of import duty on minerals and related materials, petroleum products, chemicals and related products, machinery and transport equipments.

***{Paragraphs 13.1 & 13.3}***

- Duty foregone under various export promotion schemes during the year 2007-08 was Rs. 64,022 crore which was approximately 62 per cent of the total receipts of customs duty.

***{Paragraph 13.4.1}***

- Customs revenue of Rs. 2,104.47 crore was not realised by the department at the end of financial year 2007-08. Of this, an amount of Rs. 207.39 crore was not recovered for over ten years, despite being not disputed.

***{Paragraph 13.6.2}***

## Chapter XIV: Incorrect assessment of customs duties

- Incorrect assessment of customs duty totalling Rs. 47.31 crore was detected in audit, in a few cases. These arose mainly due to incorrect assessment of motorcycle parts and MP-3 players, non-realisation of cost recovery charges, non-levy of duty on aviation turbine fuel etc.

***{Paragraphs 14.1 to 14.8}***

## Chapter XV: Duty exemption schemes

- Revenue of Rs. 33.24 crore was due from exporters/importers those had availed the benefits of the duty exemption schemes but had not fulfilled the prescribed obligations/conditions.

***{Paragraphs 15.1 to 15.7}***

## Chapter XVI: Classification

- Duty of Rs. 5.70 crore was short levied due to misclassification of goods in 22 cases.

***{Paragraphs 16.1 to 16.10}***

## Chapter XVII: Exemptions

- Duty of Rs. 5.52 crore was short levied on account of extending the benefit of exemption notifications, incorrectly.

***{Paragraphs 17.1 to 17.4}***

## Chapter XVIII: Non-levy/short levy of additional duty

- Additional duty totalling Rs. 93 lakh was not levied or short levied on goods imported by 52 importers.

***{Paragraphs 18.1 to 18.4}***

## Glossary of terms and abbreviations

| Expanded form | Abbreviated form |
|---|---|
| Central Board of Excise and Customs | CBEC |
| Central Excise Tariff Heading | CETH |
| Container Freight Station | CFS |
| Cost Insurance Freight | CIF |
| Commissionerate of central excise | Commissionerate |
| Countervailing Duty | CVD |
| Customs Tariff Heading | CTH |
| Customs, Excise & Service Tax Appellate Tribunal | CESTAT |
| Director General of Foreign Trade | DGFT |
| Duty Exemption Pass Book | DEPB |
| Duty Free Credit Entitlement Certificate | DFCEC |
| Duty Free Replenishment Certificate | DFRC |
| Excise Law Times | ELT |
| Export Obligation | EO |
| Export Oriented Unit | EOU |
| Export Performance | EP |
| Export Promotion Capital Goods | EPCG |
| Export Promotion Zone | EPZ |
| Free on Board | FOB |
| Goods transport agency | GTA |
| Hand Book of Procedures | HBP |
| High speed diesel | HSD |
| Harmonized System of Nomenclature | HSN |
| Inland Container Depot | ICD |
| Joint Director General of Foreign Trade | JDGFT |
| Letter of Permission | LOP |
| National calamity contingent duty | NCCD |
| Net Foreign Exchange Earning as a Percentage of Export | NFEP |
| Non Tariff | NT |
| Personal ledger account | PLA |
| Regional Licensing Authority | RLA |
| Retail Sale Price | RSP |
| Show Cause Notice | SCN |
| Small scale industries | SSI |
| Software Technology Park | STP |
| The Ministry of Finance | the Ministry |

# SECTION 1 – CENTRAL EXCISE

# CHAPTER I
# CENTRAL EXCISE RECEIPTS

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

The budget estimates, revised estimates and actual receipts of central excise duties during the years 2003-04 to 2007-08 are exhibited in the following table and graph:-

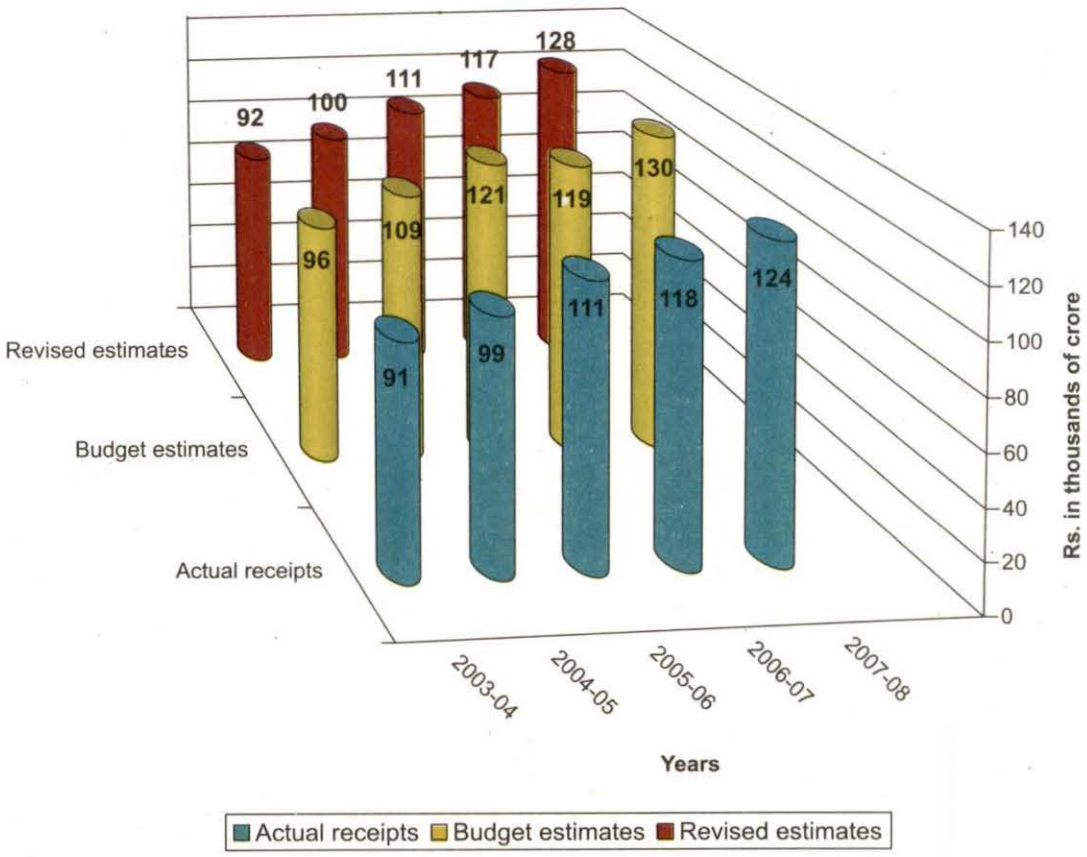
**Table no. 1**

**(Amounts in crore of rupees)**

| Year | Budget estimates | Revised estimates | Actual receipts* | Difference between actual receipts and budget estimates | Percentage variation |
|---|---|---|---|---|---|
| 2003-04 | 96,396 | 91,850 | 90,774 | (-) 5,622 | (-) 5.83 |
| 2004-05 | 1,08,500 | 1,00,000 | 99,125 | (-) 9,375 | (-) 8.64 |
| 2005-06 | 1,20,768 | 1,11,006 | 1,11,226 | (-) 9,542 | (-) 7.90 |
| 2006-07 | 1,19,000 | 1,17,266 | 1,17,613 | (-) 1,387 | (-) 1.17 |
| 2007-08 | 1,30,220 | 1,27,947 | 1,23,611 | (-) 6,609 | (-) 5.07 |

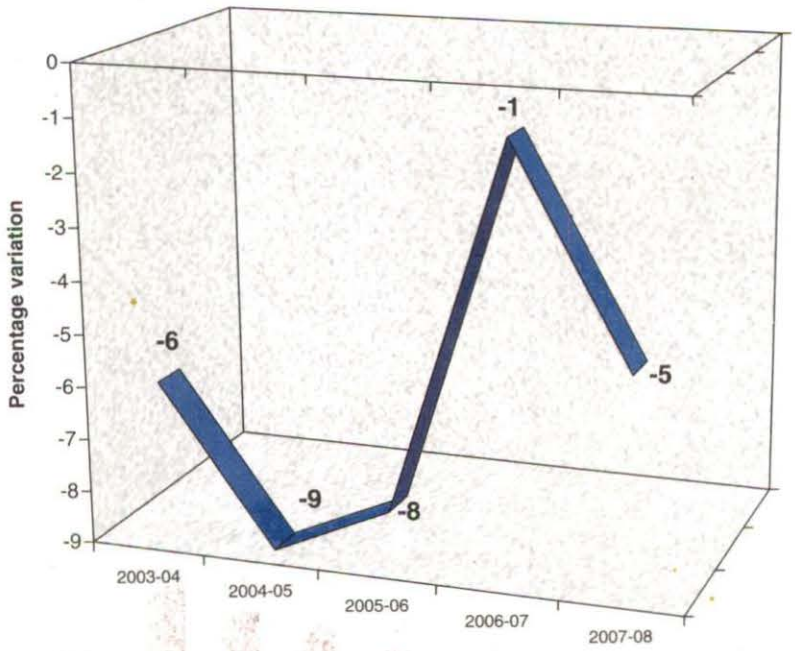
* Figures as per Finance Accounts

**Graph 1: Central Excise Receipts - Budget, Revised and Actual**



The actual collections fell short of the budget estimates year after year. Despite this, Government continued to make optimistic projections during presentation of the annual budget. The budget estimate 2007-08 was pitched at Rs.1,30,220 crore, an increase of 9.43 per cent over budget estimates, 11.05 per cent over revised estimate and 10.72 per cent over actual receipts of 2006-07. However, the collections in 2007-08 fell short of the budget estimates by Rs.6,609 crore or 5.07 per cent. The percentage variation between the actual receipts and the budget estimates during the years 2003-04 to 2007 08 is depicted in the following graph:

**Graph 2: Percentage variation of actual receipts over budget estimates**




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

The values of output** from the manufacturing sector vis-à-vis receipt of central excise duties through personal ledger account (cash collection) during the years 2003-04 to 2007-08 were as mentioned in the following table and graph:-

**Table no. 2**

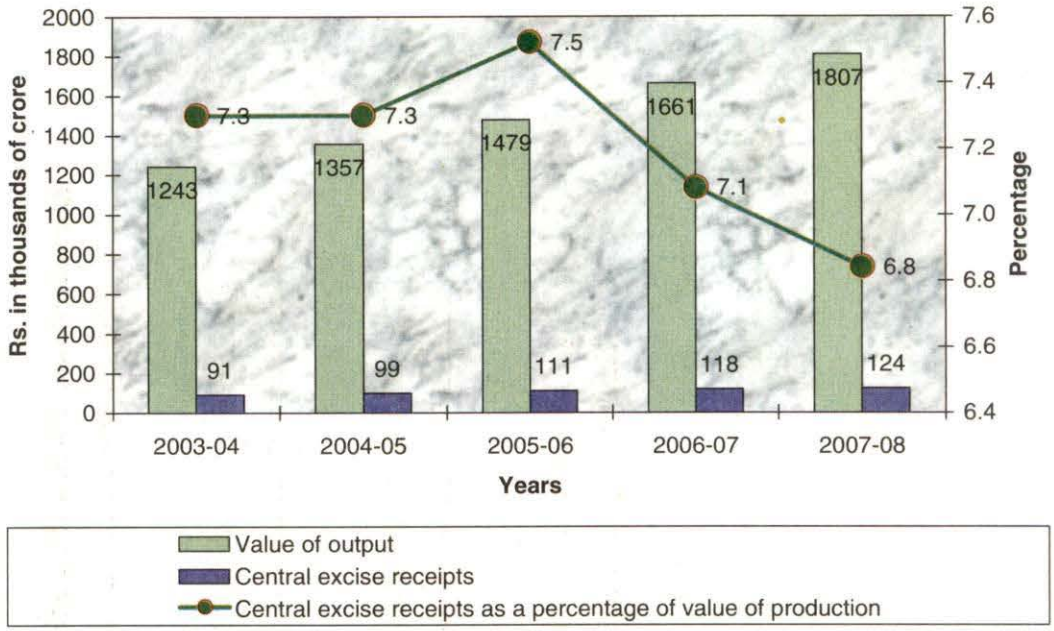
**(Amounts in crore of rupees)**

| Year | Value of output* | Central excise receipts | Central excise receipts as a percentage of value of production |
|---|---|---|---|
| 2003-04 | 12,42,849 | 90,774 | 7.30 |
| 2004-05 | 13,57,191 | 99,125 | 7.30 |
| 2005-06 | 14,79,338 | 1,11,226 | 7.52 |
| 2006-07 | 16,61,297 | 1,17,613 | 7.08 |
| 2007-08 | 18,07,491 | 1,23,611 | 6.84 |

* Estimated figure, Source: Central Statistical Organisation (Government of India).

**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 producer's values that is the market price at the establishment of the producers. As separate figures of value of production by small scale industry units and for export production were not available, these have not been excluded from the value of output indicated.

**Graph 3: Central excise receipts and value of production**




The foregoing table reveals that value of output had increased by a factor of 1.45 during the years 2003-04 to 2007-08 and the corresponding increase in the central excise receipts was by a factor of 1.36. Accordingly the central excise duties had generally kept steady pace with the value of output.

## 1.3 Central excise receipts vis-à-vis cenvat availed

A comparative statement showing the details of central excise duty paid through personal ledger account (PLA) and the amount of cenvat availed during the years 2003-04 to 2007-08 is given in the following tables and graphs: -

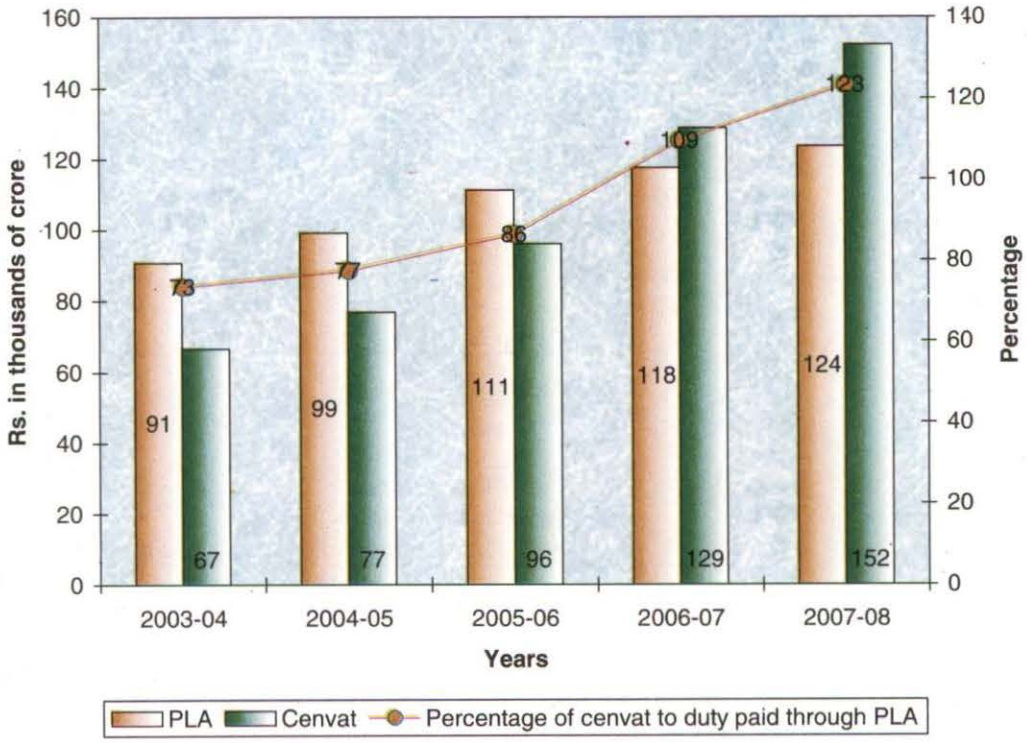
**Table no. 3**

**(Amounts in crore of rupees)**

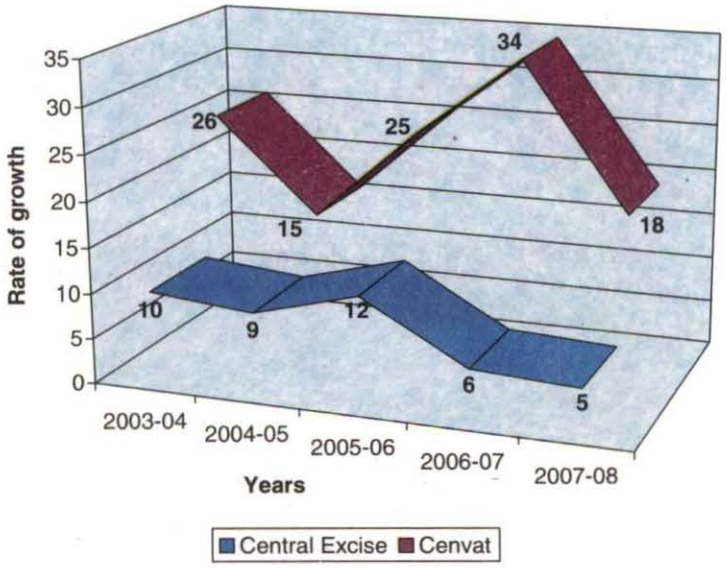
| Year | Central excise duty paid through PLA | | Cenvat availed* | | Percentage of cenvat to duty paid through PLA |
|---|---|---|---|---|---|
| | Amount | Percentage increase | Amount | Percentage increase | |
| 2003-04 | 90,774 | 10.28 | 66,576 | 25.52 | 73.34 |
| 2004-05 | 99,125 | 9.20 | 76,665 | 15.15 | 77.34 |
| 2005-06 | 1,11,226 | 12.21 | 96,050 | 25.29 | 86.36 |
| 2006-07 | 1,17,613 | 5.74 | 1,28,698 | 33.99 | 109.42 |
| 2007-08 | 1,23,611 | 5.10 | 1,52,210 | 18.27 | 123.14 |

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

**Graph 4: Central excise receipts (PLA) and Cenvat**




**Graph 5: Rate of growth of Central excise receipts (PLA) and Cenvat**




Thus, while central excise receipts had grown only by 36 per cent during the years 2003-04 to 2007-08, the growth in cenvat availed during the relevant period was much more at 129 per cent. Percentage of cenvat availed of, to duty paid by cash, increased constantly during the years 2003-04 to 2007-08.

Cenvat credit availed of during 2006-07 and 2007-08 was more than the duty paid through PLA. One of the reasons for the excessive use of cenvat credit compared to duty payment by cash could be the misuse of the cenvat credit scheme. The incorrect use of this facility has been reported in chapter III of this report, in addition to a similar chapter in each year's audit report.

## 1.4 Cost of collection

The expenditure incurred during the year 2007-08 in collecting central excise duty alongwith the corresponding figures for the preceding four years is given in the following table and graph:-

**Table no. 4**

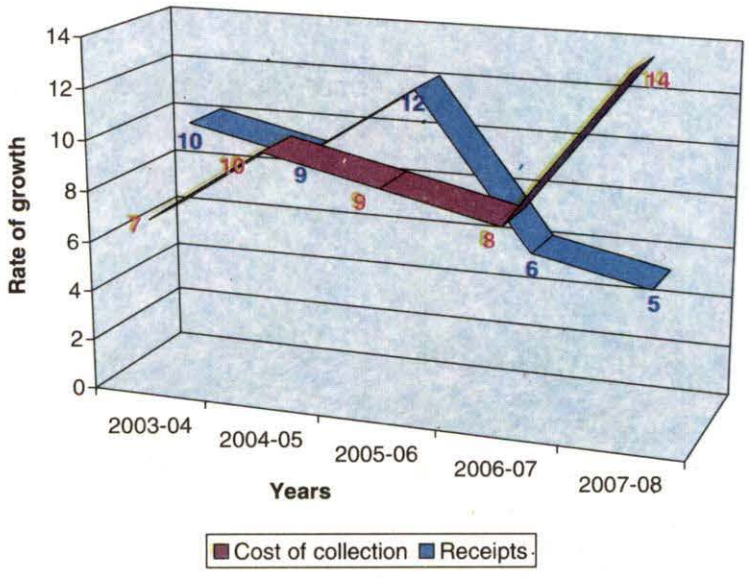
**(Amounts in crore of rupees)**

| Year | Receipts from excise duty | | Expenditure on collection$ | | Cost of collection as a percentage of receipts |
|---|---|---|---|---|---|
| | Amount | Percentage increase over the previous year | Amount* | Percentage increase over the previous year | |
| 2003-04 | 90,774 | 10.28 | 750.58 | 6.80 | 0.83 |
| 2004-05 | 99,125 | 9.20 | 825.90 | 10.03 | 0.83 |
| 2005-06 | 1,11,226 | 12.21 | 901.02 | 9.10 | 0.81 |
| 2006-07 | 1,17,613 | 5.74 | 974.49 | 8.15 | 0.83 |
| 2007-08 | 1,23,611 | 5.10 | 1,107.28 | 13.62 | 0.90 |

* Figures as per Finance Accounts

$ Expenditure figure include expenditure incurred for collection of service tax as separate figures for these are not maintained by the Ministry

**Graph 6: Percentage growth in central excise receipts and cost of collection**



## 1.5 Outstanding demands

The number of cases and amounts involved in demands* for excise duty outstanding for adjudication/recovery as on 31 March 2007 and 31 March 2008 are mentioned in the following table:-

**Table no. 5**

**(Amounts in crore of rupees)**

| Pending decision with | As on 31 March 2007 | | | | As on 31 March 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 |
| Adjudicating officers | 155 | 8,972 | 99.89 | 5,534.88 | 165 | 11,097 | 112.91 | 11,264.78 |
| Appellate Commissioners | 428 | 4,240 | 60.00 | 1,092.17 | 367 | 5,380 | 48.66 | 883.53 |
| Board | 6 | 91 | 0.03 | 101.94 | 3 | 15 | 0.12 | 1.43 |
| Government | 11 | 62 | 1.49 | 11.08 | 19 | 61 | 6.49 | 45.46 |
| Tribunals | 1,162 | 8,710 | 666.79 | 14,312.47 | 1,373 | 8,309 | 460.41 | 10,662.59 |
| High Courts | 623 | 1,046 | 277.49 | 3,336.72 | 615 | 1,061 | 144.46 | 610.76 |
| Supreme Court | 87 | 152 | 56.21 | 1,361.67 | 77 | 127 | 21.67 | 269.12 |
| Pending for coercive recovery measures | 4,374 | 7,535 | 1,223.90 | 3,644.17 | 5,020 | 8,713 | 1,236.41 | 4,654.03 |
| **Total** | **6,846** | **30,808** | **2,385.80** | **29,395.10** | **7,639** | **34,763** | **2,031.13** | **28,391.70** |

* Figures furnished by the Ministry

A total of 42,402 cases involving duty of Rs. 30,422.83 crore were pending as on 31 March 2008 with different authorities, of which 27 per cent in terms of number were with the adjudicating officers of the department. Pendency with department's adjudicating officers had increased from 9,127 in 2006-07 to 11,262 in 2007-08 i.e. an increase of 23.39 per cent and pendency for recovery of demands had increased from 11,909 cases in 2006-07 to 13,733 cases in 2007-08 i.e. an increase of 15.32 per cent.

## 1.6 Fraud/presumptive fraud cases

The position of fraud/presumptive fraud cases** alongwith the action taken by the department against the defaulting assessees during the period 2005-06 and 2007-08 is shown below:-

**Table no. 6**

**(Amounts 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 |
| 2005-06 | 782 | 916.81 | 505.54 | 196 | 103.10 | 87.25 | 43 | 1.62 |
| 2006-07 | 917 | 3,315.96 | 1,587.40 | 183 | 186.72 | 171.37 | 38 | 3.67 |
| 2007-08 | 1,021 | 950.88 | 775.63 | 292 | 137.59 | 157.98 | 105 | 0.93 |
| **Total** | **2,720** | **5,183.65** | **2,868.57** | **671** | **427.41** | **416.60** | **186** | **6.22** |

** Figures furnished by the Ministry

The foregoing table indicates that while a total of 2,720 cases of fraud/presumptive fraud were detected during the years 2005-08 by the department involving duty of Rs. 5,183.65 crore, it raised a demand of Rs. 2,868.57 crore only and recovered Rs. 416.60 crore (14.52 per cent) out of it. Similarly, out of a penalty of Rs. 427.41 crore that was imposed, the department could recover only Rs. 6.22 crore (1.5 per cent).

## 1.7 Commodities contributing major revenue

Commodities which yielded revenue* of more than Rs. 1000 crore during 2007-08 alongwith corresponding figures for 2006-07 are mentioned in the following table:-

**Table no.7**

**(Amounts in crore of rupees)**

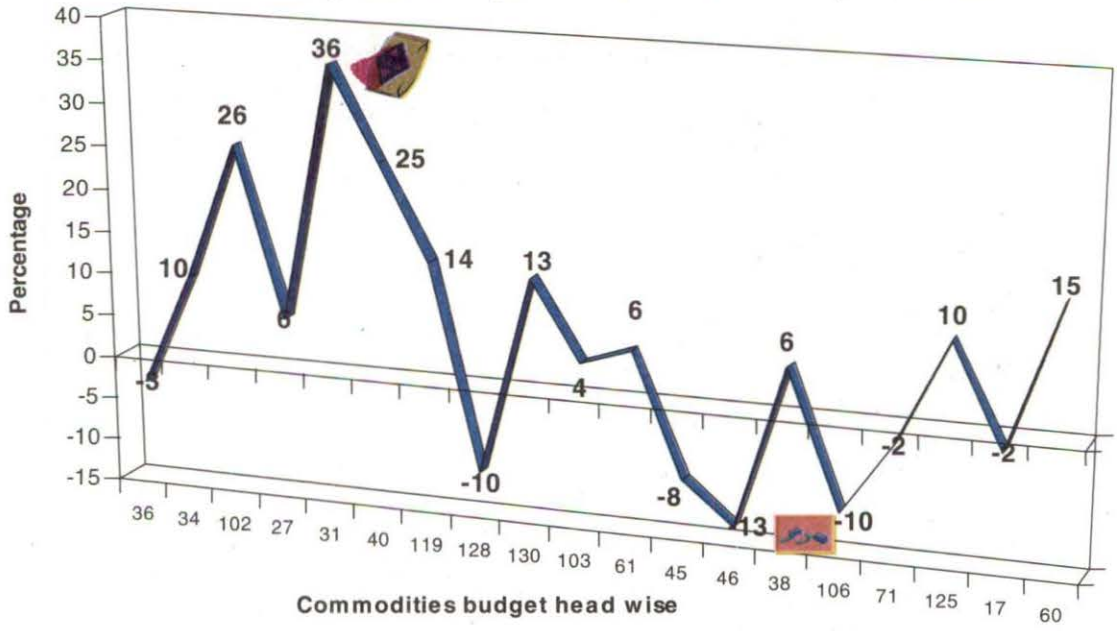
| Sl. No. | Budget head | Commodity | 2006-07 (Actual) | 2007-08 (Actual) | Percentage variation of actual over previous year | Percentage share in total collection |
|---|---|---|---|---|---|---|
| 1. | 36 | Refined diesel oil | 24,671.54 | 23,847.80 | (-) 3.34 | 19.40 |
| 2. | 34 | Motor spirit | 18,302.95 | 20,101.47 | 9.83 | 16.35 |
| 3. | 102 | Iron and steel | 12,685.20 | 15,940.28 | 25.66 | 12.97 |
| 4. | 27 | Cigarettes | 7,701.35 | 8,152.49 | 5.86 | 6.63 |
| 5. | 31 | Cement | 5,149.40 | 6,990.97 | 35.76 | 5.69 |
| 6. | 40 | All other mineral oils and products falling under chapter 27 | 5,050.72 | 6,312.81 | 24.99 | 5.13 |
| 7. | 119 | All other machinery, articles and tools falling under chapter 84 | 3,825.99 | 4,359.94 | 13.96 | 3.55 |
| 8. | 128 | Motor cars and other motor vehicles | 3,021.63 | 2,715.81 | (-) 10.12 | 2.20 |
| 9. | 130 | All other motor vehicles falling under chapter 87 | 2,606.09 | 2,948.16 | 13.13 | 2.40 |
| 10. | 103 | Articles of iron and steel | 2,432.51 | 2,529.67 | 3.99 | 2.05 |
| 11. | 61 | Plastic and articles thereof | 2,395.74 | 2,537.01 | 5.90 | 2.06 |
| 12. | 45 | Organic chemicals | 2,043.55 | 1,870.95 | (-) 8.45 | 1.52 |
| 13. | 46 | Pharmaceutical products | 2,007.23 | 1,739.45 | (-) 13.34 | 1.41 |
| 14. | 38 | Furnace oil | 1,877.29 | 1,984.82 | 5.73 | 1.61 |
| 15. | 106 | Aluminium and articles thereof | 1,590.41 | 1,425.80 | (-) 10.35 | 1.16 |
| 16. | 71 | Paper and paper board, articles of paper pulp or paper or paper board | 1,289.54 | 1.263.24 | (-) 2.04 | 1.03 |
| 17. | 125 | All other electronic and electrical goods falling under chapter 85 | 1,229.80 | 1,356.58 | 10.31 | 1.10 |
| 18. | 17 | Cane or beet sugar and chemically pure sucrose in solid form | 1,225.36 | 1,205.87 | (-) 1.59 | 0.98 |
| 19. | 60 | Miscellaneous chemical products | 1,183.52 | 1,365.62 | 15.39 | 1.11 |

* Figures furnished by the Ministry.

The above table reveals that there was lower collection of revenue during 2007-08 from some of these commodities compared to the previous years. These commodities were pharmaceutical products, aluminium and articles thereof, motor cars and other motor vehicles, organic chemicals, refined diesel oil, paper and paper board, articles of paper pulp or paper or paper board and cane or beet sugar and chemically pure sucrose in solid form. The most

substantial dip in revenue was from 'pharmaceutical products'. The percentage variation of revenue during the year 2007-08 from these commodities over the previous year is depicted pictorially in the following graph: -

**Graph 7: Percentage variation of revenue from major commodities**




## 1.8 Remission of revenue

Central excise duty remitted/abandoned* or written off due to various reasons for the years 2006-07 and 2007-08 is shown in the following table:-

**Table no. 8**

**(Amounts in crore of rupees)**

| | | 2006-07 | | 2007-08 | |
|---|---|---|---|---|---|
| | | Number of cases | Amount | Number of cases | Amount |
| **Remitted due to :** | | | | | |
| (a) | Fire | 19 | 0.53 | 7 | 1.20 |
| (b) | Flood | 12 | 0.79 | 4 | 0.89 |
| (c) | Theft | 2 | 3.47 | 0 | 0.00 |
| (d) | Other reasons | 669 | 3.40 | 529 | 3.90 |
| **Written off due to :** | | | | | |
| (a) | Assessees having died leaving behind no assets | 13 | 0.04 | 1 | 0.01 |
| (b) | Assessees untraceable | 147 | 5.23 | 114 | 6.97 |
| (c) | Assessees left India | 2 | 0.03 | 0 | 0.00 |
| (d) | Assessees incapable of payment of duty | 19 | 0.02 | 0 | 0.00 |
| (e) | Other reasons | 110 | 1.57 | 2 | 0.08 |
| **Total** | | **993** | **15.08** | **657** | **13.05** |

* Figures furnished by the Ministry

## 1.9 Contents

This section of the report contains 163 paragraphs, featured individually or grouped together, arising from test check of records maintained in departmental offices and premises of the manufacturers. The revenue implication of these paragraphs is Rs. 717.49 crore. The concerned Ministries/departments had accepted (till December 2008) audit observations in 104 paragraphs involving Rs. 156.27 crore and had recovered Rs. 43.13 crore.

## 1.10 Impact of audit reports

### *1.10.1 Revenue impact*

During the last five years (including the current year's report), audit had pointed out short levy of central excise duty totalling Rs. 12,918.12 crore through 883 audit paragraphs. Of these, the Government had accepted audit observations in 590 audit paragraphs involving Rs. 3,542.97 crore and had since recovered Rs. 216.31 crore. The details are shown in the following table:-

**Table no. 9**

**(Amounts in crore of rupees)**

| Year of Audit Report | Paragraphs included | | Paragraphs accepted | | | | | | Recoveries effected | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Pre printing | | Post printing | | Total | | Pre printing | | Post printing | | Total | |
| | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount |
| 2003-04 | 217 | 1,897.94 | 151 | 814.30 | 1 | 0.16 | 152 | 814.46 | 30 | 27.73 | 25 | 22.39 | 55 | 50.12 |
| 2004-05 | 227 | 7,696.94 | 122 | 200.40 | -- | -- | 122 | 200.40 | 32 | 20.02 | 57 | 20.78 | 89 | 40.80 |
| 2005-06 | 124 | 1,410.39 | 89 | 1,315.73 | -- | -- | 89 | 1,315.73 | 35 | 25.97 | 29 | 19.94 | 64 | 45.91 |
| 2006-07 | 152 | 1,195.36 | 118 | 57.30 | 5 | 998.81 | 123 | 1,056.11 | 59 | 23.57 | 21 | 12.78 | 80 | 36.35 |
| 2007-08 | 163 | 717.49 | 104 | 156.27 | -- | -- | 104 | 156.27 | 41 | 43.13 | -- | -- | 41 | 43.13 |
| **Grand Total** | **883** | **12,918.12** | **584** | **2,544.00** | **6** | **998.97** | **590** | **3,542.97** | **197** | **140.42** | **132** | **75.89** | **329** | **216.31** |

### *1.10.2 Amendment to Act/Rules*

The Government had amended Act/Rules addressing the concerns raised by audit through audit reports. Some of these important changes are briefly mentioned in the following table:-

**Table no. 10**

| Reference of audit report (AR) paragraph | Issue raised in audit | Amendment to Act/Rules etc. |
|---|---|---|
| **Paragraphs 6.2.1 and 6.2.3 of AR no. 11 of 2005** | **Removal of used capital goods on which cenvat credit was availed, without payment of duty.** | **Rule 3(5) of the Cenvat Credit Rules, 2004 amended to provide for payment of amount equal to cenvat credit taken on capital goods reduced by 2.5 per cent for each quarter of a year {Notification No.39/2007 – CE (NT) dated 13 November 2007}.** |
| **Paragraph 11.1.1 of AR no. 7 of 2006** | **Revenue forgone due to non-valuation of automobile parts on the basis of maximum retail price (MRP) for levying excise duty.** | **Parts, components and assemblies of automobile have been included in section 4A for the purpose of assessment on the basis of MRP {Notification No.11/2006-CE (NT) dated 29 May 2006}.** |

| Reference of audit report (AR) paragraph | Issue raised in audit | Amendment to Act/Rules etc. |
|---|---|---|
| Paragraph 11.1.4 of AR no. 7 of 2006 | Revenue forgone due to non-valuation of medicated plaster (3004.90) on the basis of maximum retail price (MRP) for levying excise duty. | Medicaments other than those which are exclusively used in Ayurvedic, Unani, Siddha, Homeopathic or Bio-chemic systems have been included in section 4A for the purpose of assessment on the basis of MRP {Notification No.14/2008-CE (NT) dated 1 March 2008}. |
| Paragraph 16.1.2 of AR no. 7 of 2006 | Excisable goods are cleared on payment of duty at the appropriate rate prevalent at the relevant point of time but at a later date the same was sold at higher rate of duty. The excess duty collected was not paid to Government as the person at the sales point was not liable to pay duty. | Section 11D of the Central Excise Act, 1944, has been amended enabling recovery of amount from any person who collects amount as duty of excise. Section 11DD of the above Act has also been amended enabling recovery of interest on delayed deposit of said amount (Section 76 of the Finance Act, 2008). Earlier, such recovery was possible only from persons liable to pay duty. |
| Paragraphs 10.5.1 of AR no. 7 of 2006, 10.1.1 of AR no. 7 of 2007 and 3.1.6 and 3.2 of AR no. CA 7 of 2008 | Inputs used in dutiable as well as exempted goods without maintaining separate account of its use in exempted goods. Reversal of cenvat credit was done on proportionate basis of use of inputs in exempted goods which was not allowed under the rules. | Rule 6(3) has been amended to provide option either to pay amount at 10 per cent of the value of exempted goods or to reverse proportionate credit attributable to inputs and input services used in exempted goods {Notification No.10/2008 CE (NT) dated 1 March 2008}. |
| Paragraph 3.9 of AR no. CA 7 of 2008 | Non-recovery of credit taken on inputs used in the finished goods burnt/destroyed in fire. | Rule 3(5C) has been inserted under the Cenvat Credit Rules, 2004 for reversing the credit taken on the inputs used in the manufacture of goods which have been lost or destroyed by natural cause or by unavoidable accident {Notification No.33/2007-CE (NT) dated 7 September 2007}. |
| Paragraph 1.7.1.1 of AR no. PA 6 of 2008 | Non-recovery of excise duty on aluminium dross obtained as by-product during manufacture of aluminium ingots treating it as non-excisable. | An explanation below section 2(d) of the Central Excise Act, 1944, has been inserted by the Finance Act, 2008 making all such products excisable which are capable of being bought and sold for a consideration. |

## 1.11 Follow-up on audit reports

Public Accounts Committee, in their Ninth Report (Eleventh Lok Sabha) desired that remedial/corrective action taken notes (ATNs) on all paragraphs of the Reports of the Comptroller and Auditor General, duly vetted by audit, be submitted to them within a period of four months from the date of the laying of the audit report in Parliament.

Review of outstanding action taken notes on paragraphs relating to central excise contained in earlier audit reports on indirect taxes indicated that the Ministries had not submitted remedial action taken notes on eight paragraphs. The delay in response in these cases ranged from nine months to fifty three months. Summarised position of outstanding action taken notes is depicted in the following table:-

Table no.11

| No. of ATNs pending | Related audit paragraph and audit report | Name of the Ministry |
|---|---|---|
| 4 | 12.1 of 11 of 2004, 17.2 of 7 of 2006, 15.2 of 7 of 2007 and 8.2 of CA 7 of 2008 | Ministry of Commerce and Industry |
| 1 | 8.1 of CA 7 of 2008 | Ministry of Textiles |
| 3 | 3.10, 6.1.1 (86, 57, 89) and 6.4 (140) of CA 7 of 2008 | Ministry of Finance |

# CHAPTER II
# NON-LEVY/SHORT LEVY OF DUTY

Rules 9 and 49 read with rule 173G of the Central Excise Rules, 1944, prescribe that goods attracting excise duty shall not be removed, from the place of manufacture or storage, unless excise duty leviable thereon has been paid. If a manufacturer, producer or licencee of a warehouse, violates these rules or does not account for the goods, then besides such goods becoming liable for confiscation, penalty not exceeding the duty on such excisable goods or ten thousand rupees, whichever is greater, is also leviable under rule 173Q. Similar provisions exist in rules 4 and 25 of the Central Excise Rules, 2002 which came into force from 1 March 2002. Some cases of non-levy/short levy of duty totalling Rs. 298.18 crore, noticed in test check, are described in the following paragraphs. These observations were communicated to the Ministry through 17 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in seven draft audit paragraphs with money value of Rs. 7.41 crore of which Rs. 6.47 crore had been recovered.

## 2.1 Non-recovery of refunded duty on retrospective amendment

The Government vide notification dated 8 July 1999 allowed exemption by way of refund of duty paid on specified goods through PLA (cash) by certain manufacturers of North Eastern States. Exemption for manufacturers of tobacco products was withdrawn on 1 March 2001. By section 154 of the Finance Act, 2003 (enacted on 14 May 2003), the benefit of refund of duty paid on cigarettes and pan masala containing tobacco were withdrawn retrospectively from 8 July 1999. Recoveries of exemption already availed were to be made within 30 days from 14 May 2003.

M/s North Eastern Tobacco Company (NETCO) Ltd., Amingaon in Shillong commissionerate, manufacturing cigarettes, availed of the benefit of exemption from payment of duty under notification dated 8 July 1999 from the date of commencement of commercial production of their finished goods which was 15 December 1999. Accordingly, the assessee was allowed refund of duty of Rs. 93.51 crore paid through cash during December 1999 to June 2000. After invocation of the Finance Act, 2003, on 14 May 2003, the amount of Rs. 93.51 crore refunded to the assessee was recoverable from the assessee by 13 June 2003 but remained unrealised till date. Besides above, the assessee was also liable to pay duty of Rs. 28.13 crore not paid on clearances of goods during August and September 2000, which was also outstanding for recovery.

This was pointed out to the Ministry/department in February 2008; its reply had not been received (December 2008).

## 2.2 Non-achievement of 'net foreign exchange (NFE)' earnings and non-payment of central excise duty

In terms of the Foreign Trade Policy (paragraph 8.5 of EXIM Policy 2002-07), the export oriented units should be positive 'net foreign exchange (NFE)'

earner. NFE is to be calculated cumulatively for a period of five years from the date of commencement of commercial production. Further, paragraph (F) (3) (d)(II) of customs notification dated 31 March 2003 also stipulates that in case of failure to achieve positive NFE, the duty equal to the portion of the duty leviable on capital goods and other than capital goods, but for exemption contained in the said notification would be leviable and such duty shall bear the same proportion as the unachieved portion of NFE to be achieved, along with interest. In respect of indigenous goods, the above principle is applicable as per paragraph 4(b) of central excise notification dated 31 March 2003 and interest is leviable under section 11 AB of the Central Excise Act.

M/s NALCO, Rolled Product Unit, Angul, a 100 per cent export oriented unit, in Bhubaneswar I commissionerate, started commercial production on 15 June 2002 and failed to export the finished products between 15 June 2002 and 28 February 2007 resulting in non-fulfillment of positive NFE. The unit had procured imported as well as indigenous goods of Rs.232.79 crore without payment of customs/excise duty of Rs.77.39 crore. As such, the assessee was required to pay the duty along with interest.

On this being pointed out (July 2005), the department intimated (November 2007) that show cause notice for Rs. 77.25 crore had been issued which was pending adjudication.

Reply of the Ministry had not been received (December 2008).

## 2.3 Duty not levied on goods captively consumed

Bodies (including cabs), for the motor vehicles of tariff headings 87.01 to 87.05 are classifiable under tariff heading 87.07. In terms of notification dated 1 March 2002 (serial no. 214), the rate of duty has been fixed at 16 per cent ad valorem in respect of the motor vehicles falling under tariff headings 87.02 to 87.04 or 87.16 and manufactured by a manufacturer other than the manufacturer of the chassis.

The CESTAT, Bangalore, in its judgement dated 23 April 2007, in the case of Kerala State Road Transport Corporation Vs. CCE, Trivandrum {2007 (216) ELT 69 (Tri Bang)} decided that bodies built on duty paid chassis are classifiable under tariff heading 87.07 attracting central excise duty and that exemption for the motor vehicle of tariff headings 87.02. 87.03 and 87.04 is not applicable to bodies of tariff heading 87.07.

Four units of M/s Karnataka State Road Transport Corporation, Bangalore, in Bangalore I, Bangalore III, Mysore and Belgaum commissionerates, engaged in bus body building activity, built bus bodies on duty paid chassis, for own consumption. However, duty was not paid on the bodies so built. The cost of bodies built during the period from April 2001 to March 2008 was Rs. 441.19 crore and the duty not paid on the same was Rs. 71.74 crore. This was recoverable with interest of Rs. 20.49 crore and penalty of equal amount of duty.

On this being pointed out (March 2006), the department stated (between January and June 2007) that the motor vehicles viz., buses manufactured by the body building units were covered under serial no. 212 (i) of exemption

notification dated 1 March 2002. It further stated that periodical show cause notices had been issued to the assessee to protect revenue.

Reply of the department was not acceptable in view of the decision of CESTAT Bangalore mentioned above and that the product was assessable to duty under serial no. 214 of exemption notification dated 1 March 2002 as motor vehicles in the instant case were manufactured by a manufacturer other than the manufacturer of chassis.

Reply of the Ministry had not been received (December 2008).

## 2.4 Inaction by the department on defaults in payment of duty

Rule 8 of the Central Excise Rules, 2002, envisages that the duty on the goods removed from the factory or the warehouse during a month shall be paid by the 5th day of the following month provided that in case of goods removed during March, the duty shall be paid by the 31st day of March. If the assessee fails to pay duty by due date, rule 8 prescribes levy of interest at the rate of 2 per cent per month or Rs. 1000 per day whichever is higher but not exceeding the amount of duty not paid by due date till 31 March 2005. Thereafter, the interest is to be charged at the rate prescribed under section 11AB of the Central Excise Act.

Further, sub-rule (3A) of rule 8, as amended by notification dated 31 March 2005 and effective upto 31 May 2006, provides that if the assessee fails to pay duty, beyond a period of thirty days from the due date, then the assessee shall forfeit the facility to pay the duty in monthly installments under sub rule (1) for a period of two months, starting from the date of communication of the order passed by the assistant/deputy commissioner of central excise, in this regards or till such date on which all dues including interest thereon are paid, whichever is later and during this period the assessee shall be required to pay duty for each consignment by debiting their account current. This sub-rule was further amended from 1 June 2006 prescribing payment of duty in cash for each consignment during the period of default and the provision relating to forfeiture of the facility to pay duty in installments for a period of two months was omitted. Rule also provides that in the event of any failure, it shall be deemed that such goods have been cleared without payment of duty and consequences and penalties as provided in these rules shall follow.

**2.4.1** M/s Dewas Metal Sections Ltd., Unit II, in Indore commissionerate, engaged in the manufacture of various excisable products did not pay duty amounting to Rs. 11.53 lakh for the months of July, August, November, December 2004 and for January, February and March 2005 till the end of August 2005. The duty of Rs. 11.53 lakh and interest of Rs. 0.9 lakh was paid on 5 September 2005 in cash. The correct amount of interest to be paid was Rs. 2.99 lakh against which the assessee had paid Rs. 0.91 lakh only. The differential interest of Rs. 2.07 lakh was not paid till May 2007. Though the assessee had defaulted in payment of duty for more than 30 days during financial year 2004-05 and continued to default during the financial year 2005-06 which ranged from 158 to 396 days. The assessee was yet to pay the differential interest, but he was allowed to pay duty from cenvat credit account and utilised the same for Rs. 14.85 crore during the period April 2005 to May

2007 instead of paying duty in cash. No action was taken by the department to forfeit the cenvat credit facility and levy of interest and penalty. This also resulted in financial accommodation to the assessee amounting to Rs. 14.85 crore besides recovery of differential amount of interest.

On this being pointed out (January 2008), the department stated (March 2008) that this was a case of differential duty on which interest at the rate of 13 per cent per annum was leviable under section 11AB and the provisions of rule 8 were not applicable.

The reply of the department was not acceptable as differential duty, due to short payment, was recoverable under provisions of rule 8. Further, rule 8 does not empower the department to exempt an assessee who frequently indulges in short payment, from higher amount of interest and or penal action.

Reply of the Ministry had not been received (December 2008).

2.4.2 M/s G.E.I. Hammon Industries Ltd., Bhopal, in Bhopal commissionerate, engaged in the manufacture of heat exchanger and parts thereof, defaulted in payment of excise duty of Rs. 1.14 crore for the goods cleared in the month of March 2005 and the same was paid with interest of Rs. 2.58 lakh on 14 June 2005 i.e. after 75 days from due date. The assessee had also short paid interest of Rs. 0.46 lakh which was not recovered. It was further noticed that the assessee paid excise duty of Rs. 60.31 lakh during the months of May and June 2005 from cenvat credit which was in contravention of the provisions of the rule. This attracted consequences and penalties under the said rule.

On this being pointed out (April 2007), the department stated (May 2007) that the defaulted duty amount pertained to the period upto 31 March 2005 and therefore the rules as existed on 31 March 2005 would be applicable and not the rules which came into existence from 1 April 2005. However, the penalty of Rs. 10,000 was recovered in April 2007.

The reply of the department was not acceptable as the duty for the month of March 2005 was to be paid by 31st March itself which was not paid on the same day and hence the default of duty commenced from 1 April 2005 and the same would be governed by the rules in existence during the currency of default. Further, the recovery of interest of Rs. 2.58 lakh at 13 per cent per annum by the department under the rules applicable from 1 April 2005 also support the audit's contention.

Reply of the Ministry had not been received (December 2008).

2.4.3 M/s GKW Ltd., Powmex Steel Division, in Bhubaneswar II commissionerate, engaged in manufacture of HSS bright rods and bars etc. defaulted in payment of duty of June 2005 by 31 days. No order was issued by the department forfeiting the facility of payment of duty on monthly basis. The assessee utilised Rs. 56.96 lakh from cenvat credit account (in August 2005 and September 2005) and duty of Rs. 1.26 crore was paid through PLA (but not consignment wise) in September and October 2005 (Rs. 75.00 lakh) and November 2005 (Rs. 51.00 lakh). This was in violation of the Rules and tantamounted to clearance of goods without payment of duty of Rs. 1.83 crore. Penalty was not levied by the department for the said violation.

This was pointed out to the Ministry/department in July 2007; its reply had not been received (December 2008).

## 2.5 Downgrading of intermingled quantity of petroleum products

The Board had clarified on 22 April 2002 that on intermingling of petroleum products pumped through pipelines, the duty on intermixed part of superior kerosene/motor spirit/high speed diesel (SKO/MS/HSD) as the case may be, might be quantified and higher of the two values should be adopted.

M/s Bharat Petroleum Corporation Ltd., Irugur, in Coimbatore commissionerate, received non-duty paid petroleum products from the refineries under bond through pipelines and warehoused them in their storage tanks. The assessee also received MS, HSD, SKO etc., through pipelines from their installations for filling in the storage tanks. The pumping of the products through the pipelines resulted in mixing of MS/SKO, HSD/SKO etc. The assessee stored such mixed products in two separate tanks and downgraded the mixed/intermingled quantity of 1107.85 kilo litre of MS/SKO or MS/HSD as HSD and cleared the products as HSD during November 2003 to July 2004 which was in contravention of the Board's clarification cited above. This resulted in short payment of duty of Rs. 95.24 lakh.

On this being pointed out (September 2004), the department initially did not admit the audit observation (March 2005) but subsequently stated (December 2007) that show cause notice demanding duty of Rs. 79.36 lakh with equal amount of penalty for downgrading of MS and SKO to HSD during the period from November 2002 to March 2004 had been issued. Action taken for recovery of balance amount of duty of Rs. 18.46 lakh had not been received (March 2008).

Reply of the Ministry had not been received (December 2008).

## 2.6 Incorrect classification resulted in non-levy of duty

In view of amendment to the Central Excise Tariff Act, 1985, di-calcium phosphate is classifiable under tariff heading 28352500 with effect from 1 March 2005.

M/s Samriti Chemicals Ltd., in Nasik commissionerate, manufactured di-calcium phosphate and cleared it without payment of duty classifying the product under chapter 23 as animal feed supplement. Since the product was classifiable under tariff heading 28352500 because of its specific inclusion in the description of this heading, classification under chapter 23 was not correct. This resulted in non-levy of duty of Rs. 42.45 lakh during the period from April 2005 to September 2007.

On this being pointed out (July 2007), the department intimated (January 2008) that the show cause notice was under issue.

Reply of the Ministry had not been received (December 2008).

## 2.7 Establishment charges not recovered

The Board had clarified on 14 December 1995 and 26 October 1998 that the custodians would bear the cost of security staff posted at Inland Container Deport (ICD)/Container Freight Stations (CFS). The cost of the posts created on a cost recovery basis was fixed at 1.85 times of monthly average cost of the post plus dearness allowance, city compensatory allowance, house rent allowance etc., vide Ministry's letter dated 1 April 1991. As per the provisions contained in clause 10 of the above circular, the commissioner of central excise and customs was to decide the number of officials required to be posted at ICD/CFS considering the work load at a station.

Scrutiny of the records of the office of the assistant commissioner, central excise, Panipat, in Rohtak commissionerate, revealed that one superintendent and one inspector of central excise were posted at ICD Baburpur but establishment charges were not recovered from the custodian in respect of staff posted at the ICD. Details of establishment charges prior to April 2003 and date of commencement of and posting of staff at the ICD was not available with the division. The amount recoverable for the period from April 2003 to March 2007 worked out to Rs. 28.32 lakh. The amount involved for the period prior to April 2003 was requested to be ascertained by the department.

This was pointed out to the Ministry/department in August and September 2007; its reply had not been received (December 2008).

## 2.8 Other cases

In 640 other cases of non-levy/short levy of duty involving duty of Rs. 8.21 crore, the Ministry/department had accepted all audit observations and had reported recovery of Rs. 6.47 crore in 639 cases till December 2008.

# CHAPTER III
# CENVAT CREDIT

Under cenvat credit scheme, credit is allowed for duty paid on 'specified inputs/capital goods' and service tax paid on 'specified input services' used in the manufacture of finished goods. Credit can be utilised towards payment of duty on finished goods subject to the fulfilment of certain conditions. A few cases of incorrect use of cenvat credit involving duty of Rs. 187.54 crore noticed during test check are mentioned in the following paragraphs. These observations were communicated to the Ministry through 78 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 53 draft audit paragraphs with money value of Rs. 60.15 crore of which Rs. 31.30 crore had been recovered.

## 3.1 Credit facility not withdrawn despite violation of prescribed conditions

Notification dated 31 July 2001 exempts specified goods cleared from units in Kutch, from so much of the amount of duty which is paid, other than the amount of duty paid by utilisation of cenvat credit. Clause 2A(d) of the notification stipulates that the manufacturer shall submit a statement of duty paid other than by way of utilisation of cenvat credit, alongwith the refund amount which he has taken credit and the calculation particulars of such credit taken, to the assistant commissioner/deputy commissioner of central excise by the 7th day of the next month to the month under consideration.

Further, clause 2A(f) of the notification states that in case manufacturer fails to comply with the above provisions, he shall forfeit the option to take credit of the amount of duty paid during the month under consideration, other than by way of utilisation of cenvat credit under the Cenvat Credit Rules, 2002.

M/s VVF Ltd., and three others, in Rajkot commissionerate, availed of cenvat credit facility and also availed of the benefit of exemption under notification dated 31 July 2001. The assessees availed of credit of Rs. 80.96 crore during the period 2005-07 for the duty paid through PLA. The statement of duty paid through PLA and other required documents were submitted with delay ranging from one to 155 days. Since the assessees had violated the provision of clause 2A(d), the option to take credit for the month under consideration was required to be forfeited and credit taken was to be recovered. The amount of credit recoverable was Rs. 80.96 crore.

On this being pointed out (March 2008), the department accepted the observation and stated (March 2008) that there was only procedural lapse as upheld by CESTAT in the cases of M/s Vinay Cements Ltd. {2002 (147) ELT 724} and M/s K. K. Beverages {2002 (148) ELT 567}.

The department's reply is not convincing as the decisions relied upon were not relevant to the case. The cases before CESTAT related to the notifications dated 8 July 1999 which did not contain specific provision as contained in notification dated 31 July 2001 referred by audit wherein a specific provision

in paragraph 2A(f) debars the assessees from availing credit in case of violation of the provisions contained in paragraph 2A(a) to (e).

Reply of the Ministry had not been received (December 2008).

## 3.2 Cenvat credit on capital goods availed in excess of permissible limits

Rule 4(2)(a) and (b) of the Cenvat Credit Rules, 2004 enunciates that cenvat credit in respect of capital goods received in the premises of the provider of output service at any time in a financial year shall be taken only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year and the balance 50 per cent credit may be taken in any subsequent financial year. Rule 14 of the said rules provide that where the cenvat credit has been taken or utilised wrongly, the same alongwith interest shall be recovered.

**3.2.1** M/s Bharti Airtel Ltd., in Hyderabad II commissionerate, engaged in providing cellular phone services procured capital goods during the period from October 2006 to March 2007 and took full credit of Rs. 40.50 crore during 2006-07 on such capital goods even though they were eligible for taking credit only to the extent of Rs. 20.25 crore being 50 per cent of the duty paid. The excess credit of Rs. 20.25 crore taken by the assessee was recoverable along with interest of Rs. 58.32 lakh.

On this being pointed out (January 2008), the department accepted the audit observation and reported (May 2008) that the assessee had paid Rs. 20.25 crore. The department further stated (May 2008) that the assessee had not utilised the excess availed credit, charging of interest on the credit lying unutilised was not warranted in view of judicial decisions of Punjab and Haryana High Court {2007 (214) ELT 173} which was upheld by the Supreme Court also {2007 (214) ELT – A 50}.

The reply of the department was contrary to the provisions of rule 14 of the Cenvat Credit Rules, which stipulated charging of interest where cenvat credit had been taken wrongly. Further, the anomalous situation which had cropped up due to above judicial pronouncements needs to be remedied by making the relevant provisions more explicit and unambiguous, as otherwise the provisions of the said rule with regard to recovery of interest were not enforceable in any case even though the assessees commit breach of the provisions by taking 100 per cent instead of 50 per cent credit on capital goods in the year of their procurement.

Reply of the Ministry had not been received (December 2008).

**3.2.2** M/s Spice Communication Ltd., Bangalore in Bangalore commissionerate of service tax, engaged in rendering telecom services availed 100 per cent cenvat credit amounting to Rs. 10.40 crore on capital goods during the period from April 2006 to September 2006. The internal audit party of the department pointed out the excess availing of credit and the assessee reversed the credit, wrongly availed, amounting to Rs. 5.20 crore in November 2006. Audit observed that interest of Rs. 16.01 lakh leviable under rule 14 of the said rules was not demanded on the ground that the erroneous

availing of credit had not resulted in overdrawal. However, interest was recoverable as rule provides recovery of interest on taking of credit wrongly.

On this being pointed out (January 2008), the Ministry (November 2008) stated that the excess credit taken was not utilised before reversal and hence no interest was payable.

Reply of the Ministry is not acceptable as rule 14 of the Cenvat Credit Rules, stipulates charging of interest where cenvat credit had been taken wrongly.

***Audit recommends that Government should amend the applicable rules, post judicial pronouncements, to bring in clarity/specificity regarding interest payment in such cases.***

## 3.3 Re-credit of the disallowed wrong credit

Prior to 1 March 2003, utilisation of cenvat credit on Additional Duties of Excise (Goods of Special Importance Act), 1957, {(AED GSI)} was restricted to payment of AED (GSI) only. Rule 3(6)(b) of the Cenvat Credit Rules, 2002, was amended with effect from 1 March 2003 to allow credit of AED (GSI) for payment of duty of excise leviable under the Central Excise Tariff Act, 1985.

In terms of section 124 of the Finance Act, 2005 (amendment of Act 23 of 2004), wrongly availed and utilised credit of AED (GSI) was required to be recovered with interest in 36 equal installments.

M/s Apollo Tyres Ltd., in Vadodara II commissionerate, availed of credit of Rs. 18.79 crore of additional excise duty paid under Additional Excise Duties (Goods of Special Importance) Act, prior to 1 March 2000. The assessee also utilised the same in the month of March 2003. The department ordered the assessee to pay the wrongly availed and utilised credit of AED (GSI) with interest in 36 equal installments (principal amount of Rs. 52.19 lakh and interest of Rs. 10.12 lakh, total Rs. 62.31 lakh per month). Accordingly, assessee paid Rs. 14.09 crore up to September 2007 (Rs. 52.19 lakh per month) and also availed of the credit of the same. The availing of credit of the recovered amount, on account of incorrect utilisation of credit, was not correct and was required to be reversed.

On this being pointed out (December 2007), the Ministry admitted the audit observation and stated (November 2008) that a show cause notice for Rs. 18.79 crore had been issued.

## 3.4 Separate account for common inputs used in dutiable/exempted goods not maintained

Rule 6 of the Cenvat Credit Rules, 2002/2004, enunciates that where a manufacturer avails of cenvat credit on common inputs/services and manufactures both dutiable and exempted goods, but opts not to maintain separate accounts for receipt and use of inputs/services in both categories of final products, then he shall pay an amount equal to eight per cent (ten per cent from 10 September 2004) of the price of the exempted final product.

3.4.1 Eighteen assessees engaged in manufacture of various dutiable and exempted final goods in Ahmedabad (1), Bangalore II (1), Bhopal (1), Belapur (1), Chennai III (1), Cochin (1), Haldia (2), Dibrugarh (1), Jaipur I (3), Kolkata V (1), Lucknow (1), Pune I (1), Ranchi (1), Raigarh (1) and Surat II (1) commissionerates, cleared final goods valuing Rs. 126.75 crore during the period between April 2004 and August 2007. The assessees had used common inputs in the manufacture of both dutiable and exempted final goods and had not maintained separate accounts of inputs used in the exempted products. Therefore, they were required to pay Rs. 12.53 crore (being 8 or 10 per cent of the price of the exempted goods as applicable).

On this being pointed out (between April 2006 and March 2008), the Ministry admitted the audit observations in thirteen cases and stated (between July and September 2008) that show cause notices for Rs. 11.84 crore had been issued in seven cases of which demand of Rs. 3.11 crore had been confirmed in one case besides imposition of penalty of Rs. 3.11 crore. In five other cases, duty of Rs. 0.92 crore had been recovered.

In the case of the assessee in Bangalore II commissionerate, the Ministry stated that the manufacturer had maintained separate account for dutiable and exempted goods and hence conditions of rule 6(3)(b) were not violated. Reply of the Ministry is not acceptable as re-verification revealed that separate inventory of input goods was not maintained by the assessee and the department had also confirmed this fact and issued show cause notice to the assessee in April 2008.

Reply in the remaining cases had not been received (December 2008).

3.4.2 M/s Diamond Beverages Pvt. Ltd., Kolkata, in Kolkata VI commissionerate, engaged in the manufacture of dutiable aerated waters (tariff sub-heading 2202.20) also manufactured exempted fruit pulp based soft drink 'mazza' using common inputs like sugar, mineral water and chemicals. The assessee availed of cenvat credit on the common inputs but did not maintain separate inventory of such common inputs used in the manufacture of dutiable aerated waters as well as exempted mazza. The assessee had not paid the amount of eight per cent (ten per cent with effect from 10 September 2004) on the sale of exempted product 'mazza'. This resulted in non-payment of Rs. 85.37 lakh between May 2002 and December 2005.

On this being pointed out (June 2005), the Ministry stated (September 2006) that the assessee had maintained separate accounts of inputs issued for the manufacture of dutiable and exempted goods, and had debited the duty involved in the manufacture of exempted goods. As a result the assessee had availed of the credit only on the quantity of inputs issued for the manufacture of dutiable goods. The Ministry also cited Supreme Court's judgement in the case of M/s Chandrapura Magnet Wires (P) Ltd. in support of their view.

Reply of the Ministry is not acceptable since further verification (May 2008) revealed that none of the two conditions, viz. (i) maintenance of separate accounts of inputs issued for the manufacture of dutiable and exempted goods; and (ii) use of such inputs in the manufacture of dutiable goods, had been fulfilled by the assessee while availing cenvat credit. The assessee took credit on all the inputs intended for use in the manufacture of dutiable as well as

exempted goods, but reversed the credit on such inputs well after its utilisation in the manufacture of exempted product. The reply of the Ministry is also contrary to the Board's circular dated 19 August 2002 which clarified that in cases of such violation of rules, the assessee had no option but to pay eight/ten per cent of the price of the exempted goods.

Further response of the Ministry had not been received (December 2008).

**3.4.3** Seven assessees, one each in Belapur, Dewas, Hyderabad I, Indore, Nasik, Pune II and Thane II commissionerates, engaged in manufacture of both dutiable and exempted final goods, cleared exempted goods valued Rs. 108.29 crore during the period between September 2004 and December 2007. The assessees had availed cenvat credit of the entire service tax paid on common input services like telephones, goods transport agency services, business auxiliary services, technical consultancy services, courier services, clearing and forwarding agent services, recruitment services etc. The assessees did not maintain separate accounts for common input services and also did not pay 10 per cent of the value of exempted goods. This resulted in non-payment of amount of Rs. 10.83 crore which was recoverable with interest.

On this being pointed out (between March 2007 and March 2008), the Ministry admitted the audit observations in four cases and stated (between July 2008 and November 2008) that while show cause notice for Rs. 3.08 crore had been issued to the assessees in Hyderabad I and Thane II, show cause notices for Rs. 5.87 crore were under issue to the assessee in Belapur commissionerate. It also reported recovery of Rs. 12.44 lakh from assessee in Dewas commissionerate. Reply in three cases had not been received (December 2008).

## 3.5 Cenvat credit on inputs used in non-excisable goods – (electricity)

According to rule 2(k) of the Cenvat Credit Rules, 2004, 'input' inter-alia includes goods used for generation of electricity in or in relation to manufacture of final products or for any other purpose within the factory of production. Therefore, the electricity generated captively within a factory should be consumed internally and not supplied/sold to other units. Rule 6 of the Cenvat Credit Rules, 2002/2004, enunciates that where a manufacturer avails of cenvat credit on common inputs/services and manufactures both dutiable and exempted goods, but opts not to maintain separate accounts for receipt and use of inputs/services in both categories of final products, then he shall pay an amount equal to eight per cent (ten per cent from 10 September 2004) of the price of the exempted final product.

**3.5.1** M/s Indo Rama Synthetics Ltd., in Nagpur commissionerate, engaged in the manufacture of polyester yarn, availed of cenvat credit on furnace oil used in production of electricity. The electricity so produced was partly used for manufacture of final products and part of it was sold to M/s Indo Rama Textiles Ltd., Butibori. The assessee sold 1,392.18 lakh unit of electricity to M/s Indo Rama Textiles Ltd., during the years 2003-04 to 2005-06. Cenvat

credit of Rs 5.41 crore availed of on the furnace oil utilised in the manufacture of such electricity was not paid which was recoverable with interest.

On this being pointed out (November 2006 and March 2007), the Ministry admitted the audit observation and stated (June 2008) that a show cause notice for Rs. 5.44 crore had been issued.

**3.5.2** M/s Triveni Engineering and Industrial Ltd., in Meerut I commissionerate, engaged in manufacture of sugar and molasses also produced electricity and sold it to M/s U.P. Power Corporation valuing Rs. 26.45 crore during 2006-07. Cenvat credit on inputs like lubricant, paint and chemicals used in generation of electricity were availed and utilised for payment of duty on excisable final products. Since no separate account of those inputs were maintained, an amount of Rs. 2.64 crore being ten per cent of the price of electricity sold was recoverable.

On this being pointed out (June 2007/January 2008), the department stated (November 2007) that a show cause notice for recovery of objected amount alongwith interest had been issued to the assessee.

Reply of the Ministry had not been received (December 2008).

**3.5.3** M/s Mawana Sugar Works, in Meerut I commissionerate, engaged in manufacture of sugar and molasses also produced electricity and sold the electricity to the U.P. Power Corporation valuing Rs. 3.83 crore during March 2006 to April 2007. Cenvat credit on inputs like lubricating oil, grease etc., used in generation of electricity, were availed and utilised for payment of duty on final products. Since no separate accounts of those inputs were maintained, an amount of Rs. 38.27 lakh being ten per cent of the price of electricity was recoverable.

On this being pointed out (May 2007), the department admitted the audit observation and intimated (November 2007) that a show cause notice was under process of issue.

Reply of the Ministry had not been received (December 2008).

## 3.6 Dual benefit by taking credit on inputs and collecting duty on exempted final products

Rule 6 of the Cenvat Credit Rules, 2004, envisages that where an assessee manufactures final products, part of which are chargeable to duty and part of which are exempt but avails of credit of duty on inputs meant for use in both the categories of final products and does not maintain separate accounts, he shall pay an amount equivalent to eight per cent (ten per cent from 10 September 2004) of the price charged for the exempted goods. The amount so payable is in lieu of cenvat credit availed of on inputs used in the manufacture of exempted goods and hence the liability is to be borne by the manufacturer itself.

The Ministry also clarified on 9 September 2002 that where a manufacturer debits an amount equal to eight per cent in terms of rule 6 of the Cenvat Credit Rules, 2002, and collects it from the buyers, then the amount so collected should be deposited to the credit of the Government.

Further, the CESTAT in the case of M/s Vimal Moulders (India) Ltd. {2004 (164) ELT 302} had held that the amount of eight per cent paid by the manufacturer but collected from the customer was to be deposited with the Government as per the provisions of section 11 D of the Central Excise Act.

M/s Texmaco Ltd., in Kolkata III commissionerate, manufactured bogie and coupler and cleared them for use in railway wagons after availing of exemption under notification dated 1 March 2002. As per provisions of rule 6 of the Rules, the assessee also reversed an amount of Rs. 6.39 crore being ten per cent of the price. This amount was realised from Indian Railways, the ultimate buyers, between May 2004 and November 2005. The amount so realised was not paid to the Government which was recoverable with interest.

On this being pointed out (May 2006), the department stated (March 2007) that the demand was under issue.

Reply of the Ministry had not been received (December 2008).

## 3.7 Exemption from duty on finished goods without paying back the credit relating to inputs in stock

Rule 9(2) of the Cenvat Credit Rules, 2002 envisages that a manufacturer who opts for exemption from the duty of excise under a notification based on the value or quantity of clearance in a financial year and avails cenvat credit on inputs before such option is exercised, shall pay an amount equivalent to the cenvat credit, if any, on inputs lying in stock or in process or contained in final products lying in stock on the date of option exercised. If after payment of the said amount, balance still remained in the account, the same shall lapse and shall not be allowed to be utilised for payment of duty on any excisable goods.

M/s Himachal Futuristic Communication Ltd., Chambaghat, in Chandigrah I commissionerate, engaged in the manufacture of COR DECT WLL (telecommunication equipments) availed of cenvat credit of duty paid on inputs. The assessee opted to avail exemption from payment of duty with effect from 20 December 2004 under the area based exemption notification dated 10 June 2003. Though the assessee was having inputs in stock/contained in finished goods/or work in progress on 20 December 2004 on which cenvat credit of Rs. 1.85 crore had already been availed yet it did not pay back this amount of Rs. 1.85 crore. The department also did not take any action to recover this amount.

On this being pointed out (March 2006 and December 2007), the Ministry admitted the audit observation and intimated (October 2008) that the demand for Rs. 1.85 crore had been confirmed and penalty of Rs. 1.85 crore imposed but the assessee had gone in appeal with the CESTAT.

## 3.8 Removal of capital goods without payment of appropriate duty

Rule 3(5) of the Cenvat Credit Rules, 2004, stipulates that if inputs or capital goods, on which cenvat credit has been availed, are removed 'as such' from a

factory or from premises of an output service provider, duty equivalent to the amount of credit availed on such inputs or capital goods shall be paid.

3.8.1 M/s Supreme Industries Ltd., in Noida commissionerate, availed of credit amounting to Rs. 3.11 crore on capital goods received in the factory during August 1995 to November 2005. The capital goods were cleared from the factory during December 2006 to February 2007 on payment of duty amounting to Rs. 1.28 crore, which resulted in short payment of duty of Rs. 1.83 crore which was recoverable alongwith interest.

On this being pointed out (November/December 2007), the department issued a show cause notice (January 2008) which was pending for adjudication.

Reply of the Ministry had not been received (December 2008).

3.8.2 M/s Lakshmi Machine Works Unit-II, in Coimbatore commissionerate, engaged in the manufacture of textile machinery and parts thereof availed of cenvat credit of the duty paid on capital goods. Twelve items of capital goods were cleared (between May 2006 and March 2007) 'as such' to their sister units on payment of duty of Rs. 24.24 lakh based on their value. However, the assessee did not pay the duty equal to the credit (Rs. 1.47 crore) availed in respect of such capital goods as prescribed. This resulted in short recovery of credit of Rs. 1.23 crore.

On this being pointed out (September 2007 and January 2008), the department admitted the audit observation and stated (May 2008) that draft show cause notice was under issue.

Reply of the Ministry had not been received (December 2008).

3.8.3 Rule 3(5A) of the Cenvat Credit Rules, 2004 envisages that if the capital goods are cleared as waste and scrap, the manufacturer shall pay an amount equal to the duty leviable on transaction value.

M/s Indian Oil Corporation Ltd., Barauni, in Patna commissionerate, engaged in manufacture of petroleum products, cleared capital goods as waste and scrap worth Rs. 5.84 crore during the year 2005-07 without payment of excise duty. The duty leviable thereon worked out to Rs. 95.29 lakh which was recoverable with interest.

On this being pointed out (September 2007), the department intimated (March 2008) issue of a demand of Rs. 90.26 lakh.

Reply of the Ministry had not been received (December 2008).

3.8.4 M/s Kitchen Appliances India Ltd., in Kolkata III commissionerate, engaged in the manufacture of colour television and refrigerator, availed of cenvat credit of duty paid on capital goods during November 2006. Some of these capital goods, not having been found fit for use in the manufacture, were returned to the original supplier during the month of December 2006. However, duty of Rs. 42.71 lakh equivalent to credit availed was not paid.

On this being pointed out (November 2007), the Ministry admitted the audit observation and stated (July 2008) that the amount of Rs. 42.71 lakh had been recovered and a show cause notice had been issued for imposition of penalty and recovery of interest.

## 3.9 Excess transfer of cenvat credit to sister units

Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, envisages that where the excisable goods are not sold by the assessee, but are used for consumption by him or on his behalf, in production or manufacture of other articles, the value shall be 115 per cent (110 percent from 5 August 2003) of the cost of production or manufacture of such goods.

M/s Ranbaxy Laboratories Ltd., Paonta Sahib, in Chandigarh I commissionerate, engaged in the manufacture of bulk drugs (tariff heading 29.42), transferred 6,484 kilogram of lovastatin (bulk drug) during the period from April 2002 to October 2003 to its sister concerns. The duty was paid from cenvat credit adopting a price of Rs. 41,500 per kilogram which was higher by Rs. 17,153 per kilogram from the cost of production. The price of bulk drugs was artificially inflated so as to transfer the surplus unutilised credit to sister concerns. The clearances made in contravention of the provisions of the said rule 8, resulted in excess transfer/availment of credit of Rs. 1.78 crore by the assessee/sister units between April 2002 to October 2003.

On this being pointed out (March 2004 and March 2007), the department stated (March 2007) that the goods were correctly cleared by adopting value of Rs. 41,500 per kilogram in terms of rule 8 of the said Rules.

The reply of the department was not acceptable because the value under rule 8, as per cost audit reports, worked out to only Rs. 24,347 per kilogram, which was approximately 70 per cent lower than the price adopted by the assessee for clearance of goods to its sister units.

Reply of the Ministry had not been received (December 2008).

## 3.10 Violation of the applicable rules

In terms of rule 7(1)(b) of the Cenvat Credit Rules, 2001 and 2002, credit can be taken on the basis of supplementary invoice issued by a manufacturer from factory or depot or from the premises of consignment agent except in those cases where additional duty became recoverable from the manufacturer on account of any non-levy or short levy by reasons of fraud, collusion or any willful mis-statement or suppression of facts or contravention of any provision of the Act or the Rules made there under with intent to evade payment of duty.

M/s Dharampal Satya Pal Ltd. and M/s S. Gopal & Co. Barotiwala, in Chandigarh I commissionerate, engaged in the manufacture of pan masala containing tobacco and chewing tobacco respectively, availed of credit on the basis of supplementary invoices issued by its sister units. Since the supplementary invoices were issued after debiting the differential duty (as pointed out by audit) on account of undervaluation of goods which were initially cleared in contravention of the provisions of section 4 of the Act, read with Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the availing of credit was not in consonance with the provision of rule 7(1)(b) of the Cenvat Credit Rules. This resulted in incorrect availing of

credit of Rs. 1.65 crore during September 2001 and from January 2002 to May 2002.

On this being pointed out (May 2003), the department stated (December 2003) that the credit availed under the provision of rule 7(1)(b) cannot be denied.

Reply of the department was not acceptable as in these cases duty was paid short in contravention of the provisions of section 4 of the Central Excise Act, 1944 and Valuation Rules, 2000, which was recovered after being detected by audit (DAP 87 of 2002-03). Therefore, credit of duty paid was not admissible under rule 7(1)(b) of the Cenvat Credit Rules.

Reply of the Ministry had not been received (December 2008).

## 3.11 Short recovery of amount on exempted final goods

Footwear of retail sale price not exceeding Rs. 250 per pair are exempt from duty provided retail sale price is indelibly marked or embossed on the footwear itself.

The CESTAT, in the case of M/s Time Watches Ltd., {2004 (174) ELT 452}, held that wherever inputs are used in the manufacture of exempted as well as dutiable goods and no separate accounts are maintained, the manufacturer is required to pay 8 or 10 per cent of the total price of clearance of exempted goods excluding sales tax and other taxes and abatement on MRP on account of taxes is not available while calculating price of exempted goods.

M/s Condor Footwear Ltd., in Surat I commissionerate, manufactured dutiable as well as exempted footwear (price not exceeding Rs. 250 per pair) using common inputs. The assessee did not maintain separate accounts of use of common inputs in both categories of goods. The assessee paid 10 per cent of the value of exempted footwear which was lower than the retail sale price (MRP). This was not correct as assessee was required to pay 10 per cent of the MRP as footwear were exempt from duty and no deduction was available in terms of said decision of CESTAT. This resulted in short recovery of Rs. 1.63 crore during the period from April 2005 to March 2007.

On this being pointed out (August 2007), the department stated (December 2007) that the transaction value was to be taken into account for the purpose of reversal of cenvat credit under rule 6 and not the price declared under MRP as assessment on the basis of MRP was only to be done for excisable goods and not exempted goods.

The reply is not acceptable in view of decision of the CESTAT cited above. Further, as the footwear were covered under section 4A and were cleared under MRP hence, the value of such product shall be retail sale price for all purposes.

Reply of the Ministry had not been received (December 2008).

## 3.12 Credit on ineligible capital goods

Under rule 2(b)/2(a) of the Cenvat Credit Rules, 2002/2004, the term 'capital goods' for the purpose of allowing credit of duty means (i) all goods falling

under chapters 82, 84, 85, 90, heading 68.02 and sub-heading 6801.10 of first schedule of Central Excise Tariff Act, 1985, (ii) pollution control equipment, (iii) components, spares and accessories of goods specified at (i) and (ii) above, (iv) moulds and dies, (v) refractories and refractory materials, (vi) tubes, pipes and fittings thereto and (vii) storage tanks. In the case of M/s Nava Bharat Ferro Alloys Ltd., the Tribunal held {2004 (174) ELT 375} that (i) HR coils, channels, plates and hard plates are general purpose items having multifarious use and are not covered by the definition of capital goods and (ii) columns of heavy fabricated structures and bracings, used as supporting columns of a boiler, etc., are in the nature of construction material and are not eligible for credit as capital goods.

M/s Tata Refractories Ltd., Belpahar, in Bhubaneswar II commissionerate, engaged in manufacture of refractories and refractory materials availed of cenvat credit of Rs. 21.19 lakh on various construction materials like M.S. Bar, channels, angles, HR plates, beams, TMT bars, etc., during the period between July 2005 and March 2006 even though none of these items qualified under the definition of capital goods and hence, were not eligible for cenvat credit.

On this being pointed out (September 2006), the department reported (May 2007) that a show cause notice had been issued in April 2007 for Rs. 1.31 crore covering the period from April 2003 to November 2006.

Reply of the Ministry had not been received (December 2008).

## 3.13 Credit on the basis of improper duty paying documents

Rule 11 of the Central Excise Rules, 2002, read with rule 7 of the Cenvat Credit Rules, 2002, stipulates that no excisable goods shall be removed from a factory or a warehouse except under an invoice signed by the owner of the factory and cenvat credit shall also be taken on the basis of the invoice issued by the manufacturer for clearance of finished goods or the clearance of inputs 'as such' from his factory. Rule 11(2) specifies that the invoices should be serially numbered and contain the details of the registration number, name and address of the consignee, description, classification, time and date of removal, mode of transport and vehicle number, rate of duty, quantity and value of goods and duty payable thereon.

M/s Auro Weaving Mills, Baddi, in Chandigarh I commissionerate, engaged in the manufacture of fabrics (tariff sub-heading 5207.20/5511.10) availed of credit on input (yarn) on the basis of consolidated invoices issued for total quantity of yarn cleared during a month by its sister unit (M/s Auro Textiles, Baddi). However, these invoices did not contain the details of inputs and time of removal and vehicle numbers, etc., in which the inputs were transported. Thus these invoices were not proper documents as these did not have complete details necessary for assessing the goods. Accordingly, credit amounting to Rs. 83.33 lakh availed during the year 2004-05 was irregular.

On this being pointed out (December 2005), the department stated (September 2007) that an invoice issued by a manufacturer for clearance of goods or inputs as such was a valid legal document in terms of rule 7(1)(a) of the Cenvat Credit Rules, 2002, hence there was no irregularity.

The reply of the department was not correct because a single invoice issued for the entire lot of goods (inputs) supplied in a month was neither permissible nor traceable to the consignment sent. Invoices were required to be issued consignment wise for being traceable to goods sent and received as inputs by the buyers.

Reply of the Ministry had not been received (December 2008).

## 3.14 Cenvat credit on inputs not used in manufacture of final products

Under the provisions of rule 3 of the Cenvat Credit Rules, 2002, a manufacturer is allowed to take credit of specified duties paid on any inputs or capital goods received in the factory of manufacture of final product for use in or in relation to the manufacture of final products.

3.14.1 M/s Joyco India Ltd., Baddi, in Chandigarh I commissionerate, engaged in the manufacture of bubble gum/lollipop availed of credit on 'tattoos/printed transfers' which were not used in or in relation to the manufacture of the final products. Since the 'tattoos/printed transfers' were cleared as such with finished goods and had no nexus with the manufacturing stream of the final products, the availing of cenvat credit of Rs. 81.60 lakh during the period from June 1997 to March 2002 was not correct.

On this being pointed out (February 2000 and December 2002), the department stated (between February 2003 and April 2005) that show cause notices covering the period from September 2001 and August 2002 were issued but demands were dropped in adjudication. However, the department had filed appeals in the CESTAT which were pending for decision (April 2008). Action taken for recovery of credit for the period from June 1997 to April 1998 had not been intimated.

Reply of the Ministry had not been received (December 2008).

3.14.2 M/s Mahanagar Gas Ltd., in Mumbai II commissionerate, manufactured compressed natural gas at the mother stations through compressors and transported to daughter booster stations (DBS) through cascades mounted on light commercial vehicles. The assessee availed cenvat credit of Rs. 55 lakh during the period from March 2001 to March 2004 on cascades, dispensers and lubricant installed and used at the DBS. As no manufacturing activity was carried out at DBS, these stations could not be treated as factories. Thus, cascades/dispensers could not be construed as installed in the factory and used in the manufacture of excisable goods. Further, no payment of duty at DBS was made. Hence, cenvat credit under rule 3 was not admissible.

On this being pointed out (October 2004), the Ministry admitted the audit observation and intimated (July 2008) that the demand of Rs. 64.65 lakh with penalty of equal amount and interest for the period March 2001 to December 2004 had been confirmed. However, the assessee had preferred an appeal with the Tribunal which was pending decision.

## 3.15 Cenvat credit of research and development cess

Cess leviable under the Research and Development Cess Act, 1986, is not an item specified for availing of the cenvat credit under the Cenvat Credit Rules.

M/s Indian Additives Ltd., Manali, in Chennai I commissionerate, engaged in the manufacture of lubricating oil additives paid research and development cess on royalty paid to M/s. COPL, and availed of cenvat credit of Rs. 55.67 lakh in July 2007. Since research and development cess was not eligible for cenvat credit under the Cenvat Credit Rules, the credit utilised incorrectly was recoverable with interest of Rs. 3.62 lakh.

On this being pointed out (October and December 2007), the Ministry admitted the audit observation and reported (December 2008) that the assessee had paid duty of Rs. 55.67 lakh and interest of Rs. 3.75 lakh.

## 3.16 Non-recovery of cenvat credit contained in materials written off/found short

The Board clarified on 22 February 1995 that where modvat credit is availed on inputs but later on the value thereof is written off fully in books of accounts on their becoming obsolete or unfit for use in manufacturing process, the credit should be recovered. The Board further clarified on 16 July 2002 that in respect of capital goods, components, spare parts etc., which are written off before use, the cenvat credit availed on such items are to be paid back on the same lines as applicable to inputs.

**3.16.1** M/s Hindustan Petroleum Corporation Ltd., Visakha Refinery, in Visakhapatnam I commissionerate, engaged in the manufacture of petroleum products, availed of cenvat credit on several inputs, capital goods, stores and spares received in the refinery. The assessee had fully written off some of the stores and spares items valuing Rs. 3.16 crore during 2003-04 and 2004-05 even before they were put to use but did not reverse or pay the cenvat credit availed on such items. The corresponding duty attributable to such written off materials, not reversed, worked out to Rs. 50.52 lakh.

On this being pointed out (March 2006), the Ministry admitted the audit observation and reported (July 2008) that a show cause notice demanding duty of Rs. 92.74 lakh had been issued. Further developments in the case had not been received (December 2008).

**3.16.2** M/s Yokogawa India Ltd., Bangalore, in Bangalore I commissionerate, engaged in the manufacture of distributed control system, availed of cenvat credit on different inputs received in its factory. Audit observed that during the years from 2001-02 to 2004-05, the assessee had written off full value of some raw materials, declaring them as either defective or short in stock but did not reverse or pay back the cenvat credit. The value of written off inputs amounted to Rs. 3.19 crore on which credit to be reversed was Rs. 51.06 lakh.

On this being pointed out (August 2005), the department reported (October 2007) recovery of Rs. 52.30 lakh.

The Ministry stated (November 2008) that the Tribunal in many cases had ruled that writing off of value of inputs in the accounts was no ground for

recovery of credit if the goods were physically available in the factory. Therefore, the Cenvat Credit Rules had been amended on 11 May 2007 enabling recovery of cenvat credit availed if the value of inputs is written off fully. After this, the assessee had reversed credit of Rs. 58.18 lakh for the period from 2001-02 to 2006-07.

## 3.17 Short or non-payment of duty on removal of raw material

Rule 3(4) of the Cenvat Credit Rules, 2004, stipulates that the cenvat credit may be utilised for payment of an amount equal to cenvat credit taken on inputs if such inputs are removed 'as such' or after being partially processed.

M/s Century Laminating Company Ltd., in Meerut II commissionerate, engaged in the manufacture of paper based decorative laminates, formaldehyde, post form particle board, post form MDF board, synthetic resin adhesive, BOPP in lump form, impregnated paper, furniture etc. sold/cleared inputs valuing Rs. 6.72 crore during the year 2005-06 on which cenvat credit had been availed. However, the assessee paid duty of Rs. 64.91 lakh against the payable duty of Rs. 107.46 lakh. This resulted in short payment of Rs. 42.55 lakh.

On this being pointed out (February 2007), the department intimated (March 2008) that show cause notice was being issued.

Reply of the Ministry had not been received (December 2008).

## 3.18 Other cases

In 623 other cases of incorrect use of cenvat credit involving duty of Rs. 15.70 crore, the Ministry/department had accepted (till December 2008) all audit observations and had reported recovery of Rs. 10.01 crore in 597 cases.

# CHAPTER IV
# EXEMPTIONS

Under section 5A(1) of the Central Excise Act, 1944, the Government is empowered to exempt goods attracting excise duty 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 illustrative cases of incorrect allowance of exemptions involving short levy of duty of Rs. 136.17 crore are mentioned in the following paragraphs. These observations were communicated to the Ministry through 18 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 10 draft audit paragraphs with money value of Rs. 69.42 crore of which Rs. 1.65 crore had been recovered.

## 4.1 Exemption on goods produced and consumed within the factory

4.1.1 Notification dated 16 March 1995 provides exemption from duty to the excisable goods manufactured in a factory and consumed within the same factory in or in relation to manufacture of other excisable goods, provided the final products in which these are used are not fully exempt or are not chargeable to 'nil' rate of duty.

M/s Indian Oil Corporation Ltd., in Haldia commissionerate, engaged in the manufacture of petroleum products, cleared liquified petroleum gas (LPG) (tariff heading 27.11) on payment of duty at 'nil' rate under notification dated 1 March 2006, as amended. The manufacturing process of LPG indicated that while a portion of LPG had been manufactured within the refinery directly from crude distillation units by distillation process, a considerable portion of LPG was also produced through the 'fluidised catalytic cracking unit' wherein the excisable intermediate products, namely, reduced crude oil/light oil/intermediate oil/heavy oil and the like each falling under tariff heading 27.10 were used as feed stock on which exemption was availed under notification dated 16 March 1995. Since, the final product (i.e. LPG) attracted duty at 'nil' rate, the exemption from duty of Rs. 50.68 crore availed on intermediate products between 2 May 2005 and 31 March 2007 was not correct.

This was pointed out to the Ministry/department in June 2007; its reply had not been received (December 2008).

4.1.2 M/s BHEL, in Hyderabad I commissionerate, manufactured components/accessories/parts of power plant equipments and other auxiliary items like chambers, exhaust fans, rotors, stators, reduction gears, tube systems, shells, plugs, sockets, connectors, generators, turbines etc. and used these for captive consumption in the manufacture of power plant equipments. Audit observed that the power plant equipments were partly cleared on payment of duty and partly without payment of duty under the exemption notification dated 1 March 2002/2006. During the period from June 2005 to December 2006, the assessee cleared power plant equipments valuing

Rs. 315.19 crore without payment of duty claiming exemption. The cost of intermediate goods involved in these duty free clearances was estimated to be Rs. 189.11 crore. The incorrectly availed exemption from duty on these intermediate goods, consumed in exempted final products worked out to Rs. 30.86 crore.

On this being pointed out (February 2007), the Ministry admitted the audit observation and reported (June 2008) that a show cause notice was under issue. Further developments in this case had not been intimated (December 2008).

**4.1.3** By a notification dated 9 July 2004, the Government exempted tractors and their parts, from the payment of duty when used within the factory of production for manufacture of tractor.

Rule 9 of the Central Excise Rules, 2002, read with notifications No.35/2001 and 36/2001-CE (NT) dated 26 June 2001 as amended on 17 September 2002 prescribes that if the person has more than one premises requiring registration, separate registration certificate shall be obtained for each of such premises. However, the commissioner may provide single registration certificate if two or more premises of the same factory (where processes are interlinked) are segregated by public road, railway line or canal, subject to the conditions that the products manufactured/produced in one premises are substantially used in other premises for manufacture of final products and electricity supplies, labour/work force, administration/work management etc. are common.

M/s Escorts (Agri Machinery Group) Ltd., Faridabad, in Delhi IV commissionerate, had three plants engaged in manufacture of agricultural tractors, diesel IC engines and its parts. The assessee was granted two registration certificates by the department in December 2001 (plant 1) and May 2003 (plant 2 and 3). Parts of tractors and diesel IC engines (under tariff headings 87.08 and 84.09) were manufactured in plant 1 and supplied to plant 2 and 3 for manufacturing tractors (under tariff heading 87.01). The assessee was paying central excise duty on clearance of tractor parts to plants 2 and 3 as well as to spare parts division for further sale in open market and availing cenvat credit for supply of parts to plant 2 and 3.

In order to avail the benefit of exemption under the aforesaid notification dated 9 July 2004, the assessee applied for single registration certificate on 23 July 2004 for all the three plants, which was also granted by the department on 1 September 2004 though plant 1 and plants 2 and 3 were neither situated within the same premises nor interlinked being situated at a distance of more than one kilometre. Moreover, plant 1, 2 and 3 had separate electricity supplies, separate labour/work force, separate administration/work management and separate accounting records etc. Thus, the common registration certificate granted to the three plants was in violation of the rules. The assessee cleared tractor parts valuing Rs. 24.72 crore to plant 2 and 3 between September 2004 and March 2005 on which exemption of duty of Rs. 4.03 crore availed incorrectly. This duty of Rs. 4.03 crore was recoverable with interest.

On this being pointed out (January 2006), the department admitted that registration certificate was issued inadvertently and confirmed (April 2008)

the demand of Rs. 26.34 crore for the period 22 September 2004 to 31 March 2007. Report on recovery had not been received (May 2008).

Reply of the Ministry had not been received (December 2008).

4.1.4 'National calamity contingent duty (NCCD)' has been imposed on polyester filament yarn falling under tariff heading 54.02 at one per cent ad valorem, with effect from 1 March 2003. By a notification dated 17 May 2003, NCCD on the products falling under tariff heading 54.02 has been exempted if such goods are manufactured from the goods falling under tariff heading 54.02.

M/s Indorama Synthetics Ltd., Butibori in Nagpur commissionerate, manufactured drawn texurised polyester yarn (DTY) and partially oriented polyester yarn (POY) falling under tariff sub-headings 5402.32 and 5402.42 respectively and cleared the same on payment of appropriate duty. The assessee also consumed POY captively in the manufacture of DTY and claimed exemption from all duties of excise (including NCCD) leviable on POY, under notification dated 16 March 1995. The assessee also claimed exemption of NCCD leviable on DTY under notification dated 17 May 2003. As DTY manufactured out of POY, was exempted from the levy of NCCD, the assessee was required to pay NCCD on POY consumed captively in the manufacture of DTY. However, the assessee had not paid NCCD either at POY stage (captive) or at DTY stage (finished). During the period from 17 May 2003 to 31 October 2003, the assessee cleared 1,63,93,422 kilograms of POY valued at Rs. 9.81 crore for manufacture of DTY without payment of NCCD of Rs. 98.05 lakh.

On this being pointed out (November 2003 and January 2008), the Ministry admitted the audit observation and reported (September 2008) recovery of Rs. 1.36 crore alongwith interest of Rs. 6.17 lakh.

## 4.2 Exemption under notification applicable to goods sold

4.2.1 Notification dated 9 July 2004 stipulates that specified textiles fabric and yarn under chapters 50 to 63 of the Central Excise Tariff Act, 1985 are exempt from payment of duty provided no credit of duty, paid on inputs or capital goods has been taken under the Cenvat Credit Rules, 2002.

M/s Jaya Shree Textiles, Rishra (a unit of Aditya Birla Nuvo Ltd.), in Kolkata IV commissionerate, engaged in the manufacture of fabrics and yarns under chapters 51 and 55, availed of the exemption under the said notification. The records of the assessee disclosed that cenvat credit was also availed on inputs like, soda ash, hydrochloric acid and various lubricants, consumed in the manufacture of said final products. Since the benefit of cenvat credit was availed, the exemption from duty of Rs. 7.63 crore availed of, during the period between 9 July 2004 and 30 June 2006, was not correct.

On this being pointed out (June 2006), the department initially stated (October 2006) that the proportionate cenvat credit taken was reversed by the assessee prior to the clearance of the exempted goods and hence exemption was availed correctly in terms of the Supreme Court judgement in the case of M/s Chandrapura Magnet Wires (P) Ltd. {1996 (81) ELT 3 (SC)}. Later on it

stated (February 2008) that the issue was detected by the department prior to audit and accordingly, a show cause notice for Rs. 7.63 crore had been issued on 3 July 2007.

The reply of the department was not correct as the reversal of cenvat credit on inputs was done much after utilisation of such inputs in the manufacturing process and so, the Supreme Court judgment cited by the department was not relevant in this case. Further, audit had pointed out the issue on 26 June 2006, whereas the department had taken up the matter with the assessee more than a year later on 3 July 2007. Besides, no documents could be provided to audit to establish the detection of the case by the department, prior to audit.

Reply of the Ministry had not been received (December 2008).

**4.2.2** M/s Cheviot Company Ltd., in Kolkata VII commissionerate, engaged in the manufacture of jute yarn and sacking bags, cleared sacking bags without payment of duty, availing exemption from duty under notification dated 9 July 2004 cited above. The assessee had also taken cenvat credit of education cess paid on various inputs, namely, jute batching oil, lubricating oil and packing materials used in the manufacture of final products. Since cenvat credit of education cess had been taken in cenvat account, simultaneous availing of exemption was not correct. Exemption from duty of Rs. 5.39 crore during the period between April 2005 and August 2006 was accordingly, incorrect.

On this being pointed out (September 2006), the Ministry admitted the audit observation and intimated (August 2008) that a demand of duty of Rs. 5.39 crore had been confirmed and in addition penalty of Rs. 5.39 crore had also been imposed.

**4.2.3** In terms of notification dated 8 January 2004, all items of machinery, including instruments, apparatus and appliances, auxiliary equipments and their components/parts, required for setting up of water supply plants for agricultural and industrial use; and pipes needed for delivery of water from its source to the plant and from there to the storage facility, are exempted from whole of the duty of excise, subject to the condition that a certificate issued by the collector/deputy commissioner/district magistrate of the district in which the project is located is produced to the deputy/assistant commissioner of central excise that such goods were cleared for the intended use as specified above.

M/s BHEL Bhopal, in Bhopal commissionerate, engaged in manufacture of various machineries, cleared turbines and generators to M/s. Patel Engineering Ltd., Hyderabad for setting up three lift irrigation schemes in Mahbubnagar district and availed exemption from duty under the above notification. The scrutiny of certificate issued by the district magistrate of Mahbubnagar district indicated that turbines and generators were not covered in the certificate. The goods were meant for setting up of water supply plants for providing safe drinking water and not for lift irrigation schemes. Therefore, exemption from duty of Rs. 6.40 crore availed of between November 2006 and March 2007 was incorrect.

On this being pointed out (February 2008), the department stated (May 2008) that a show cause notice was under issue. Reply of the Ministry had not been received (December 2008).

4.2.4 Notification dated 1 March 2003 provides exemption on specified goods subject to the condition that the manufacturer shall not avail of the credit of duty on inputs under rule 3 or rule 11 of the Cenvat Credit Rules, 2002. Rule 11 (2) of the Cenvat Credit Rules, 2004, provides that a manufacturer who opts for exemption from the whole of the duty of excise leviable on goods manufactured by him under the aforesaid notification, shall be required to pay an amount equivalent to the cenvat credit, allowed in respect of inputs lying in stock or in process or contained in final products lying in stock on the date when such option was exercised.

The Supreme Court in the case of M/s Chandrapur Magnet Wires (P) Ltd., {1996 (81) ELT 3 (SC)} has held that exemption from duty on final product will be admissible if the manufacturer debits the cenvat credit account before removal of such exempted goods.

M/s Elcon Drugs and Formulations Ltd., and M/s Karnani Pharmaceuticals Pvt. Ltd., in Jaipur I commissionerate, exercised option to switch over from cenvat facility to exemption under the notification dated 1 March 2003 for the financial year 2005-06 on 1 April 2005 and for the financial year 2006-07 on 1 April 2006. However, the assessees did not pay the amount equivalent to the cenvat credit in respect of inputs lying in stock or in process or contained in final products lying in the stock before removal/clearance of exempted final product. Removal of goods without payment of duty under the aforesaid notification was, therefore incorrect. This resulted in short payment of duty of Rs. 48.75 lakh.

On this being pointed out (October 2005 and November 2006), the department stated (September 2006) that a show cause notice had been issued to M/s Elcon Drugs and Formulations Ltd., in June 2006. In the second case it stated (August 2007) that the judgement of Supreme Court in case of M/s Chandrapur Magnet Wires (P) Ltd., nowhere pronounced that reversal of credit should be before or after the removal of goods.

Reply of the department was not acceptable as the Supreme Court had expressly opined this requirement of reversal of credit prior to removal of goods (paragraph 6 of their judgement).

Reply of the Ministry had not been received (December 2008).

4.2.5 Notification dated 1 March 2001 (Sl. No.131) and dated 1 March 2002 (Sl. No.126) allowed the concessional rate of duty of Rs. nine per kilogram on certain yarns falling under chapter 54 of the central excise tariff if these were manufactured out of 'textured or draw twisted yarn' on which appropriate duty of excise had been paid and no credit under the Cenvat Credit Rules had been availed.

M/s Vardhman Threads Ltd., Baddi, in Chandigarh I commissionerate, manufactured polyester and nylon yarn (tariff sub-heading 5402.62) and cleared these on payment of duty at Rs. nine per kilogram under the aforesaid notification inspite of the fact that these yarns were not manufactured from 'textured or draw twisted yarn'. The assessee had also availed credit on inputs. Since the finished yarn was not manufactured out of the textured or draw twisted yarn, the assessee was not entitled for the exemption. This

resulted in incorrect availing of exemption from duty of Rs. 20.19 lakh during the period from October 2001 to March 2003.

On this being pointed out (January 20004), the department stated (August 2005) that show cause cum demand notices issued in this case were adjudicated and the demands confirmed but were subsequently set aside by the appellate commissioner. It was also stated (March 2006) that the department had accepted the order-in-appeal.

Reply of the department was not relevant to this issue raised in audit as the show cause notices were issued on other grounds viz., applying the unspecified process of waxing and lubrication for producing finished yarn unrelated to audit observation.

Reply of the Ministry had not been received (December 2008).

## 4.3 Exemption under notification applicable to export oriented units

By a notification dated 1 March 1997 as amended, specified goods are leviable to concessional rate of duty provided that the goods are produced in an export oriented unit out of indigenous raw materials and are cleared in domestic tariff area (DTA).

M/s NALCO (Rolled Product Unit) Ltd., Angul, a 100 per cent EOU in Bhubaneswar I commissionerate, engaged in the manufacture of aluminium strips and cold rolled sheets/coils, manufactured goods using both indigenous and imported raw materials and cleared its entire finished product at the concessional rate of duty, under the above notification. Since the assessee manufactured its finished product out of indigenous and imported raw materials, the duty exemption granted in DTA sale was not applicable to it and differential duty of Rs. 3.38 crore for the period from November 2002 to March 2005 was recoverable.

On this being pointed out (July 2005), the department admitted the audit observation and stated (April 2008) that a show cause notice for Rs. 6.62 crore pertaining to the period from November 2002 to March 2006 had since been issued (June 2007).

Reply of the Ministry had not been received (December 2008).

## 4.4 Small scale industry exemption

Notification dated 1 March 2003 provided small scale industry (SSI) exemption to a manufacturer, on the clearance of goods for home consumption upto the aggregate value of Rs. one crore during the current financial year subject to the condition that the aggregate value of all excisable goods for home consumption did not exceed Rs. three crore in the preceding financial year. Paragraph 4 of the notification also stipulates that the goods manufactured in rural area under other assessee's brand name will have to be included for the calculation of prescribed limit for clearances during current year as well as for previous year.

M/s Jaywin Remedies and M/s Chemonix India Pvt. Ltd., in Ahmedabad III commissionerate, had not clubbed their clearances of branded goods and own goods in the current financial year though it was required to be clubbed as both the units fell within the rural area during the period from 2001-02 to 2005-06. The assessees were ineligible for the SSI benefit as the clubbed value of clearances in the current as well as previous years exceeded the prescribed limits. This resulted in incorrect availing of exemption of duty of Rs. 70.02 lakh, which was recoverable with interest.

On this being pointed out (June 2006), the Ministry admitted the audit observation and stated (October 2008) that show cause notices for Rs. 1.22 crore had since been issued to the assessees.

## 4.5 Refund under area based exemption notification

Under a notification dated 14 November 2002, specified excisable goods produced by a unit located in notified areas of Jammu and Kashmir were exempt from that portion of duty which was paid by the manufacturer in cash provided the unit is set up or has undergone substantial expansion on or after 14 June 2002.

M/s Sun Pharmaceutical Industries Jammu, in Jammu and Kashmir commissionerate, engaged in manufacture of allopathic pharmaceutical preparations, imported (April 2005) 4,950 kilogram sodium flurbiprofen dihydrate (bulk drug) from China. These bulk drugs were sent (April 2005) to sister concern M/s Sun Pharmaceutical Industries Ltd., Ahmednagar (Maharashtra) for conversion to flurbiprofen BP on job work challan, without intimating the department. However, no records were available to substantiate the receipt of raw material in Jammu factory. The sister concern (job worker), after conversion, returned only 3,395 kilogram of flurbiprofen BP to the assessee during May and June 2005. This was shown cleared (May - June 2005) by the assessee on the sale invoices, which did not bear any vehicle numbers, in the same condition and under the same batch numbers under which it was processed by the job worker, without carrying out further processing/manufacture at his factory, to another sister concern M/s Sun Pharmaceutical Industries Ltd., Madhurakantam, Kanchipuram (Tamil Nadu) on the assessable value of Rs. 1.49 crore with excise duty of Rs. 23.90 lakh. The assessee was allowed refund of duty of Rs. 23.90 lakh. Since no manufacturing process was undertaken in the assessee's factory, refund of duty was incorrect and was recoverable with interest. The disposal of balance quantity of 1,555 kilogram (4,950 less by 3,395) of raw material with excise duty involvement of Rs. 11.17 lakh was also not explained to audit.

Similarly, the assessee imported (May 2005) 2,700 kilogram of bulk drug 3 chloro- 5- acetyl iminodibenzyl from China and showed it as transferred to its sister concern M/s Sun Pharmaceutical Industries Ltd., Panoli (Gujarat) for conversion to CLM - 5 on job work basis, without intimating the department. No records were available to substantiate the mode/receipt of raw material in Jammu factory and its subsequent dispatch to the job worker. The final product CLM - 5 had subsequently been shown cleared (July 2005) from its Jammu factory to another sister concern M/s Sun Pharmaceutical Industries Ltd., Madhurakantam, Kanchipuram (Tamil Nadu), under the same batch

numbers of the job worker, at an assessable value of Rs. 2.25 crore with central excise duty payment of Rs. 36.67 lakh. The assessee was allowed refund of Rs. 36.67 lakh. No records were available to substantiate that the inputs were received in assessee's factory and any process was carried out to produce final goods. The number of the vehicle in which the product was dispatched was also not found recorded on the sale invoices, making it probable that the same had actually been cleared from the job worker's factory but shown cleared from the Jammu factory in order to avail the benefit of exemption of excise duty. The grant of the refund of excise duty of Rs. 36.67 lakh was incorrect.

Again the assessee imported in October 2005, 11,000 kilogram of bulk drug 3, 7 - dimethyl - 1- 5- oxohexyl - 3, 7- hydro- IH- purine- 2, 6 dione (crude) from China. These bulk drugs were shown transferred (October 2005) to its sister concern M/s Sun Pharmaceutical Industries Ltd., Panoli (Gujarat) for conversion to pentoxifylline on job work basis through job work challan, without intimating the department. Of this, 10,779.040 kilogram of pentoxifylline was shown sent by the job worker to Jammu in trucks as per the stock transfer notes of 13 January 2006. However, no supporting evidence regarding receipt of final product in Jammu factory was available on record. The same quantity of manufactured product was then shown cleared by the assessee from Jammu factory to another sister concern M/s Sun Pharmaceutical Industries Ltd., Madhurakantam Kanchipuram (Tamil Nadu) on the same date viz. 13 January 2006 in the same trucks. The product with assessable value of Rs. 1.85 crore involving central excise duty of Rs. 26.02 lakh was shown cleared on 13 January 2006 under batch numbers of the job worker and refund of central excise duty was availed. Since neither raw material/processed final product was received by the assessee nor any manufacturing activity had taken place in Jammu, refund of duty of Rs. 26.02 lakh was not correct.

The total duty in these three cases aggregating to Rs. 73.86 lakh was refunded incorrectly and was recoverable with interest and penalty.

On this being pointed out (December 2007 and April 2008), the Ministry admitted the audit observations relating to the refund of duty of Rs. 26.02 lakh and reported (December 2008) issue of show cause notice to the assessee. Reply for the remaining amount of refund had not been received (December 2008).

## 4.6 Exemption availed beyond the validity period of notification

By a notification dated 16 March 1995, as amended till 24 January 2006, all goods supplied to the Samyukta Programme under the Ministry of Defence were exempt from duty upto 31 May 2006. After the expiry of the said period of exemption, no immediate extension was granted by the Central Government but by a subsequent notification dated 21 August 2006, the exemption was again provided prospectively which remained in force upto 1 December 2007.

M/s Electronics Corporation of India Ltd., in Hyderabad III commissionerate, engaged in manufacture of electronic components cleared UHF/VHF photo type systems valuing Rs. 3.18 crore on 31 July 2006 to Defence Electronics

Research Laboratory under Ministry of Defence without payment of duty on the ground that the goods were intended for use in Samyukta Programme and hence were eligible for exemption under the above mentioned notification. This was not correct as on the date of clearances, exemption was not available and therefore duty of Rs. 51.98 lakh was payable.

On this being pointed out (January 2007), the department admitted the audit observation and reported (August 2007/June 2008) that a show cause notice demanding Rs. 51.98 lakh besides interest and penalty had been issued in July 2007.

Reply of the Ministry had not been received (December 2008).

## 4.7 Other cases

In 16 other cases of exemptions involving duty of Rs. 1.42 crore, the Ministry/department had accepted all audit observations and had reported recovery of Rs. 23.41 lakh in 12 cases till December 2008.

# CHAPTER V
# DEMANDS NOT RAISED OR ADJUDICATED

Short payment or non-payment of duty on excisable goods is to be recovered by issuing show cause notice (SCN) under section 11A of the Central Excise Act, 1944, followed up with its adjudication and completion of recovery proceedings. Period of limitation for issue of SCN is one year (six months upto 11 May 2000) in normal cases of non-levy/short levy of duty. In case of short levy/non-levy is due to fraud, collusion etc., limitation period stands extended to five years. Some illustrative cases of demands not raised or realised, involving duty of Rs. 49.25 crore are discussed in the following paragraphs. These observations were communicated to the Ministry through three draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations with money value of Rs. 6.92 lakh and had reported recovery of Rs. 6.92 lakh.

## 5.1 Demands not raised

The Supreme Court in the case of M/s Madhumilan Syntex Pvt. Ltd., {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.

**5.1.1** Test check of records of the central excise divisions, Simla and Baddi under Chandigarh I commissionerate, indicated that the department had detected short payment of duty on account of wrong availing of area based exemption, undervaluation of goods, incorrect availing of cenvat credit, clearance of goods without payment of duty etc., in 22 cases involving duty of Rs. 44.32 crore between the period from April 2003 to March 2007. In one of these cases, the department had also booked offence case against the assessee viz., M/s Nekon Industries, Baddi. It was also observed that the draft show cause notice was also prepared and sent by the division office to the commissionerate for issuance. However, show cause notices were not issued for recovery of duty due of Rs. 44.32 crore.

The irregularities were pointed out to the Ministry/department in October/December 2007; its reply had not been received (December 2008).

**5.1.2** Under rule 96ZO and 96ZP of the Central Excise Rules, 1944, read with section 3A of the Central Excise Act, 1944, duty of excise on non-alloy steel ingots/billets and hot re-rolled products (chapter 72) was leviable with reference to annual capacity of production. Further, the duty relating to the period 1 September 1997 to 31 March 1998 was required to be paid by the end of March 1998 and for the subsequent financial years, by the 31st March of the relevant year. If a manufacturer failed to pay duty by the due date, he was liable to pay outstanding amount of duty along with interest at the rate of 18 per cent per annum and a penalty equal to outstanding amount of duty or Rs. five thousand which ever was greater.

M/s Shree Kangra Steels Ltd., Nalagarh and M/s Atul Castings Ltd., Nalagarh, in Chandigarh I commissionerate, engaged in the manufacture of M.S. ingots

were liable to pay duty of Rs. 1.69 crore, under section 3A of the Act, during August 1997 to March 2000. The assessees, however, had paid duty only of Rs. 1.32 crore. Differential duty of Rs. 37.04 lakh was not paid by the assessee which was recoverable with interest and mandatory penalty of Rs. 1.69 crore.

On this being pointed out (November 2000), the department stated (November 2001 and January 2007) that no time limit had been fixed for the payment of compounded levy installments. The assessees had, however, been persuaded to deposit the amount. Two show cause notices for Rs. 16.75 lakh were also stated (January 2007) to have been issued (December 2006 and January 2007).

The reply of the department was not acceptable as any short payment or non-payment of duty on any excisable goods was to be recovered by issuing a mandatory show cause cum demand notice under section 11A to be followed up with its adjudication and recovery proceedings. The period of limitation for issue of show cause notice was one year (six months upto 11 May 2000) in normal cases and extended to five years in the circumstances of fraud and collusion, etc. In the instant case two show cause notices for Rs. 16.75 lakh were issued after the limitation period of 5 years and no action had been taken for demanding balance duty amount of Rs. 20.29 lakh and penalty of Rs. 1.69 crore which had also become time barred.

Reply of the Ministry had not been received (December 2008).

## 5.2 Inordinate delay in adjudication

Delhi I commissionerate, issued show cause notice to M/s Empire Safe Company in August 1987 for clandestine manufacture and clearance of steel and wooden furniture which was adjudicated by the adjudicating officer confirming demand of Rs. 95.16 lakh in July 1989. The assessee filed an appeal with the CESTAT against the order. The CESTAT sent the case back to the commissioner for de novo adjudication in July 1992. Audit observed that the case was lying unadjudicated since then despite a lapse of over 15 years. Inordinate delay in adjudication of case resulted in non-recovery of duty of Rs. 95.16 lakh and interest of Rs. 1.86 crore.

This was pointed out to the Ministry/department in November 2007; its reply had not been received (December 2008).

## 5.3 Other cases

In eight other similar cases involving duty of Rs. 6.92 lakh, the Ministry/department had accepted all audit observations and had further reported recovery of Rs. 6.92 lakh.

# CHAPTER VI
# VALUATION OF EXCISABLE GOODS

Duty at ad valorem rates is charged on a wide range of excisable commodities. Valuation of such goods is governed by section 4 of the Central Excise Act, 1944, read with the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000. Valuation with reference to the retail sale price in respect of specified excisable goods is governed by section 4A of the above Act. Some cases of short levy of duty due to incorrect valuation involving revenue of Rs. 40.03 crore, are illustrated in the following paragraphs. These observations were communicated to the Ministry through 36 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 27 draft audit paragraphs with money value of Rs. 15.17 crore of which Rs. 2.63 crore had been recovered.

## 6.1 Non-inclusion of additional consideration

6.1.1 Aerated water falling under tariff sub-heading 2202.20 is leviable to duty on the basis of retail sale price (RSP) under section 4A of the Central Excise Act, 1944.

Explanation 1 under section 4A of the said Act, stipulates that retail sale price means the maximum price at which the excisable goods in packaged form is sold to the ultimate consumer and includes all taxes, local or otherwise, freight, transport charges, commission payable to dealers, and all charges towards advertisement, delivery, packing, forwarding and the like and the price is the sole consideration for such sale.

M/s Kandhari Beverages Pvt. Ltd., Baddi, in Chandigarh I commissionerate, engaged in manufacture of aerated water assessed its products to duty on RSP basis. Audit observed that the assessee had recovered price on invoices from the dealers (approximately 34 per cent) which was more than what was appropriate after availing permissible abatement from the RSP. The annual financial accounts also revealed that the assessee had large income from transportation of aerated water. Packing material (glass bottles) being returnable for which deposits had also been taken was an additional consideration in terms of Board's circulars dated 1 July 2002 and 27 February 2003. Accordingly, the price was not the sole consideration for sale as the conditions envisaged in explanation 1 to section 4A were not fulfilled. This resulted in short payment of duty of Rs. 18.02 crore during the period from April 2000 to November 2003.

On this being pointed out (January 2004), the department stated (May 2004) that the duty was correctly paid on assessable value as per section 4A of the Act.

Reply of the department is not acceptable as the value recovered on invoices from the dealers was far more than the abated value determined under section 4A of the Act, the conditions prescribed in explanation 1 to section 4A were also not fulfilled. Therefore, the assessable value was required to be re-

determined after considering the additional considerations for assessment of duty.

Reply of the Ministry had not been received (December 2008).

**6.1.2** Under section 4(3)(d) of the Central Excise Act, 1944, transaction value means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to or on behalf of, the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing etc., or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

**6.1.2.1** M/s Indian Oil Petronas Pvt. Ltd., in Haldia commissionerate, engaged in warehousing and removal of liquified petroleum gas (LPG) received under bond some consignments of LPG from M/s Reliance Industries Ltd., for warehousing of the product in the accounts of M/s IOCL, M/s HPCL and M/s BPCL. The assessee also collected from the said oil companies, an amount of storage charge in the name of terminalling charge for storing of such LPG in cryogenic condition and for its further conversion into marketable form. Such terminalling charges realised separately from their customers were not included in the assessable value of the product while paying duty. This resulted in short levy of duty of Rs. 5.14 crore during the period from February 2002 to 16 August 2004.

On this being pointed out (November 2006), the Ministry admitted the audit observation and intimated (October 2008) issue of show cause notice.

**6.1.2.2** The Government of Maharashtra introduced the package incentive scheme for deferred payment of sales tax whereby the assessee was allowed to collect sales tax from the buyer and retain it and repay it after the prescribed period of deferral. The Government of Maharashtra further amended the provisions of the Sales Tax Act and issued notification in November 2002 providing additional incentive for premature payment of sales tax liability.

Eleven assessees in Aurangabad (2), Nagpur (4), Pune II (2), Pune III (2) and Thane I (1) commissionerates, engaged in manufacture of various excisable goods, opted for premature payment of sales tax deferred liability during the years 1999-2007 under the above mentioned scheme. The records of the assessees indicated that they received cumulative discount of Rs. 30.24 crore due to premature payment of sales tax liability accrued at net present value. Sales tax amount collected but not paid to the Government was an additional income and was liable to be added in the assessable value. Non-inclusion of this additional income resulted in short levy of duty of Rs. 4.89 crore.

On this being pointed out (between November 2006 and March 2008), the Ministry admitted the audit observation in six cases and intimated (between June and December 2008) issue of show cause notices for Rs. 70.42 lakh in three cases. Reply in the remaining cases had not been received (December 2008).

**6.1.2.3** M/s Bharat Petroleum Corporation Ltd. (Mangalia installation), in Indore commissionerate, engaged in the marketing of petroleum products, cleared the goods to their depots as well as to the depots of M/s Hindustan

Petroleum Corporation Ltd., M/s Indian Oil Corporation Ltd. and other marketing company's depots etc. through pipe lines in local area and in tankers, railway wagon rakes for ultimate/onward sale and incurred expenses on account of railway freight, insurance, shunting charges for transportation of goods from Mangalia installation to depots (own and other marketing company owned). Though these charges form part of the assessable value in view of specific mention in section 4 yet these were not included in the assessable value of the goods which resulted in short levy of duty of Rs. 3.15 crore during the period from March 2004 to September 2004.

On this being pointed out (April 2006), the department stated (October 2007) that a show cause notice had been issued to the assessee.

Reply of the Ministry had not been received (December 2008).

**6.1.2.4** The Board's circular dated 12 July 2002 read with the Supreme Court's judgement in the case of PSI Data Systems Ltd., {1997 (89) ELT 3} clarified that no distinction should be made between an 'operating software' or an 'application software'. In terms of para 3 of the Supreme Court's judgement, if a computer is sold loaded with intellectual software, the value of the software will be included in the value of computer. Any floppy, disc or tape containing any tangible software supplied alongwith the computer system will, however, be assessed separately. The introduction of transaction value concept with effect from 1 July 2000 had no effect on this basic principle.

M/s Himachal Futuristic Communication Ltd., Solan Wireless Division Unit III OLTE, in Chandigarh I commissionerate, engaged in the manufacture of telecommunication equipments OLTE, DLC and STM (tariff heading 85.17) cleared DLC systems to BSNL/MTNL without adding the value of preloaded software in the assessable value of the systems. Splitting of value of software, etc., loaded on machinery resulted in short levy of duty of Rs. 1.45 crore during the year 2002-03.

On this being pointed out (February 2003), the department admitted the audit observation and intimated (September 2007) issue of show cause notice for Rs. 3.88 crore for the period April 2002 to December 2005.

Reply of the Ministry had not been received (December 2008).

**6.1.2.5** M/s Bharat Refractories Ltd., Bokaro, in Ranchi commissionerate, engaged in the manufacture of refractory bricks, entered into contracts with M/s Bokaro Steel Plant and other steel company for supply of refractories. The term of purchase orders provided for a performance guarantee clause according to which the assessee would, in addition to the agreed price per unit, be entitled for bonus amount for such of those refractories which achieved additional life period. The assessee received performance incentive bonus of Rs. 2.88 crore during the period between April 2005 and March 2008 from the buyers through supplementary claims over and above the invoice prices of refractories on which duty was paid but did not pay duty of Rs. 47.05 lakh on this additional amount even though the said bonus amount had a direct nexus to the goods sold. This was recoverable with interest.

This was pointed out to the Ministry/department in May 2008; its reply had not been received (December 2008).

## 6.2 Incorrect allowance of deduction

The Board clarified on 30 June 2000 that transaction value includes all elements which add value to the goods before these are marketed. Where the assessee charges an amount as price for the goods, the amount so charged and paid or payable for the goods will form part of the assessable value. If, in addition to the amount charged as price from the buyer, the assessee also recovers any other amount by reason of or in connection with sale, then such amount shall also form part of the assessable/transaction value. Taxes are deductible on actual basis either paid or payable by the assessee.

M/s Dabur India Ltd., Hajmola and Chyavanprash Divisions, in Chandigarh I commissionerate, engaged in the manufacture of ayurvedic medicines, worked out assessable value of the goods after deducting some expenses including taxes, on average basis. The average was worked out on the basis of the actuals of the previous year which was not permissible deductions in terms of the Board's circular dated 30 June 2000. This resulted in undervaluation of goods and consequential short levy of duty of Rs. 66 lakh for the years 2001-02 to 2004-05.

On this being pointed out (January 2004 and January 2006), the department stated (January 2008) that the demands aggregating Rs. 90.80 lakh for the period from July 2000 to December 2006 had been confirmed besides an equivalent penalty had been imposed. It was also stated that on appeal of the assessee, the demand had been vacated by the appellate commissioner. The appellate orders had been appealed against in the Tribunal by the department.

Reply of the Ministry had not been received (December 2008).

## 6.3 Incorrect determination of cost of excisable goods

Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that where the excisable goods are not sold by the assessee, but are used for consumption by him or on his behalf in the manufacture of other articles, the value shall be 115 per cent (110 per cent from 5 August 2003) of the cost of production or manufacture of such goods.

**6.3.1** M/s Wockhardt Ltd., in Surat II commissionerate, cleared bulk drugs viz., ranitidine hydrochloride to its sister concern unit i.e. M/s Wockhardt Ltd., Chikalthana for manufacturing of other goods on payment of duty based on valuation at maximum price fixed under Drugs Price Control Order (DPCO) instead of deriving the value on cost basis. Duty was paid at Rs. 690 per tonne instead of Rs. 1,300 per tonne between February 2004 and June 2005 and Rs. 625 per tonne instead of Rs. 2,280 per tonne between July 2005 and January 2007. This resulted in short levy of duty of Rs. 51.26 lakh.

On this being pointed out (July 2007), the Ministry admitted the audit observation and reported (October 2008) recovery of duty of Rs. 51.26 lakh and interest of Rs. 11.45 lakh in July and December 2007 respectively.

**6.3.2** M/s BESCO Ltd., in Kolkata VII commissionerate, engaged in the manufacture of railway track construction material (chapter 73) and bogie (tariff heading 86.07) availed of cenvat credit on inputs used in the manufacture of dutiable as well as exempted final products and paid an

amount of 8 per cent (10 per cent with effect from 10 September 2004) on the price of the exempted products. The records relating to the transfer of stock to sister unit indicated that the price of such exempted products was much less as valuation of the product was not done at 115 per cent (110 per cent with effect from 5 August 2003 onwards) of cost price of the product in terms of valuation rules. This resulted in short payment of duty of Rs. 45.73 lakh during the period between April 2003 and December 2005.

On this being pointed out (February 2006), the Ministry admitted the audit observation and reported (August 2008) that a show cause notice for Rs. 46.84 lakh had been issued in March 2007.

6.3.3 M/s Hyva (India) Pvt. Ltd., in Belapur commissionerate, cleared semi finished goods valued at Rs. 24.30 crore from its factory at Mahape to its own unit located at EL-125, Mahape on payment of duty in January 2007. The assessable value of the goods was not determined under the provisions of rule 8 of the Valuation Rules, 2000. Non-adoption of 110 per cent of cost price as assessable value, resulted in undervaluation of goods to the tune of Rs. 2.43 crore with consequential short levy of duty of Rs. 39.66 lakh.

On this being pointed out (September 2007), the department stated (October 2007) that the assessee had stopped manufacturing activity at the unit located at C-150 and started a new factory at EL-125 and therefore the provisions of rule 8 were not applicable. It further stated that out of the total value of Rs. 24.30 crore cleared, the value of the semi finished goods cleared amounted to Rs. 6.23 crore and inputs cleared as such was valued at Rs. 18.07 crore. Subsequent verification revealed that duty of Rs. 10.27 lakh was recovered in November 2007.

The reply of the department is not acceptable as both the units existed concurrently and therefore the clearances from the unit at C-150 to EL-125 in Mahape were covered under the provisions of rule 8. The department was further requested to verify the correctness of the amount of Rs. 18.07 crore stated to be the value of clearances of inputs as such. Reply on this point had not been received (December 2008). However, subsequent verification in April 2008 revealed that the department had issued show cause notice for Rs. 40.05 lakh in February 2008.

Reply of the Ministry had not been received (December 2008).

6.3.4 M/s Hindustan Lever Ltd., in Haldia commissionerate, engaged in the manufacture of 'organic surface active agent' transferred the bulk stock of such intermediate product to its sister unit on payment of duty for further use in the manufacture of detergent powder. Records disclosed that the assessee had not taken into account the cost of service (job charges) while determining the cost of production of the goods during the year 2004-05 (upto October 2005). Non-inclusion of such cost in the valuation of the product resulted in short levy of duty of Rs 28.58 lakh during the period from April 2004 to October 2005.

On this being pointed out (December 2005), the Ministry admitted the audit observation and reported (September 2008) that a show cause notice for Rs. 52.51 lakh had been issued (December 2007) covering the period from April 2004 to March 2007.

## 6.4 Valuation of samples meant for free distribution

The Board clarified on 25 April 2005 that in case of free samples, the valuation should be determined under rule 4 of the Central Excise Valuation (Determination of Price of Excisable goods) Rules, 2000. The validity of circular dated 25 April 2005 was upheld by the High Court of Bombay in the case of Indian Drugs Manufactures Association Vs. Union of India on 28 September 2006.

6.4.1 M/s. Charak Pharma Pvt. Ltd., in Vapi Commissionerate, cleared physician samples worth Rs. 2.49 crore during May 2005 to December 2006 after payment of duty of Rs. 40.56 lakh. Audit observed that the value of samples was arrived at on costing basis which was lower than the value which should have been arrived at on the basis of transaction value of similar goods in terms of rule 4 of the Valuation Rules. Incorrect adoption of value, resulted in short payment of duty of Rs.45.68 lakh which was recoverable with interest of Rs. 5.85 lakh (till February 2007).

On this being pointed (July 2007), the Ministry admitted the audit observation and stated (June 2008) that a show cause notice for Rs. 47.67 lakh had been issued (June 2008).

6.4.2 M/s Anod Pharma Pvt. Ltd., in Kanpur commissionerate, engaged in manufacture of patent or proprietary medicaments had been clearing goods under retail sale price (RSP) based assessment with effect from 28 June 2005. The assessee also manufactured physicians' samples and cleared them on payment of duty at mutually agreed price ranging between Rs. 17.75 and Rs. 34.75 per unit as against the declared RSP of Rs. 150 and Rs. 300 per unit. The assessee should have adopted assessable value under rule 4 of the said rules for the purpose of valuation of the samples. Incorrect adoption of the value resulted in short payment of duty of Rs. 25.34 lakh during the years 2005-06 and 2006-07.

On this being pointed out (October/November 2007), the department stated (January 2008) that valuation of free samples had been done under rule 4 of the Valuation Rules.

Reply of the department was not acceptable as RSP of the products was available and hence value under rule 4 should be the comparable value based on RSP. Therefore adoption of mutually agreed price as assessable value on payment of duty was not correct.

Reply of the Ministry had not been received (December 2008).

## 6.5 Other cases

In 49 other cases of valuation of excisable goods involving duty of Rs. 4.01 crore, the Ministry/department had accepted all audit observations and had reported recovery of Rs. two crore in 37 cases till December 2008.

# CHAPTER VII
# CESS NOT LEVIED OR DEMANDED

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

Some of the cases in which cess amounting to Rs. 4.39 crore was not levied or demanded are mentioned in the following paragraphs. These observations were communicated to the Ministry through six draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in three draft audit paragraphs with money value of Rs. 2.82 crore of which Rs. 0.36 crore had been recovered.

## 7.1 Non-levy of cess on textiles and textile machinery

Under section 5(A)(1) of the Textile Committee Act, 1963 and notification issued there under on 1 June 1977, cess at the rate of 0.05 per cent ad valorem is leviable on all textiles and textile machinery manufactured in India. The authority to collect such cess is vested with the 'Textile Committee' constituted under section 3 of the Act.

### *7.1.1 Textiles*

**7.1.1.1** M/s Silvasa Industries Ltd. (now known as M/s IPCL Kharadpada) at Silvasa, in Gujarat, manufactured textured and twisted yarn valuing Rs. 2234.34 crore during the period from the year 2003-04 to 2005-06 but the applicable cess amounting to Rs. 1.12 crore leviable thereon was not paid. The department also did not demand it.

On this being pointed out (November 2007), the Ministry of Textiles stated (July 2008) that show cause notice had been issued to the assessee. Further developments in this case had not been received (December 2008).

**7.1.1.2** Test check of records of 127 units engaged in the manufacture of processed textile fabrics in the state of Maharashtra and six units manufacturing unprocessed fabrics, cotton yarn blends etc., in the state of Himachal Pradesh revealed that they did not pay textile cess amounting to Rs. 1.48 crore for the period from April 2001 to June 2006. The Textile Committee also did not take any action for recovery of cess.

On this being pointed out (between January 2004 and June 2007), the Ministry of Textiles stated (July 2008) that cess of Rs. 22.61 lakh had been recovered from 15 units in Maharashtra and Rs. 32.21 lakh had been recovered from 6 units in Himachal Pradesh. Show cause notices to 110 units in Maharashtra had been issued. Show cause notices in remaining two cases were in process of issue.

### *7.1.2 Textile machinery*

M/s Himson Textiles Engineering Industries Pvt. Ltd., Surat, M/s Trumac Engineering Company Ltd., Ahmedabad and M/s Alidhara Textool Engineering Pvt. Ltd., Silvasa in the state of Gujarat, manufactured and cleared textile machineries worth Rs. 384.86 crore between the period from

April 2002 to March 2007 but the applicable cess amounting to Rs. 19.24 lakh was not paid.

On this being pointed out (November 2007), the Ministry of Textiles stated (July 2008) that show cause notices had been issued to the assessees.

## 7.2 Non-recovery of education cess collected by assessee

By the Finance (No 2) Act, 2004, education cess, at the rate of two per cent of the aggregate of all duties of excise under the provisions of the Central Excise Act, 1944, or under any other law for the time being in force, was imposed with effect from 9 July 2004. This was in addition to any other duties of excise chargeable on such goods.

M/s Bharat Petroleum Corporation Ltd., in Indore commissionerate, functioning as a bonded warehouse from September 2003 and was paying excise duty on the removal of specified petroleum products to its own depots and other companies depots. The assessee removed petroleum products without payment of education cess of Rs. one crore during the period from 9 July 2004 to September 2004 whereas cess was collected from end users but was not remitted to the Government. The same was recoverable alongwith interest.

On this being pointed (August 2005), the department stated (June 2007) that no education cess was payable on the closing stock of 8 July 2004.

Reply of the department was not acceptable as the assessee had collected the education cess from end users and hence it was recoverable under section 11 D of the Central Excise Act.

Reply of the Ministry of Finance had not been received (December 2008).

## 7.3 Cess on cement not demanded

Under provisions of section 9(1) of the Industries (Development and Regulation) Act, 1951 and the Cement Cess Rules, 1993 made thereunder, cess is leviable at the rate of Re. 0.75 per tonne of cement manufactured and removed. The authority to collect such cess is vested with the Development Commissioner of Cement Industry, under the Ministry of Industry.

M/s Sanghi Industries Ltd., (Cement Division) in Gujarat, manufactured and removed 61,49,429 tonne of cement between 2003-04 and 2006-07 but did not pay cess amounting to Rs. 46.12 lakh. Similarly, M/s Kalyanpur Cements Ltd., in the state of Bihar manufactured and cleared 14.10 lakh tonne of cement during the years between 2004-05 and 2006-07 but cess of Rs. 10.58 lakh payable thereon was not paid. The department also did not demand the cess.

Thus, cess aggregating to Rs. 56.70 lakh was recoverable from both the assessees.

On this being pointed out (December 2007), the Ministry of Industry directed (January 2008) the District Collector (Kutch) to take effective steps to recover

the cess from the first assessee. Reply in the case of second assessee had not been received (December 2008).

## 7.4 Other cases

In 16 other cases involving non-levy of cess of Rs. 13.09 lakh the Ministries/department had accepted all audit observations and had reported full recovery.

# CHAPTER VIII
# NON-LEVY OF INTEREST AND PENALTY

Where any duty of excise has not been levied or paid or has been short levied or short paid or erroneously refunded, the person liable to pay duty as determined under section 11A, is in addition to the duty, liable to pay interest at the rate of 20 per cent per annum till 11 May 2000, 24 per cent with effect from 12 May 2000, 15 per cent with effect from 13 May 2002 and 13 per cent from 12 September 2003 under the relevant sections of the Central Excise Act, 1944. Some illustrative cases of non-levy of interest and penalty involving revenue of Rs. 1.93 crore are mentioned in the following paragraphs. These observations were communicated to the Ministry through five draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in four draft audit paragraphs with money value of Rs. 1.23 crore of which Rs. 0.65 crore had been recovered.

## 8.1 Non-recovery of interest

**8.1.1** Where the cenvat credit has been taken or utilised wrongly, the same along with the interest is to be recovered from the manufacturers under rule 14 of the Cenvat Credit Rules.

M/s BHEL Bhopal, in Bhopal commissionerate, engaged in manufacture of machines availed wrong/excess modvat/cenvat credit in five cases during the period from 1996 to 2002 on inputs/capital goods. The cases were decided in appeals by the Commissioner (Appeals) {in November 2005 (1 case), December 2006 (2 cases) and January 2007 (2 cases)} in favour of the department. Accordingly, the duty was to be paid with interest. Although the assessee paid back the wrong/excess credit availed but did not pay applicable interest amounting to Rs. 32.34 lakh. The department also did not demand interest.

On this being pointed out (February 2008), the department stated (May 2008) that the party had since paid an amount of interest of Rs. 4.87 lakh and the balance amount due was being recovered.

Reply of the Ministry had not been received (December 2008).

**8.1.2** Section 11AA of the Central Excise Act, 1944, provides that where a person chargeable with duty determined under section 11A fails to pay such duty within three months from the date of such determination, he shall pay, in addition to duty, interest at the specified rate on such duty from the date immediately after the expiry of the said period of three months till the date of payment of such duty. However, if the duties are determined before 26 May 1995 (viz. the date of enactment of Finance Bill, 1995) and any person fails to pay such duty within three months from the said date of enactment, then such person shall be liable to pay interest under this section from the date immediately after three months till the date of payment of such duty.

Audit observed that Bhubaneswar II commissionerate had confirmed a demand of Rs. 11.94 lakh on 30 November 1987 against M/s Orissa Industries Ltd. for non-payment of duty on refractory and refractory materials. The

assessee paid duty between 29 January 2002 and 11 August 2004 in installments. The interest which was leviable from 26 August 1995 to 10 August 2004 was neither paid by the assessee nor was it demanded by the department. This resulted in non-recovery of interest of Rs. 20.04 lakh.

On this being pointed out (November 2005), the Ministry accepted (July 2008) the audit observation. Report on recovery had not been received (December 2008).

## 8.2 Penalty on arrears of compounded levy

In terms of sub rule (3) of rule 96ZO (effective from 1 September 1997) of the Central Excise Rules, 1944, in the case of an assessee opting to work under the compounded levy scheme, based on the capacity of the furnace, the duty was required to be paid on monthly installments, so determined. In the event of failure to pay the said installments by due dates of the month, an interest at 18 per cent per annum was leviable. A penalty equivalent to the amount in arrears as on 30 April of each financial year was also leviable under the provisions of the said rule.

M/s Rama Steels Ltd., in Chandigarh I commissionerate, engaged in the manufacture of M.S. ingots (sub-heading 7206.90) was paying duty under the compounded levy scheme. The assessee was in arrears for installment payment every month and Rs. 70 lakh was outstanding for the year 1999-2000. Neither arrears of compounded levy were recovered with interest nor was action initiated for levying penalty of Rs. 70 lakh for the year 1999-2000.

On this being pointed out (December 2000 and August 2007), the department intimated (March 2008) that a show cause cum demand notice for penalty of Rs. 1.68 crore for delayed payment of installments during the period from 1997-1998 to 1999-2000 had been issued (January 2008) which was pending for adjudication. The department had also admitted the observation in an inter-departmental meeting (May 2008).

Reply of the Ministry had not been received (December 2008).

## 8.3 Other cases

In 58 other cases of non-levy of interest and penalty of Rs. 66.34 lakh, the Ministry/department had accepted all audit observations and had reported recovery of Rs. 56.42 lakh in 57 cases till December 2008.

# SECTION 2 – SERVICE TAX

# CHAPTER IX
# SERVICE TAX RECEIPTS

## 9.1 Tax administration

Service tax was introduced from 1 July 1994 through the Finance Act, 1994. Administration of service tax has been vested with the central excise department under the Ministry of Finance (the Ministry). The Central Board of Excise and Customs (the Board) has set up a separate apex authority headed by the Director General Service Tax (DGST) at Mumbai for the administration of service tax. Commissioners of central excise/service tax have been authorised to collect service tax within their jurisdiction.

## 9.2 Trend of receipts

Revenue projected through annual budget and actual receipts from service tax during the years 2003-04 to 2007-08 is exhibited in the following table and graph:-

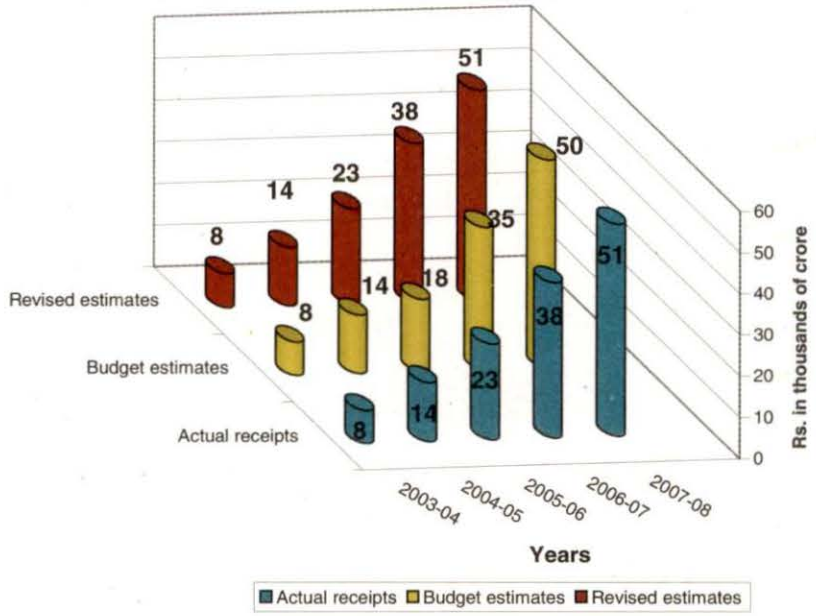
**Table no. 1**

**(Amounts in crore of rupees)**

| Year | No. of services subjected to service tax | Budget estimates | Revised budget estimates | Actual receipts* | Difference between actual receipts and budget estimates | Percentage variation |
|---|---|---|---|---|---|---|
| 2003-04 | 58 | 8,000 | 8,300 | 7,890 | (-) 110 | (-) 1.38 |
| 2004-05 | 71 | 14,150 | 14,150 | 14,199 | 49 | 0.35 |
| 2005-06 | 81 | 17,500 | 23,000 | 23,055 | 5,555 | 31.73 |
| 2006-07 | 97 | 34,500 | 38,169 | 37,598 | 3,098 | 8.98 |
| 2007-08 | 104 | 50,200 | 50,603 | 51,301 | 1,101 | 2.19 |

* Figures as per Finance Accounts

**Graph 1: Service Tax Receipts - Budget, Revised and Actual**



In 2004-05, 2005-06, 2006-07 and 2007-08 actual collections had been higher than the budget estimates by 0.35, 31.73, 8.98 and 2.19 per cent respectively.

## 9.3 Outstanding demands

The number of cases and amount involved in demands for service tax outstanding* for adjudication/recovery as on 31 March 2008 are mentioned in the following table:-

**Table no. 2**

**(Amounts in crore of rupees)**

| Pending decision with | As on 31 March 2007 | | | | As on 31 March 2008 | | | |
|---|---|---|---|---|---|---|---|---|
| | 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 |
| Adjudicating officers | 200 | 63,503 | 0.48 | 1,946.28 | 196 | 76,620 | 0.42 | 4,092.80 |
| Appellate Commissioners | 13 | 1,011 | 0.58 | 172.46 | 53 | 1,937 | 1.59 | 301.40 |
| Board | 0 | 11 | 0.00 | 0.98 | 0 | 6 | 0.00 | 0.04 |
| Government | 0 | 3 | 0.00 | 1.60 | 0 | 1 | 0.00 | 0.71 |
| Tribunals | 14 | 955 | 30.04 | 897.56 | 22 | 1,419 | 4.24 | 1,423.05 |
| High Courts | 12 | 104 | 4.35 | 43.82 | 8 | 155 | 1.37 | 66.56 |
| Supreme Court | 0 | 2 | 0.00 | 3.10 | 0 | 13 | 0.00 | 4.01 |
| Pending for coercive recovery measures | 83 | 18,313 | 6.50 | 293.25 | 5,056 | 14,414 | 11.17 | 456.66 |
| **Total** | **322** | **83,902** | **41.95** | **3,359.05** | **5,335** | **94,565** | **18.79** | **6,345.23** |

* Figures furnished by the Ministry

A total of 99,900 cases involving tax of Rs. 6,364.02 crore were pending as on 31 March 2008 with different authorities, of which 77 per cent in terms of number were with the adjudicating officers of the department. Pendency with these adjudicating officers had been increased from 63,703 in 2006-07 to 76,816 in 2007-08 i.e. an increase of 20.58 per cent and pendency for recovery of demands had increased from 18,396 cases in 2006-07 to 19,470 cases in 2007-08 i.e. an increase of 5.84 per cent.

## 9.4 Fraud/presumptive fraud cases

The position of fraud/presumptive fraud cases* alongwith the action taken by the department against defaulting assessees during the period 2005-06 to 2007-08 is depicted in the following table:-

**Table no. 3**

**(Amounts 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 |
| 2005-06 | 1,790 | 685.90 | 484.27 | 253 | 9.40 | 116.88 | 56 | 0.53 |
| 2006-07 | 2,466 | 591.50 | 287.29 | 413 | 56.24 | 235.65 | 90 | 2.77 |
| 2007-08 | 1,716 | 787.18 | 574.54 | 171 | 179.04 | 331.74 | 34 | 2.74 |
| **Total** | **5,972** | **2,064.58** | **1,346.10** | **837** | **244.68** | **684.27** | **180** | **6.04** |

* Figures furnished by the Ministry

The above data indicates that while a total of 5,972 cases of fraud/presumptive fraud were detected during the years 2005-08 by the department involving tax of Rs. 2,064.58 crore, it raised demand of Rs. 1,346.10 crore only and recovered Rs. 684.27 crore (50.83 per cent). Similarly, out of the penalty of Rs. 244.68 crore that was imposed, the department could recover only Rs. 6.04 crore (2.47 per cent).

## 9.5 Contents

This section contains 158 paragraphs featured individually or grouped together with a revenue implication of Rs. 276.72 crore. The Ministry/department had accepted (till December 2008) audit observations in 112 paragraphs involving Rs. 47.43 crore and had recovered Rs. 23.22 crore.

## 9.6 Impact of audit reports

### *9.6.1 Revenue impact*

During the last five years (including the current years' report), audit through its audit reports had pointed out short levy and other deficiencies with revenue implication of Rs. 726.34 crore in 434 audit paragraphs. Of these, the Government had accepted audit observations in 329 audit paragraphs involving Rs. 195.90 crore and had since recovered Rs. 63.92 crore. The details are shown in the following table:-

**Table no. 4**

**(Amounts in crore of rupees)**

| Year of Audit Report | Paragraphs included | | Paragraphs accepted | | | | | | Recoveries effected | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Pre printing | | Post printing | | Total | | Pre printing | | Post printing | | Total | |
| | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount | No. | Amount |
| 2003-04 | 20 | 17.56 | 19 | 17.25 | Nil | Nil | 19 | 17.25 | 2 | 0.33 | 5 | 0.41 | 7 | 0.74 |
| 2004-05 | 48 | 86.57 | 42 | 35.59 | Nil | Nil | 42 | 35.59 | 8 | 5.41 | 14 | 3.00 | 22 | 8.41 |
| 2005-06 | 83 | 266.47 | 38 | 28.40 | -- | -- | 38 | 28.40 | 20 | 7.38 | 5 | 1.06 | 25 | 8.44 |
| 2006-07 | 125 | 79.02 | 117 | 65.49 | 1 | 1.74 | 118 | 67.23 | 60 | 18.19 | 30 | 4.92 | 90 | 23.11 |
| 2007-08 | 158 | 276.72 | 112 | 47.43 | -- | -- | 112 | 47.43 | 57 | 23.22 | -- | -- | 57 | 23.22 |
| **Grand Total** | **434** | **726.34** | **328** | **194.16** | **1** | **1.74** | **329** | **195.90** | **147** | **54.53** | **54** | **9.39** | **201** | **63.92** |

### *9.6.2 Amendment to Act/Rules*

The Government had amended Act/Rules addressing the concerns raised by audit through audit reports. Some of these important changes are shown in the following table:-

**Table no. 5**

| Reference of audit report (AR) paragraph | Related issue raised in audit | Amendment to Act/Rules etc. |
|---|---|---|
| Paragraphs 18.1 of AR no.7 of 2007 and 10.3 of AR no. CA 7 of 2008 | Incorrect exemption availed of by the persons other than the goods transport agencies not fulfilling the conditions of the notification dated 3 December 2004. | Unconditional exemption provided by notification No.13 of 2008-ST dated 1 March 2008 from service tax upto 75 per cent of the gross amount charged as freight by GTA. |

| | Reference of audit report (AR) paragraph | Related issue raised in audit | Amendment to Act/Rules etc. |
|---|---|---|---|
| | Paragraphs 11.1 of AR no. CA 7 of 2008 | Utilisation of cenvat credit by output service provider in excess of the prescribed limit of 20 per cent in cases where input service credit was used in output services not chargeable to tax or exempt from tax without maintaining separate accounts of the use of input services. | Rule 6(3) has been amended to provide option either to pay amount at 8 per cent of the value of exempted services or to reverse proportionate credit attributable to inputs and input services used in exempted goods {Notification No.10/2008 CE (NT) dated 1 March 2008}. |

# CHAPTER X
# GRANT OF CENVAT CREDIT OF SERVICE TAX

Cenvat credit of service tax paid on input services was allowed for utilisation against the same output service with effect from 16 August 2002 under the Service Tax Credit Rules, 2002. From 10 September 2004, the said Rules were integrated with the Cenvat Credit Rules, 2004. Under Cenvat Credit Rules, the credit availed can be utilised for payment of central excise duty on finished goods or service tax payable on output services subject to fulfilment of certain conditions. A few cases of incorrect grant of cenvat credit involving tax of Rs. 177.55 crore, noticed in test check are described in the following paragraphs. Many of these observations relate to companies providing cellular services to public. These observations were communicated to the Ministry through 71 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 43 draft audit paragraphs with money value of Rs. 14.56 crore of which Rs. 4.71 crore had been recovered.

## 10.1 Utilisation of cenvat credit not restricted to prescribed limits

Rule 3 of the Cenvat Credit Rules, 2004, allows a provider of taxable service to take credit of specified duties and service tax paid on any input, input service or capital goods received in the premises of the provider of output service on or after 10th day of September 2004. Further, rule 6(3) of the Cenvat Credit Rules, 2004, provides that where a provider of output service avails of cenvat credit in respect of any inputs or input services and provides such output services which are chargeable to tax or are exempt and does not maintain separate accounts in respect of both category of services, then the provider of output service shall utilise credit only to the extent of an amount not exceeding twenty per cent (35 per cent prior to 10 September 2004) of the amount of service tax payable on taxable output service.

**10.1.1** M/s Vodafone Essar Digilink Ltd., and M/s Bharti Hexacom Ltd., in Jaipur I commissionerate, engaged in the activity of providing both taxable and exempted cellular phone services, availed cenvat credit on inputs, input services and capital goods. The assessees had not maintained separate account for inputs and input services used in the exempted and taxable services. The assessees provided taxable service on which tax payable was Rs. 103.06 crore during the period from April 2006 to March 2007. The assessees utilised credit of Rs. 74.46 crore as against the admissible limit of Rs. 20.61 crore (20 per cent of the tax payable). This resulted in excess utilisation of cenvat credit of Rs. 53.85 crore which was required to be recovered.

On this being pointed out (October 2007 and February 2008), the department stated (March 2008) that rule 6 imposed restriction for availing and utilisation of cenvat credit on inputs and input services only and not on capital goods.

The reply is not relevant as rule 6(3)(c) of the said Rules restricts utilisation of credit upto 20 per cent of the amount of service tax payable on output service. This means that the remaining eighty per cent of tax is to be paid from PLA/cash.

Reply of the Ministry had not been received (December 2008).

**10.1.2** M/s Vodafone Essar Cellular Ltd., Coimbatore, in Coimbatore commissionerate and M/s Bharti Airtel Ltd., Chennai in Chennai commissionerate, engaged in the activity of providing taxable as well as exempted telephone services did not maintain separate account of input services used for the taxable and exempted output services. However, during the period April 2005 to September 2007, the assessees had not restricted the utilisation of the cenvat credit to 20 per cent of the service tax liability. The service tax liability of the assessees for the said period was Rs. 78.36 crore and the admissible limit considering the 20 per cent cap worked out to Rs. 15.67 crore. However, the assessees had utilised credit of Rs. 59.21 crore resulting in excess utilisation of cenvat credit by Rs. 43.54 crore.

The observation was pointed out to the department/Ministry between December 2007 and May 2008; its reply had not been received (December 2008).

**10.1.3** M/s Vodafone Essar South Ltd, Chennai (previously M/s Hutchison Essar South Ltd.), in Chennai commissionerate, engaged in providing telephone service using common input services for taxable as well as exempted services, did not restrict utilisation of the cenvat credit to 20 per cent as envisaged in the foregoing rule. On this being pointed out by the department (September 2005), the assessee paid (December 2005) Rs. 84.89 lakh along with interest towards the excess utilisation of input credit for the period from September 2004 to May 2005. Verification of records by audit revealed that the service tax payable for the said period was Rs. 7.22 crore and after restriction of the utilisation of credit to 20 per cent, the tax payable in cash was Rs. 5.78 crore, whereas the amount paid in cash (including Rs. 84.89 lakh demanded and paid subsequently) was Rs. 4.65 crore. This resulted in short payment of Rs. 1.13 crore as tax, in cash.

Similarly, out of the service tax of Rs. 44.38 crore payable for the subsequent period from June 2005 to March 2007, the tax paid in cash was Rs. 21.50 crore as against Rs. 35.50 crore resulting in short payment of service tax in cash, by Rs. 14 crore. Thus, the total excess utilisation of cenvat credit amounted to Rs. 15.13 crore for the period from September 2004 to March 2007 which was required to be paid in cash. Interest, under section 75 of the Finance Act, 1994, was also recoverable.

On this being pointed out (December 2007 and February 2008), the department stated (March 2008) that the word 'credit' appearing in rule 6(3)(c) referred to credit of inputs and input services only and the restriction of 20 per cent utilisation was not applicable to the credit of capital goods and further stated that the order in original dated 3 January 2007, confirming demand of Rs. 84.89 lakh, passed by the commissioner, was legal and correct and was accepted by the reviewing authority.

Reply of the department is not relevant as rule 6(3) (c) of the Rules restricts utilisation of credit upto 20 per cent of the amount of service tax payable on output service. This means that the remaining eighty per cent of tax is to be paid from PLA or in cash. Further, audit had not questioned the legality and correctness of the order in original dated 3 January 2007 of the commissioner,

as an adjudicating authority cannot traverse beyond the demand raised in the show cause notice. Audit had only pointed out that the demand raised itself was short by Rs. 1.13 crore.

Reply of the Ministry had not been received (December 2008).

**10.1.4** M/s Spice Communication Ltd., (Mohali), in Chandigarh I commissionerate, was engaged in the activity of providing taxable as well as exempted cellular phone (mobile phone) services and was not maintaining separate accounts in respect of both categories of services. The assessee received Rs. 473.04 crore towards taxable services provided to subscribers during 2006-07 on which service tax of Rs. 57.38 crore was payable. The assessee was entitled to utilise cenvat credit to the extent of Rs. 11.47 crore only and balance of Rs. 45.91 crore was required to be paid in cash. The assessee, however, utilised cenvat credit of Rs. 24.89 crore (Rs. 11.17 crore on inputs plus Rs. 13.72 crore on capital goods) and deposited balance of Rs. 32.49 crore in cash. This resulted in excess utilisation of cenvat credit of Rs. 13.42 crore (Rs. 24.89 crore minus Rs. 11.47 crore) which was required to be recovered along with interest.

On this being pointed out (November 2007), the department stated (May 2008) that cenvat credit on capital goods was not covered under the 20 per cent limit.

The reply of the department was not relevant because under rule 6(3)(c) of the Cenvat Credit Rules 2004, the provider of output service was required to utilise credit only to the extent of an amount not exceeding 20 per cent of the amount of service tax payable on taxable output service.

Reply of the Ministry had not been received (December 2008).

**10.1.5** M/s Bharti Airtel Ltd., (formerly known as Bharti Infotech Ltd.), Bhopal, in Bhopal commissionerate, engaged in providing telephone and leased circuit services, availed of cenvat credit on inputs, capital goods and input services used for providing taxable as well as exempted services. The assessee, however, utilised cenvat credit exceeding 20 per cent of their tax liability towards taxable output service which was incorrect. This resulted in excess utilisation of cenvat credit of Rs. 12.05 crore during the period from April 2006 to March 2007, which was required to be paid in cash. The assessee was also liable to pay interest under rule 14 of the said Rules.

On this being pointed out (March 2008), the department stated (May 2008) that show cause notice was under issue.

Reply of the Ministry had not been received (December 2008).

**10.1.6** M/s Bharat Sanchar Nigam Ltd., Ernakulam, in Cochin commissionerate, availed of cenvat credit of service tax paid on input services and excise duty paid on capital goods. The assessee did not maintain separate accounts and hence was entitled to utilise cenvat credit only to the extent of twenty per cent of the tax liability. However, the assessee, utilised cenvat credit in excess of 20 per cent between July 2006 and August 2006. The credit utilised in excess amounted to Rs. 1.36 crore, which was recoverable with interest.

On this being pointed out (January 2007), the department stated (January 2008) that the restriction for using 20 per cent of cenvat credit for payment of

service tax applied only for credit on inputs and input services and the assessee had availed credit in excess of 20 per cent on capital goods only which was governed by rule 4(2)(a) and rule 6(4) of the Cenvat Credit Rules, 2004.

Reply of the department was not acceptable in view of the explicit provisions of rule 6(3)(c) which restricts utilisation of credit to the extent of twenty per cent of the tax payable on taxable output service.

Reply of the Ministry had not been received (December 2008).

**10.1.7** M/s Vodafone (Hutchison Essar South) Ltd., in Hyderabad II commissionerate, engaged in providing cellular phone services, availed of cenvat credit on several inputs, input services and capital goods which were used by them for rendering both taxable and exempted output services. The assessee had not maintained separate accounts for inputs/input services used in exempted services and yet did not restrict the cenvat credit utilisation to the extent of 20 per cent (35 per cent prior to 10 September 2004) as required under the Rules. Non-observance of the prescribed ceiling limits led to excess utilisation of credit of Rs. 1.20 crore, during the periods between July 2003 and February 2005. This amount was required to be paid in cash.

On this being pointed out (November 2007), the department stated (March 2008) that the ceiling limits prescribed in the rules do not apply to capital goods credit and hence capital goods credit in its entirety was available for utilisation to the assessee. After setting off the excess utilised amounts against short utilisation during subsequent months including capital goods credit, interest to the extent of Rs. 0.47 lakh was recovered for the period of delay in adjustment.

The reply of the department was not relevant as rule 6(3)(c) imposed restriction on the utilisation of cenvat credit with reference to the tax liability of output service which represents not only inputs/input service credit but also credit earned on capital goods. The adjustments allowed by the department between excess utilisation in a month against short utilisation during subsequent month by including the entire amount of capital goods credit was not correct as such an arrangement was not contemplated in the Rules and hence the entire excess credit of Rs. 1.20 crore needs to be recovered along with interest and penalty.

Reply of the Ministry had not been received (December 2008).

**10.1.8** M/s Idea Celluar Ltd., in Hyderabad II commissionerate, engaged in providing cellular phone services availed of cenvat credit on several inputs, input services and capital goods which were used by them for rendering both taxable and exempted output services. The assessee had not maintained separate accounts for input goods/input services used in exempted services and yet did not restrict the cenvat credit utilisation to the extent of 20 per cent (35 per cent prior to 10 September 2004) as required under the Rules. Non-observance of the above ceiling limits led to excess utilisation of credit of Rs. 1.02 crore between September and December 2004 which needs to be recovered alongwith interest and penalty.

On this being pointed out (December 2007), the department stated (July 2008) that the ceiling limits prescribed in the rules do not apply to capital goods

credit and hence capital goods credit in it's entirety was available for utilisation. It also stated that after setting off the excess utilised amounts against short utilisation during subsequent months including capital goods credit, interest of Rs. 1.98 lakh was recoverable for the period of delay in adjustment.

The reply of the department was not acceptable as adjustment of excess utilisation in a month against short utilisation during subsequent month was not contemplated in the Rules. Further, the contention of the department that the restriction was not applicable to capital goods credit was also not acceptable as rule 6(3)(c) of the Cenvat Credit Rules imposed restriction on the utilisation of cenvat credit which represented not only input goods/input services credit but also credit earned on capital goods.

Reply of the Ministry had not been received (December 2008). However, the Ministry had admitted similar audit observations reported vide paragraph No.11.1.2 of Audit Report No.CA 7 of 2008.

## 10.2 Cenvat credit of service tax paid on transportation services beyond the place of removal

Under the provisions of rule 3 of the Cenvat Credit Rules, 2004, a manufacturer is allowed to take credit of service tax paid on any 'input service' used in the manufacture of final goods. Service tax paid by the manufacturer for outward transportation of final products beyond the place of removal is not an input service and credit of tax paid on such service is not admissible.

Forty assessees in Bangalore (1), Cochin (2), Delhi III (4), Delhi IV (3), Guntur (1), Hyderabad I (3), Haldia (1), Jaipur II (1), Kolkata VI (1), Madurai (1), Mumbai II (1), Mumbai III (1), Nagpur (5), Patna (1), Pune III (1), Salem (2), Surat II (4), Thane I (3), Trichy (2), Tirunaveli (1) and Vadodara (1) commissionerates, engaged in manufacture of various excisable goods availed cenvat credit of service tax paid on transportation of goods from the factory gate to the customer's premises or from the depot to the customer's premises. However, cenvat credit was also availed of on the service tax paid on outward transportation of the goods exported beyond the place of removal. Availing of cenvat credit was not correct as the sales in these cases were effected at the factory gate or depot. This resulted in incorrect availing of cenvat credit of Rs. 11.27 crore between January 2005 and August 2007. This was recoverable with interest and penalty.

On this being pointed out (between April 2005 and March 2008), the Ministry admitted audit observations in sixteen cases and stated (between June and September 2008) that tax of Rs. 85.37 lakh and interest of Rs. 15.28 lakh had been recovered from seven assessees. It further stated that demand for Rs. 1.80 crore in five cases had been confirmed and show cause notices for Rs. 1.82 crore to five assessees had been issued. In one case relating to Salem commissionerate, the Ministry while reporting confirmation of demand stated that the matter was already in its knowledge.

The reply with respect to Salem commissionerate is not acceptable as the objection was discussed with the department in August 2007 and show cause

notice was issued thereafter in September 2007. Reply in the remaining cases had not been received (December 2008).

## 10.3 Cenvat credit on input services used in non-taxable output services

Rule 3 of the Cenvat Credit Rules, 2004 allows credit of duty on input services used by a service provider for rendering of any taxable output service. The rules also allow credit on common input services used by a service provider for providing taxable services/export services and also exempted services subject to observance of certain conditions/limitations on utilisation of credit. The term 'exempted services' as defined in rule 2(e) of the said Rules means taxable services which are exempt from the whole of the service tax leviable thereon and also include services on which no service tax is leviable under section 66 of the Finance Act, 1994. Section 66 extends its scope of levy only to those services which are notified under section 65 of the Act.

Information technology (IT) services are not covered under section 65 and hence they are not to be regarded either as taxable services or as exempted services for the purpose of allowing cenvat credit on corresponding input services.

M/s Satyam Computer Services Ltd., in Hyderabad II commissionerate, engaged in providing consulting engineers services, man power recruitment agency services etc., availed of cenvat credit on several input services and used such services for rendering taxable as well as non-taxable services (i.e. software development services relating to information technology to various agencies located within and outside India). Service tax credit on input services used in IT services rendered within India/exported out of India was not admissible as IT services cannot be regarded as output services/export of taxable services within the meaning of rule 2(p) of the Cenvat Credit Rules/rule 3 of the Export of Services Rules, 2005. However, the assessee incorrectly availed credit of the service tax paid on input services used for IT services. The credit attributable to such ineligible IT services for the period 2004-05 to 2006-07 worked out to Rs. 8.81 crore.

On this being pointed out (December 2007), the department stated (March 2008) that a service provider who provided both taxable services and non-taxable services (i.e. not covered under service tax act) was not prohibited from availing full credit on common inputs/input services if the utilisation of credit was limited to 20 per cent of the tax payable as laid down in rule 6(3)(c) of the Cenvat Credit Rules. It also argued that availing of credit on common input goods/input services used in software development services for home consumption/export was permissible under cenvat provisions since these input services were not utilised exclusively for such exempted services.

The reply of the department was not acceptable as the enabling provisions contained in section 94(2)(ccc) of the Finance Act, 1994/section 37(2)(xvia) of the Central Excise Act, 1944, under which cenvat credit rules were framed, limit the scope of cenvat benefits only to taxable services and not to services which are outside the purview of the Finance Act. The term 'exempted services' as defined in rule 2(e) of the said rules covered only taxable services

which were covered by section 65 of the Finance Act but were not chargeable with service tax because of exemption. The interpretation given by department for the definition of exempted services was not correct as the word 'includes' appearing in rule 2(e) should not be read in isolation but should be read in conjunction with the word 'taxable services'. The provisions of the Finance Act, 1994 or the Cenvat Credit Rules could not have application to a service which was outside the scope of the Finance Act and hence the credit availed on corresponding input services used in software development services needs recovery along with interest.

Reply of the Ministry had not been received (December 2008).

***Audit recommends that Government should amend the Finance Act to include 'IT services' in the list of services which are liable to service tax.***

## 10.4 Absence of provisions for recovery of cenvat credit on input services contained in written off output services

The Cenvat Credit Rules, 2004, allows credit on input services used by a service provider for rendering of output service and utilise such credit towards payment of service tax on output service. The amounts billed for by the service provider against customer but not realised are not liable to service tax under the Finance Act, 1994, as the basis for payment of service tax is actual realisation of cost of service. However, where the cost of service billed for became irrecoverable for any reason and the same was written off fully in the books of accounts of an assessee, the Cenvat Credit Rules do not provide for recovery of the input service credit attributable to such write off.

Rule 3(5C) of the Cenvat Credit Rules, 2004, provide recovery of cenvat credit on inputs contained in final products destroyed or damaged due to natural cause (prior to this recovery was made under Board's circular of 22 February 1995).

10.4.1 M/s Vodafone India Ltd., (Hutchison Essar South Ltd.), M/s Bharti Airtel Ltd., and M/s Karvy Stock Broking Pvt. Ltd., in Hyderabad II commissionerate and M/s Vodafone Essar Cellular Ltd., Ernakulam, M/s Idea Cellular Ltd., and Bharti Airtel Ltd., in Cochin commissionerate, engaged in rendering of cellular phone services and stock broking services, had fully written off unrealised amount of service charges of Rs. 124.76 crore pertaining to the period from April 2004 to March 2007. The corresponding cenvat credit of Rs. 2.60 crore, attributable to input services against the above write off was not paid back even though the services to that extent did not suffer service tax.

On this being pointed out (between October 2007/May 2008), the department in respect of assessees in Hyderabad II commissionerate stated (February/March 2008) that as per rule 3(5B) of the Cenvat Credit Rules, reversal of credit was warranted only when inputs or capital goods were written off fully before being put to use, whereas the input services in the instant cases were already consumed in taxable services and input services, unlike inputs or capital goods being intangible, reversal provisions were not applicable to these. The department in respect of assessees in Cochin

commissionerate stated (July 2008) that the restriction of utilisation of cenvat credit was applicable only if the final service was exempt.

The reply of the department was not acceptable as cases of write off of output services could not be dealt with differently either because the input services were intangible in nature or because such services were already consumed in the taxable services rendered. Since output goods and output services stand on same footing under Cenvat Credit Rules, cenvat benefits could not be extended to a service on which service tax was not realisable/paid.

Reply of the Ministry had not been received (December 2008).

**10.4.2** M/s. BPL Mobile Communications Ltd., and M/s Vodafone India Ltd., in Mumbai commissionerate of service tax, engaged in rendering cellular phone services had shown an amount of Rs. 142.97 crore as dues pertaining to post paid cellular services billed against customers but not realised for the period 2004-05 to 2006-07. Further, the assessees had fully written off such dues. The corresponding credit attributable to input services against the above write off was Rs. 1.84 crore which was required to be recovered with interest.

On this being pointed out (May 2008), the department stated (September 2008) that there was no provision in the rules to restrict the cenvat credit for written off amount.

Reply of the department was not acceptable as the assessee had fully written off the amount billed as it had become irrecoverable, therefore, service tax was not payable on those output services and hence credit availed on input services used for such output services was recoverable.

Reply of the Ministry had not been received (December 2008).

***Audit recommends that Government should introduce appropriate provision in the Cenvat Credit Rules to require reversal of cenvat credit on input services used for written off output services.***

## 10.5 Credit on invalid documents

Rule 9 (1) (f) of the Cenvat Credit Rules, 2004 envisages that the cenvat credit shall be taken by the provider of output service on the basis of an invoice, a bill or challan issued by an input service provider on or after 10th day of September 2004.

**10.5.1** M/s Kitchen Appliances India Ltd., in Kolkata III commissionerate, engaged in the manufacture of colour TV, DVD and refrigerator, availed of input service credit on different category of services on the basis of invoices/bills/challans which were invalid. Audit observed that some of these tax paying documents had not been addressed to the recipient unit at Salt Lake while some other documents had not originated from/distributed by any registered input service distributor on behalf of the company. The assessee had also utilised the credit so taken, incorrectly. This resulted in incorrect availing of input service credit of Rs. 1.47 crore during the period from July 2005 to October 2006.

On this being pointed out (December 2006), the department admitted the audit observation and intimated (August 2007) that a demand for Rs. 2.05 crore had

been issued covering the period from April 2004 to March 2007. Further developments in the case had not been intimated (December 2008).

Reply of the Ministry had not been received (December 2008).

10.5.2 M/s Bharti Hexacon Ltd., in Jaipur I commissionerate, engaged in the activity of providing cellular phone service, availed of cenvat credit of service tax of Rs. 99.98 lakh on the basis of debit notes issued in favour of the assessee for call site sharing expenses and leasing bandwidth on different routes in Rajasthan. The availing of service tax credit on the basis of debit notes was incorrect as the same were not specified documents for availing of credit of service tax.

On this being pointed out (October 2007 and February 2008), the department stated (April 2008) that the assessee had taken credit on the basis of invoices issued by the service provider.

Reply of the department was not acceptable as debit notes were produced to audit in support of claim of cenvat credit. Further, invoices and debit notes were two independent instruments for calling/getting payment from their customers, clients etc., which could not be raised simultaneously for a single transaction. On being pointed out by audit, the word "debit note" was replaced by 'invoice' on these debit notes and deemed converted into invoices which did not bear the serial number as per instructions contained in paragraph 3.2 of the Board's central excise manual.

Reply of the Ministry had not been received (December 2008).

## 10.6 Cenvat credit on ineligible services

Rule 3 of the Cenvat Credit Rules, 2004, provides that a manufacturer of final products may take credit of service tax paid on any input service received if such service is used in the manufacture of final products. As per rule 2(l)(ii) of the said Rules, the term 'input service' for purpose of allowing credit inter-alia, includes activities relating to business such as accounting, financing, credit rating, share registry, security and inward transportation of inputs etc. Welfare measures such as health insurance coverage, canteen facilities, etc., extended by employer to employees do not come within the ambit of input service.

10.6.1 M/s Federal Mogul Goetze (India) Ltd., in Chandigarh, M/s Dr. Reddy's Laboratory Ltd. in Hyderabad I, M/s Family Health Plan Ltd. and M/s Aurobindo Pharma Ltd. (Unit I) in Hyderabad II, M/s Microsystems India Ltd. and M/s Tecumseh Products India Ltd., in Hyderabad IV and M/s Bharat Forge Ltd., in Pune III commissionerates, engaged in the manufacture of various excisable goods/providing insurance auxiliary services, availed of cenvat credit of Rs. 1.65 crore towards service tax paid during the period between April 2003 and March 2008 on medical insurance premia for employees, catering services offered to their employees, event management and investment advisory services etc. The availing of service tax credit on these services was incorrect as such services fell outside the scope of input service.

On this being pointed out (between March and December 2007), the Ministry admitted the audit observations in five cases and intimated (between June and November 2008) recovery of Rs. 15.51 lakh, confirmation of demands of Rs. 22.71 lakh and issue of show cause notice for Rs. 7.53 lakh. Reply in the remaining two cases had not been received (December 2008).

**10.6.2** The Board clarified on 17 March 2006 that service tax paid on erection and commissioning and maintenance of wind mill is not eligible for cenvat credit as no nexus exists between wind mill and production process, where wind mills are located outside the factory premises.

M/s Ashok Leyland Ltd., in Chennai I commissionerate, engaged in the manufacture of motor vehicle chassis, paid leasing rentals for the windmills, situated in Coimbatore and Tirunelveli districts and operation and maintenance charges for the wind farm located at Gudimangalam in Coimbatore district. The assessee paid service tax of Rs. 50.48 lakh during the period 2006-07 on lease rentals, operation and maintenance charges, and availed cenvat credit, which was not correct.

On this being pointed out (September, October and November 2007), the Ministry admitted the audit observation and reported (June 2008) that show cause notice for Rs. 50.48 lakh had been issued.

## 10.7 Cenvat credit utilised for payment of tax on input services

Rule 3 (4) (e) of the Cenvat Credit Rules, 2004, allows the cenvat credit of service tax paid on input services for utilisation against service tax payable on output services.

Ten assessees one each in Ahmedabad, Chennai and Mumbai commissionerates of service tax, one each in Chennai III, Delhi III, Jalandhar, Panchkula and three in Delhi IV commissionerates of central excise, engaged in the manufacture of various excisable goods, availed of cenvat credit of duty paid on input goods/capital goods and also service tax paid on various input services. The assessee utilised the cenvat credit for payment of service tax liability towards the goods transport agencies services availed for inward transport of input goods/capital goods. This was not in order as the assessees were not output service provider. The assessee ought to have paid the service tax relating to the said services by cash. Cenvat credit of Rs. 1.11 crore, incorrectly utilised for payment of service tax on the said input services between the period from October 2004 and November 2007 was required to be recovered along with interest.

On this being pointed out (between July 2006 and February 2008), the Ministry admitted the audit observation in two cases and stated (June 2008) that demand of Rs. 37 lakh had been confirmed against both the assessees. Reply in the remaining eight cases had not been received (December 2008).

## 10.8 Cenvat credit relating to other unit

Rule 2 (l) of the Cenvat Credit Rules, 2004, defines input service as any service used by the manufacturer, whether directly or indirectly, in or in

relation to the manufacture of final products and clearance of final products from the place of removal.

M/s TVS Motors Ltd., Hosur, in Chennai III commissionerate, manufacturing mopeds, scooty and motor cycles availed of cenvat credit of Rs. 2.58 crore during 2004-05 on the service tax paid on the input services which were common to both the units of the assessee at Hosur and Mysore. From April 2005, the assessee transferred the cenvat credit of service tax paid on the input services, relating to the Mysore unit, proportionately at 38 per cent, calculated on the basis of sale value of clearance of vehicles from Mysore unit. However, no such transfer was made for the period from 10 September 2004 to 31 March 2005, which resulted in the incorrect availing of cenvat credit of Rs. 98.15 lakh.

On this being pointed out (February and March 2006), the department while admitting the audit observation (April and October 2006) stated that the inadmissible credit worked out to Rs. 1.15 crore which had been recovered in December 2006. Report on recovery of interest had not been received (April 2008).

Reply of the Ministry had not been received (December 2008).

### 10.9 Cenvat credit availed but prescribed amount not paid on exempted final product

Rule 6 of the Cenvat Credit Rules, 2004, stipulates that where a manufacturer avails of cenvat credit in respect of input goods or input services and manufactures such final products which are chargeable to duty as well as exempted goods, then the manufacturer shall maintain separate accounts for receipt, consumption and inventory of input goods and input services used in the manufacture of dutiable and exempted goods. If the exempted goods are other than those specified in sub-rule 3(a) of rule 6 and the manufacturer opts not to maintain separate accounts, then the manufacturer shall pay an amount equal to ten per cent of the sale price of the final goods.

M/s Bayer Crop Science Ltd., in Thane I commissionerate, engaged in the manufacture of both dutiable and exempted goods under chapters 30 and 38, cleared resochin under tariff sub-heading 30049056 valued at Rs. 8.07 crore during financial years 2005-06 and 2006-07 without payment of duty. The assessee had availed cenvat credit on common input services such as telephone and pager services, courier services, inward freight etc., and utilised the credit towards payment of duty on the dutiable goods. Since the assessee had not maintained separate account for common input services, the assessee was liable to pay an amount equal to ten per cent of the value of such exempted clearances. This resulted in non-payment of duty of Rs. 92.44 lakh including interest upto December 2007.

On this being pointed out (June 2007), the Ministry admitted the audit observation (July 2008) and intimated that show cause notice was under issue.

## 10.10 Cenvat credit on service tax received prior to 10 September 2004

Rule 3(1) of the Cenvat Credit Rules, 2004, provides that a manufacturer or producer of final products or a provider of taxable service shall be allowed to take credit of service tax paid on any input service received by the manufacturer of final product on or after the 10th day of September 2004.

M/s Phillips Carbon Black Ltd., M/s TFL Quinn India Ltd., M/s NRB Bearings Pvt. Ltd., M/s Hindalco Industries Ltd., and M/s Hindustan Petroleum Corporation Ltd., in Bolpur, Hyderabad I, III, Vadodara II and Visakhapatnam I commissionerates respectively, availed of cenvat credit on several input services which were received prior to 10 September 2004. Since services received prior to 10 September 2004 were not eligible for cenvat credit, availing of cenvat credit of Rs. 86.94 lakh upto 9 September 2004 was incorrect.

On this being pointed out (between May 2006 and January 2008), the Ministry admitted the audit observation in two cases and stated (June and July 2008) that the tax of Rs. 16.03 lakh had been recovered in one case and a show cause notice for Rs. 41.40 lakh had been issued in another case. Reply in the remaining three cases had not been received (December 2008).

## 10.11 Utilisation of cenvat credit paid on behalf of foreign service providers

Section 66(A) of the Finance Act, 1994, read with Taxation of Services (provided from outside India and received in India) Rule, 2006, stipulates that where any service specified in clause (105) of section 65 is provided by a person who has business or establishment or place of residence, in a country other than India, and received by a person who has business or establishment, or place of residence in India and such service shall, for the purpose of this section, be taxable service, and such taxable service shall be treated as if the recipient had himself provided the service in India.

Again, rule 3(1) (ix) of the Cenvat Credit Rules, 2004, provides that a manufacturer or producer of final products shall be allowed to take credit of the service tax leviable under section 66 of the Finance Act.

It, therefore, follows from the above that cenvat credit of service tax paid under section 66 A is not admissible to any manufacturer of final products.

M/s Vesuvious India Ltd., and M/s Areva T and D India Ltd., in Kolkata VI commissionerate, engaged in the manufacture of excisable products received taxable services provided by foreign consultants/companies. The records disclosed that both the assessees had paid service tax under section 66A on the services provided from outside India and received in India and took credit of the tax thus paid and utilised the credit against duty payable on final goods. Since provisions of the Act and Rules above did not allow such credit of service tax levied under section 66A of the Act, the availing of cenvat credit of Rs. 71.95 lakh during the period between July 2006 and October 2007 was not correct.

On this being pointed out (January 2008), the department admitted the audit observation in one case and stated (April 2008) that a show cause notice was under issue. Reply to the other case had not been received (December 2008).

Reply of the Ministry had not been received (December 2008).

## 10.12 Other cases

In 19 other cases of grant of cenvat credit involving tax of Rs. 2.94 crore, the Ministry/department had accepted all audit observations and had reported recovery of Rs. 2.02 crore in 18 cases till December 2008.

# CHAPTER XI
# NON-LEVY/NON-PAYMENT OF SERVICE TAX

Service tax is levied on specified services. The rate of tax has been fixed at 5 per cent upto 13 May 2003, 8 per cent from 14 May 2003, 10 per cent from 10 September 2004 and 12 per cent from 18 April 2006.

A few illustrative cases of non-levy/non-payment of service tax totalling Rs. 79.28 crore noticed in test check are mentioned in the following paragraphs. These observations were communicated to the Ministry through 68 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 55 draft audit paragraphs with money value of Rs. 15.68 crore of which Rs. 5.10 crore had been recovered.

## 11.1 Services rendered by indigenous service providers

### *11.1.1 Construction of buildings*

All commercial and industrial constructions have been brought under the purview of service tax with effect from 16 June 2005. As per section 65(25b) of the Finance Act, 1994, commercial or industrial construction service, inter-alia, covers construction of a new building or a civil structure or part thereof, and construction of a pipeline or conduit which is used or to be used primarily for commerce or industry or work intended for commerce or industry but does not include services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams. Construction of power plants, oil and gas extraction plants, and refineries etc. fall within the ambit of the definition of commercial and industrial constructions, as these establishments are primarily intended for carrying on business or commerce.

M/s Larsen & Toubro Ltd., in Hyderabad II commissionerate, entered into a contract with M/s Reliance Industries Ltd., during 2006 for construction of a gas extraction and purification plant in Krishna Godavari Basin near Kakinada in Andhra Pradesh. The terms of agreement inter-alia, envisage construction of onshore terminal and infrastructure work consisting of pig receivers, slag catchers, inlet separators, gas dehydration system, laying of under water pipe lines for gas extraction etc., besides civil works such as office buildings, warehouses, approach roads, access and fly over bridges and road widening. During the period from September 2006 to October 2007, the assessee received a total consideration of Rs. 136.75 crore for the above work but applicable service tax of Rs. 16.74 crore was not paid.

On this being pointed out (November 2007), the department stated (April 2008) that the issue was in the knowledge of the department and that the Directorate General of Central Excise Intelligence, Chennai Zonal unit had sent a communication on 28 February 2008 stating that the investigation into the case was in advanced stage after which a demand notice would be issued to the assessee.

The reply of the department is not acceptable as at the time when audit had raised the issue in November 2007, the department could not produce any proof that the matter was under investigation and also no demand notice was

issued to the assessee. Further more, as per the letter received from Directorate General of Central Excise Intelligence (February 2008), the preliminary report itself was communicated to the commissionerate in January 2008 and the matter was reported to be still under investigation. Further developments in the case had not been received (April 2008).

Reply of the Ministry had not been received (December 2008).

### *11.1.2 Intellectual property service*

Section 65 (55b) of the Finance Act, 1994, defines 'intellectual property service' to mean transferring temporarily or permitting the use of any intellectual property right. It also means any right to intangible property viz. trade marks, designs, patents or any other similar intangible property.

**11.1.2.1** M/s Air India Ltd., in Mumbai commissionerate of service tax, entered into an agreement with M/s Air India Charter Ltd., (AICL) in February 2006 for allowing AICL to operate low cost carrier flights on certain route network. Air India allowed AICL to use Air India's international flight rights, its brand name 'Air India' and its domain knowledge. In lieu of this, AICL was required to pay a royalty of 25 per cent of the scheduled service revenue collected on low cost carrier flights. The arrangement was for a temporary usage of such rights and brand name and was effective till March 2008. The assessee collected an amount of Rs. 99.63 crore as royalty from AICL during the year 2005-06 but service tax of Rs. 10.16 crore was not paid which was recoverable with interest and penalty.

This was pointed out to the Ministry/department in November 2007; its reply had not been received (December 2008).

**11.1.2.2** M/s Jagatjit Industries Ltd., Hamira, in Jalandhar commissionerate, permitted the use of its trade mark and other intellectual property rights to fourteen manufacturing units of Indian Made Foreign Liquor (IMFL). Under the agreement entered between the assessee and the IMFL manufacturing units, the technical personnel of the assessee company were to check the quality of liquor manufactured by the IMFL manufacturing units and test the quality of raw material and other products used by them. During the financial year 2005-06, the assessee received Rs. 10.95 crore from these units but the applicable service tax of Rs. 1.12 crore was not paid which was recoverable with interest and penalty.

On this being pointed out (March 2007), the department stated (September 2007) that a show cause notice demanding service tax of Rs. 3.79 crore for the period from 2004-05 to 2006-07 was under issue.

Reply of the Ministry had not been received (December 2008).

### *11.1.3 Software and related services*

**11.1.3.1** Maintenance or repair service was subjected to service tax with effect from 1 July 2003. Maintenance of computer software was exempted from levy of service tax vide notification dated 21 August 2003.

The department clarified on 17 December 2003 that computer software was not liable to service tax as the same was not goods. However, the Supreme Court in its judgement in the case of M/s Tata Consultancy Services {2004

(178) ELT 22} held that software falls within the definition of goods. The Board vide circular dated 7 October 2005 and 7 March 2006 clarified that maintenance or repair or servicing of software was leviable to service tax with effect from 9 July 2004 i.e. the day exemption notification dated 21 August 2003 was rescinded.

M/s IBM India Pvt. Ltd., Bangalore, in Bangalore commissionerate of service tax, providing software maintenance services, collected service charges of Rs. 33.49 crore from its clients during the period from 9 July 2004 to 7 October 2005. However, service tax of Rs. 3.41 crore leviable thereon was not paid. The department also did not take any action to recover the tax.

On this being pointed out (March 2008), the department stated (May 2008) that tax was not recoverable as the action to recover the revenue for the past period was not possible as intent to evade duty on the part of the assessee could not be alleged.

The fact remains that failure to take timely action resulted in loss of revenue. The notification dated 21 August 2003 was withdrawn on 9 July 2004 and the Board had clarified on 7 October 2005 and again on 7 March 2006 that tax was leviable from 9 July 2004. Hence, the department should have initiated action to protect Government revenue.

Reply of the Ministry had not been received (December 2008).

**11.1.3.2** On line information and data base access or retrieval service has been subjected to service tax with effect from 16 July 2001. Section 65 of the Finance Act, 1994, defines 'on line information and data base access or retrieval service' as any service provided to a customer by a commercial concern, in relation to on line information and data base access or retrieval or both in electronic form through computer network in any manner

M/s United Telecom Ltd., Bangalore, in Bangalore commissionerate of service tax, entered into a contractual agreement with Andhra Pradesh Technology Services (APTS), an Andhra Pradesh State Government Undertaking, during February 1999, for providing 'on line information and data base access or retrieval services'. The agreement, inter-alia, included providing a back bone network for data, video and voice communication throughout the state and district headquarters for application, including video conferencing, voice and data communication services to APTS. The assessee received a sum of Rs. 13.52 crore as service charges from the State Government of Andhra Pradesh, for the period from July 2001 to August 2004. Audit observed that the assessee had neither registered itself under service tax nor did it pay the applicable service tax of Rs. 88.67 lakh. Penalty and interest were also leviable.

On this being pointed out (December 2006), the Ministry admitted the audit observation and stated (June 2008) that the demand for Rs. 88.67 lakh raised against the assessee had been confirmed (March 2007) alongwith interest and penalty but CESTAT has stayed recovery.

### *11.1.4 Drilling, boring and core extraction services*

Services relating to site formation and clearance, excavation and earthmoving have been brought under service tax net with effect from 16 June 2005. As

per section 65 (97a) of the Finance Act, 1994, the said services inter alia, cover drilling, boring and core extraction services for construction or similar purposes, soil stabilisation, contaminated top soil stripping work etc.

M/s Essar Constructions (India) Ltd., in Visakhapatnam I commissionerate, engaged in construction services, entered into two separate agreements during 2006-07 with M/s National Mineral Development Corporation Ltd., (NMDCL) and M/s Essar Steels Ltd., for execution of certain earth work. The work order placed on M/s NMDCL envisaged excavation and removal of deposited slime in dry or wet condition from the Kadampal tailing dam including all lifts by mechanical means and transporting it upto a lead of 6 kilometres besides loading, unloading, leveling of soils etc. The scope of the other work order with M/s Essar Steels Ltd., included clearing of jungle, trees, excavation of soft/hard rock, excavation in borrow soils, providing and laying of stone pitching, providing graded crushed rock filter/sand filter etc., for tailing dam II at Padapur. During the period from January to April 2007, the assessee received a total consideration of Rs. 6.33 crore for the works executed but did not pay the applicable service tax of Rs. 78.21 lakh due thereon.

On this being pointed out (November 2007), the department stated (April 2008) that a show cause notice demanding service tax of Rs. 78.21 lakh besides interest and penalty had been issued in March 2008.

Reply of the Ministry had not been received (December 2008).

### *11.1.5 Goods transport agency services*

**11.1.5.1** Rule 2(1)(d)(v) of the Service Tax Rules, 1994, stipulates that the recipient of goods transport agency services is liable to pay service tax if recipient of service is a factory, a company, a corporation, a co-operative society etc.

M/s The Chittoor Co-operative Sugars Ltd., and M/s S.V. Co-operative Sugar Factory Ltd., in Tirupathi commissionerate, and M/s Sudhakar Irrigation Systems Pvt. Ltd., in Hyderabad III commissionerate, incurred an amount of Rs. 6.30 crore during the period from January 2005 to June 2007 on the transportation of inputs into their respective factories for use in manufacturing process. However, the applicable service tax of Rs. 56.14 lakh was not paid by the assessees in terms of rule 2(1)(d)(v).

On this being pointed out (November 2006 and August 2007), the department accepted the audit observations in all the cases and reported (February/April 2008) that show cause notice for Rs. 92.95 lakh for the period from January 2005 to March 2007 had been issued in the first case. It also intimated that the recovery was being done in the second case and the third assessee had paid (December 2007) service tax of Rs. 3.77 lakh and interest of Rs. 0.47 lakh covering the period from January 2006 to November 2007.

Reply of the Ministry had not been received (December 2008).

**11.1.5.2** By a notification no.32/2004-ST dated 3 December 2004, 75 per cent value of the taxable service provided by GTA to a customer is exempt from levy of service tax subject to the conditions that credit of duty paid on inputs or capital goods used for providing such taxable service is not taken and

benefit of notification no.12/2003-S.T. dated 20 June 2003 is not availed by GTA. The Board clarified on 27 July 2005 that the abatement is permissible only if the goods transport agency declared on consignment note issued, to the effect that neither credit on inputs or capital goods used for provision of service has been taken nor benefit of notification no.12/2003-ST has been taken.

M/s Meena Roadways and M/s. Ashapura Transport, in Rajkot commissionerate, raised debit notes on M/s Meena Agency Pvt. Ltd., in Rajkot for freight charges amounting to Rs. 3.87 crore during November 2006 to March 2007. The assessee was not eligible for 75 per cent abatement since no declaration on consignment note was available as required for availing of abatement. This resulted in non-payment of service tax of Rs. 47.38 lakh which was recoverable with interest and penalty.

This was pointed out to the Ministry/department in May 2008; its reply had not been received (December 2008).

### *11.1.6 Management consultancy services*

Service tax on management consultancy service has been levied with effect from 16 October 1998.

Section 69 of the Finance Act, 1994, makes a service provider of taxable service liable to get itself registered within 30 days from the date of commencing business of taxable service and where the assessee was already providing service, the date when the service is made taxable under the Act.

M/s SWS India Management Support Service Pvt. Ltd., in Delhi commissionerate of service tax, provided management consultancy services to their clients and recovered Rs. 5.73 crore as consultancy fee between 12 July 2003 and 31 March 2006 as disclosed in the income tax returns and financial records. However, neither did the assessee register itself with the department nor did it pay the applicable service tax of Rs. 53 lakh. Interest and penalty as prescribed under the Act were also leviable.

On this being pointed out (January and February 2008), the department stated (July 2008) that the assessee was not registered with the department. Action taken to recover service tax had not been intimated (August 2008).

Reply of the Ministry had not been received (December 2008).

### *11.1.7 Manpower recruitment agency services*

Any person engaged in providing any service, directly or indirectly, in any manner for recruitment or supply of manpower, temporarily or otherwise, to a client, is liable to collect and pay service tax on the gross amount charged for the services rendered.

**11.1.7.1** Bangalore Metropolitan Transport Corporation (BMTC), in Bangalore commissionerate of service tax, provided 'manpower recruitment services' (viz. the supply of application forms, question papers, answer sheets, processing and generation of merit list, etc., for recruitment of personnel for various posts) to the police department, health and family welfare department, forest department and fire department of the Government of Karnataka. The assessee earned Rs. 4.65 crore during the period from April 2002 to March

2007 for providing these services. The applicable service tax of Rs. 49.25 lakh was, however, not paid which was recoverable with interest and penalty.

On this being pointed out (August 2007), the Ministry admitted the audit observation and reported (September 2008) recovery of service tax of Rs. 48.10 lakh and interest of Rs. 12.71 lakh.

**11.1.7.2** M/s Marmagoa Steel Ltd., in Goa commissionerate, availed of the services of man power recruitment agencies. Service charges were paid to ten service providers. However, the service providers neither collected applicable service tax from the recipient of services nor they paid the service tax to the Government. Service tax not paid during the period from June 2005 to March 2007 amounted to Rs. 46.84 lakh which was recoverable with interest of Rs. 10.66 lakh and penalty of Rs. 19.67 lakh.

On this being pointed out (April 2007), the Ministry admitted the audit observation and intimated (July 2008) that show cause notice for Rs. 66.26 lakh had been issued and an amount of Rs. 42.74 lakh had since been recovered.

### *11.1.8 Club or association services*

Section 65(25a) of the Finance Act, 1994, stipulates that any person or body of persons providing services, facilities or advantage for a subscription or any other amount to its members are covered under the service of 'club or association services' but does not include (i) any body established or constituted by or under any law for the time being in force; (ii) any person or body of persons engaged in the activities of trade union or promotion of agriculture, horticulture or animal husbandry; (iii) any person or body of persons engaged in any activity having objectives which are in the nature of public service and are of a charitable, religious or political nature and (iv) any person or body of persons associated with press or media. The service came into the ambit of service tax with effect from 16 June 2005.

M/s Confederation of Indian Industry, in Delhi I commissionerate, engaged in providing services for the subscription to its members received subscription of Rs. 1.90 crore and Rs. 2.15 crore during the period 2005-06 and 2006-07, respectively. As the assessee did not fall under any categories excluded in the above definition, it was liable to pay service tax of Rs. 45.61 lakh on the subscription collected from the members. In addition, the assessee was liable to pay interest and penalty.

On this being pointed out (December 2007 and May 2008), the Ministry while admitting the audit observation stated (September 2008) that the matter was already in the knowledge of the department.

The fact remains that action to recover tax by issue of show cause notice was taken in April 2008 after flagged the issue in audit.

### *11.1.9 Cargo handling services*

Service tax on cargo handling service was levied with effect from 16 August 2002. Section 65(23) of the Finance Act, 1994 defines 'cargo handling service' to mean loading, unloading, packing or unpacking of cargo and includes cargo handling services provided for freight in special containers or

for non-containerised freight, services provided by container freight terminal or any other freight terminal, for all modes of transport and cargo handling service incidental to freight.

M/s Jai Jawan Coal Carriers Pvt. Ltd., New Delhi, in Delhi commissionerate of service tax, provided cargo handling services and recovered Rs. 3.65 crore during the period between 2003-04 and 2005-06 as disclosed in the income tax return submitted to the income tax department. However, neither did the assessee register itself with the department nor did it pay the applicable service tax of Rs. 33.11 lakh. This was recoverable with interest and penalty.

The mater was referred to the Ministry/department in January and February 2008; its reply had not been received (December 2008).

## 11.2 Services received from foreign service providers

Rule 2 (l) (d) (iv) of the Service Tax Rules, 1994, stipulates that in respect of taxable service provided by a person, who is a non-resident or is from outside India and does not have an office in India, the person receiving the taxable service in India is liable to pay service tax.

### *11.2.1 Intellectual property right service*

Section 65(55b) of the Finance Act, 1994, defines 'intellectual property service' to mean transferring temporarily or permitting the use of any intellectual property right. It also means any right to intangible property viz. trade marks, designs, patents or any other similar intangible property. The gross amount received by the holder of the intellectual property right in relation to this service is taxable with effect from 10 September 2004.

**11.2.1.1** M/s Star India Pvt. Ltd., (assessee) in Mumbai commissionerate of service tax, entered into an agreement with M/s Satellite Television Asian Region Ltd. (StarL) for grant of rights by StarL to Star India Pvt. Ltd., to distribute and market the channels Star Plus and Star Utsav. Clause 1.1 of the agreement defines StarL marks as 'trade names, trade marks, logos, service marks, copyright and characters' used by StarL and its affiliates and licensors from time to time. Clause 7 provides that the agreement shall continue for a period of 6 years. The assessee used trade marks/trade names and paid an amount of Rs. 114.38 crore during the year 2006-07 in foreign currency. However, service tax of Rs.14.00 crore leviable thereon was not paid by the assessee (M/s Star India Pvt. Ltd.).

This was pointed out to the Ministry/department in November 2007; its reply had not been received (December 2008).

**11.2.1.2** M/s Areva T&D, Perungudi, Chennai, in Chennai commissionerate of service tax engaged in manufacture of circuit breakers paid Rs. 8.73 crore as trade mark fee to their parent company in France for the period from April 2005 to December 2006. However, the assessee (M/s Areva T&D, Perungudi) did not pay service tax of Rs. 1.04 crore even though trade mark attracted service tax under intellectual property service.

This was pointed out to the Ministry/department in December 2007; its reply had not been received (December 2008).

### *11.2.2 Consulting engineers, technical know how and related services*

11.2.2.1 M/s Steel Authority of India Ltd., (SAIL) Bhilai, in Raipur commissionerate, paid Rs. 56.23 crore between April 2000 to March 2004 in foreign currency to foreign consultants for receiving technical 'know how'. Service tax of Rs. 3.41 crore was leviable for the period from 16 August 2002 to 31 March 2004 which was not paid by the assessee. This was recoverable with interest.

On this being pointed out (October 2004), the Ministry admitted the audit observation and stated (September 2008) that demand of service tax of Rs. 5.88 crore with equal amount penalty of Rs. 5.88 crore had been confirmed (December 2006).

11.2.2.2 M/s Bosch Chassis India Ltd., Gurgaon, (formerly known as M/s Kalyani Brakes Ltd., Gurgaon) in Delhi III commissionerate, availed services of foreign consultants towards services of consulting engineers, intellectual property and technical testing and analysis. The assessee paid service charges of Rs. 19.72 crore to foreign companies during the years 2003-04 and 2005-06, but service tax of Rs. 1.89 crore was not paid. Service tax was recoverable with interest and penalty.

On this being pointed out (March 2007), the department intimated (February 2008) that a show cause notice was under issue.

Reply of the Ministry had not been received (December 2008).

11.2.2.3 M/s BHEL-GE Gas Turbine Services Pvt. Ltd., in Hyderabad II commissionerate, engaged in providing of consulting engineers services, maintenance and repair services etc., received input services such as consulting engineers services, scientific and technical consultancy services, online information and database access or retrieval services, commercial training and coaching services, repair and maintenance services from several foreign agencies during the period from August 2002 to March 2006 and paid Rs. 6.99 crore in foreign currency towards the cost of services. The assessee, however, did not pay the applicable service tax of Rs. 65.36 lakh.

On this being pointed out (January 2008), the Ministry admitted the audit observation and intimated (September 2008) that a show cause notice demanding Rs. 84.13 lakh with interest and penalty had been issued.

11.2.2.4 M/s TFL Quinn India Pvt. Ltd., in Hyderabad IV commissionerate, engaged in the manufacture of leather tanning and leather finishing chemicals and other miscellaneous chemicals, plastics etc,. adopted the technology and technical know how provided by TFL, Germany and their subsidiary companies located in France & Italy. As part of the process of transfer of technology, the assessee was extended training facilities by the said foreign agencies for imparting skills to the staff/technicians of the assessee. The assessee in turn, utilised these skills/technology in his manufacturing operations. During the period from 2002-03 to 2006-07, the assessee made payments aggregating to Rs. 5.86 crore towards the cost of such services but did not discharge applicable service tax liability of Rs. 50.63 lakh.

On this being pointed out (August 2006), the Ministry admitted the audit observation, reported (September 2008) recovery of Rs. 32.44 lakh and issue of show cause notice for the recovery of balance amount of Rs. 18.18 lakh.

11.2.2.5 M/s Goodyear South Asia Tyres Pvt. Ltd., in Aurangabad commissionerate, received technical information including engineering information and technical know-how, technical assistance from M/s Goodyear Tyre and Rubber Company, Ohio, USA. The assessee paid Rs. 4.13 crore for these services during 2004-05. However, the applicable service tax of Rs. 42.13 lakh was not paid by the recipient of service.

On this being pointed out (February 2007), the Ministry admitted the audit observation and intimated (July 2008) that a show cause notice for Rs. 42.13 lakh had been issued.

11.2.2.6 M/s NPCL Bharuch (amalgamated with M/s GNFC Ltd.) and M/s. Hindalco Industries Ltd., Bharuch in Vadodara II commissionerate, paid Rs. 9.14 crore for the consulting engineers services received from foreign consulting engineering agencies between October 1998 and March 2003. However, applicable service tax totalling to Rs. 45.69 lakh was not paid by the service receiver.

On this being pointed out (November 2003 and October 2004), the Ministry admitted the audit observation and intimated (October 2008) that in respect of M/s Hindalco Industries Ltd., demand had been confirmed and in respect of M/s NPCL, it stated (December 2005 and January 2008) that show cause notice for Rs. 2.65 lakh had been confirmed and four show cause notices for Rs. 1.93 lakh had been issued to the foreign service providers.

### *11.2.3 Man power recruitment services*

M/s Dr. Reddy's Laboratories Ltd., (Unit I), in Hyderabad II commissionerate, engaged in the manufacture of bulk drugs and formulations, obtained several services from different foreign companies which, inter-alia, included manpower recruitment, scientific and technical consultancy, technical testing and analysis, business auxiliary services and intellectual property right services. The assessee made payments aggregating to Rs. 28.72 crore during the period 2002-03 to 2004-05 towards the cost of such services but did not pay service tax of Rs. 2.79 crore due thereon.

On this being pointed out (July 2007), the Ministry admitted the audit observation and stated (July 2008) that a show cause notice for Rs. 2.79 crore had been issued.

### *11.2.4 Business process outsourcing services*

M/s Proctor and Gamble Home Products Ltd., Mandideep, in Bhopal commissionerate, engaged in the manufacture of detergent powder availed 'business process outsourcing' and 'professional consultancy' services from foreign service providers and paid service charges of Rs. 19.68 crore. Neither did the assessee pay the service tax nor was it demanded by the department. This resulted in non-payment of service tax of Rs. 1.61 crore during the period from 16 August 2002 to 31 December 2004. Interest and penalty was leviable in addition to the tax.

On this being pointed out (September 2006), the department stated (October 2006) that service tax payable by the person receiving the service in India was notified on 31 December 2004. Thus, service tax was payable by the receiver of any taxable service provided by a person from outside India only with effect from 1 January 2005.

The reply of the department is not acceptable because prior to 1 January 2005, the service provided by the foreign agencies fell under the category 'consulting engineers' on which service tax was payable from 16 August 2002 in terms of rule 2(1)(d)(iv).

Reply of the Ministry had not been received (December 2008).

*11.2.5 Business auxiliary service etc.*

M/s Flakt (India) Ltd., Kolkata, in Kolkata VI commissionerate, engaged in the manufacture of excisable product received services which, inter alia, included services in the field of international marketing and sales and product support, manufacturing, purchase and administration, taxation and legal matters, treasury and finance management etc., from foreign service providers. The assessee also obtained the right to use the trade mark license of M/s Flakt Woods Group, AG Switzerland in connection with the sales and marketing of its products. The service charges were paid in foreign currency. However, service tax of Rs. 38.30 lakh payable thereon during the period between January 2003 and December 2004 was not paid, which was recoverable with interest from the recipient of services.

On this being pointed out (April 2005), the department stated (September 2007) that a demand of Rs. 88.28 lakh covering the period from January 2003 to December 2006 was under issue. Further developments in this case had not received (December 2008).

Reply of the Ministry had not been received (December 2008).

## 11.3 Other cases

In 57 other cases of non-levy/non-payment of service tax of Rs. 7.36 crore, the Ministry/department had accepted (till December 2008) all audit observations and had reported recovery of Rs. 3.40 crore in 29 cases.

# CHAPTER XII
# MISCELLANEOUS TOPICS OF INTEREST

Some illustrative cases pertaining to non-levy of interest on delayed payment of service tax, incorrect availing of exemption from tax, short levy of service tax due to undervaluation, incorrect classification of services etc., involving revenue implication of Rs. 19.89 crore noticed during test check are mentioned in the following paragraphs. These observations were communicated to the Ministry through 19 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 14 draft audit paragraphs with money value of Rs. 17.19 crore of which Rs. 13.41 crore had been recovered.

## 12.1 Interest on delayed payment of tax

Section 75 of the Finance Act, 1994, provides that where a person, liable to pay service tax under section 68 or the Rules made thereunder, fails to pay the tax or any part thereof within the prescribed time, he shall pay interest at the rate of 13 per cent per annum for the period of default. Further, penalty for failure to pay tax is also leviable, in addition to tax and interest, under section 76 of the said Act.

**12.1.1** M/s British Airways, Gurgaon, in Delhi III commissionerate, provided services as transporter of passengers embarking in India for international journey by air. The assessee charged fare (including service tax) from customers during May 2006 to October 2007 and paid service tax of Rs. 94.94 crore in November and December 2007. The assessee did not pay interest for delayed payment of service tax and the department also did not demand the interest due. This resulted in non-recovery of interest of Rs. 9.04 crore, besides penalty.

On this being pointed out (December 2007), the department intimated (March 2008) that the interest of Rs. 9.04 crore had been recovered between December 2007 and February 2008.

Reply of the Ministry had not been received (December 2008).

**12.1.2** M/s Bharat Sanchar Nigam Ltd. (BSNL), Assam Telecom Circle (Cellular Mobile Service), in Shillong commissionerate failed to deposit the service tax in time on various occasions during the period from 2004-05 to 2006-07, for which interest of Rs. 1.33 crore was recoverable. The internal audit party of the department had pointed out non-payment of interest of Rs. 1.90 lakh and non-payment of service tax of Rs.7.83 crore for the period from May 2006 to March 2007 in July 2007 but the department did not issue any show cause notice to the assessee for realisation of the interest of Rs. 1.33 crore (including Rs. 1.90 lakh pointed out by internal audit).

On this being pointed out (January 2008), the Ministry admitted (November 2008) audit observations in principle.

**12.1.3** M/s Prakash Arts and M/s ABC Engineering Works in Guntur commissionerate, M/s Whirlpool of India Ltd., in Delhi commissionerate of

service tax and M/s Ranbaxy Laboratories Ltd., Dewas, in Indore commissionerate, engaged in providing of advertising services, site preparation, excavation services and manufacture of medicaments/organic compounds did not pay quarterly service tax by the due dates during 2005-06 and 2006-07. They paid the amounts with delays ranging from 1 to 288 days. The interest due on such belated payments amounting to Rs. 84.38 lakh was neither paid by the assessee nor was it demanded by the department.

On this being pointed out (November 2007), the Ministry while accepting the audit observation intimated (November 2008) recovery of Rs. 8.89 lakh from M/s ABC Engineering Works. The department also admitted the audit observations in the cases of M/s Whirlpool of India Ltd. and M/s Prakash Arts and reported recovery of Rs. 2.85 lakh and Rs. 47.58 lakh respectively. Reply in the remaining cases had not been received (December 2008).

## 12.2 Interest on wrong credit of cenvat

Rule 14 of the Cenvat Credit Rules, 2004, provides that where cenvat credit on any input services has been taken or utilised wrongly by a service provider, the same alongwith interest shall be recovered from such provider of output service and the provisions of sections 73 and 75 of Finance Act, 1994, shall apply mutatis mutandis for effecting such recoveries.

M/s Satyam Computers Services Ltd., in Hyderabad II commissionerate, engaged in rendering of consulting engineers services, manpower recruitment agency services etc., took credit of Rs. 4.15 crore during the period between February 2006 and July 2007, of the service tax paid on health insurance services obtained from insurance companies for the welfare of their employees. The internal audit wing of the department objected to these wrong credits in August/October 2007 and in pursuance of these objections, the assessee reversed the entire credit on 31 August 2007. However, the interest payable on these incorrect credits from the date of taking credit to the date of reversal, amounting to Rs. 46.37 lakh, was neither paid by the assessee nor was it demanded by the department.

On this being pointed out (December 2007), the department stated (May 2008) that since the assessee did not utilise the excess availed amount, charging of interest on the credit lying unutilised was not warranted in view of a plethora of judicial decisions of Tribunals/High Courts {(i) 2006 (205) ELT 24, (ii) 2007 (215) ELT 119 & 433 and (iii) 2007 (6) STR 53)}. Department also stated that the decision of Punjab & Haryana High Court in this regard {2007 (214) ELT 173} was upheld by the Supreme Court also {2007 (214) ELT – A-50}.

The fact, however remains that under rule 14 of the Cenvat Credit Rules, 2004, it was statutorily required that where cenvat credit had been taken or utilised wrongly, the same alongwith interest was recoverable. The anomalous situation that had cropped up due to above judicial pronouncements needs to be remedied by Government by making the relevant provisions more explicit and unambiguous, as otherwise the provisions of the said rule with regard to recovery of interest were not enforceable even though the assessees commit breach of cenvat provisions by taking wrong credits on ineligible services.

***Audit recommends that Government should amend the Rules, in view of post judicial pronouncements, to bring the provisions of the rules, consistent with these.***

Reply of the Ministry had not been received (December 2008).

## 12.3 Exemption from tax

Under notification dated 31 March 2004, all taxable services provided by a person to a developer of special economic zone (SEZ) or a unit located in SEZ are exempt from levy of service tax if such services are consumed within the SEZ subject to fulfillment of certain specified conditions. The Ministry clarified on 28 June 2007 that since the exemption was intended to cover services meant for consumption in SEZ, taxable services provided and consumed within SEZ are only exempt from service tax and services provided outside SEZ and consumed outside SEZ do not qualify for exemption under the aforementioned notification.

M/s Karvy Computer Share Pvt. Ltd., in Hyderabad II commissionerate, engaged in providing issue and share transfer agent services, undertook initial public offer (IPO) and share transfer services during 2006-07 and 2007-08 on behalf of M/s Reliance Petroleum Ltd., and realised an amount of Rs. 12.43 crore for these services. They claimed exemption under the said notification on the ground that the said services were intended for consumption in the newly established SEZ of M/s Reliance Petroleum Ltd., at Jamnagar. The records disclosed that these services were rendered outside the SEZ as per SEBI & NSE regulations in connection with issue of shares to public on behalf of their clients. The services could not be considered as having been consumed within the SEZ as the finances mobilised out of these share offerings were wholly monitored/managed and appropriated by their corporate office located in Mumbai. Therefore, the exemption of Rs. 1.52 crore availed by the assessee was incorrect.

On this being pointed out (November 2007), the department stated (May 2008) that the Ministry's clarification was applicable to port services, cargo handling services etc., which were physically performed outside SEZ whereas the service in instant case was meant for financing SEZ and was eligible for exemption. It further stated that going by the nature of the services, their physical performance outside SEZ was immaterial as the ultimate consumption had taken place within SEZ and that their registered office which monitored the finances etc., generated out of public issue was located within SEZ.

Reply of the department was not acceptable as the corporate office which solicited the services from the assessee and which monitored/managed the finances was located at Mumbai. Even the registered office of the company which was carrying on the administration of the SEZ was also located outside the SEZ and therefore the services rendered by the assessee to these clients stand on same footing as that of a port service or cargo handling service or warehousing service rendered outside/consumed outside the SEZ as clarified by the Ministry.

Reply of the Ministry had not been received (December 2008).

## 12.4 Splitting of value of services into components to avoid tax

Section 67(1) of the Finance Act, 1994, stipulates that where provision of service is for a consideration in money, service tax is chargeable on the gross amount charged by the service provider for such service rendered by him.

M/s Narayana Coaching Centre, Nellore, in Guntur commissionerate, engaged in providing coaching services collected Rs. 12.53 crore from students towards the cost of coaching services rendered during the period from 16 June 2005 to 31 March 2007. Though all these charges were collected in relation to coaching services offered to hostellers, the assessee bifurcated these charges into tuition fee, mess charges and hostel charges and discharged service tax liability only on part consideration of Rs. 1.53 crore which represented tuition fee alone. The other two components were excluded by the assessee on the plea that they had no nexus to the coaching services rendered by him. This was not correct as all the amounts were collected in relation to rendering of coaching services and hostel and mess facilities were extended to boarders as incidental to the coaching services offered to them. Therefore, these elements were not to be segregated or separated from the total service charges. The service tax liability not discharged by the assessee on the remaining consideration of Rs. 11 crore collected during the years 2005-06 and 2006-07 amounted to Rs. 1.28 crore.

On this being pointed out (November 2007), the department while accepting the audit observation stated (April/May 2008) that show cause notices were under issue.

Reply of the Ministry had not been received (December 2008).

## 12.5 TDS not included in value of services

The Director General of Service Tax clarified in the 'frequently asked questions' on filing of returns and payment of service tax that tax deducted at source (TDS) is to be included in the gross amount charged and service tax is to be paid on the gross amount including TDS.

M/s Bharat Heavy Electricals Ltd., (HPBP unit), in Trichy commissionerate, engaged in manufacture of boiler components, paid service tax on consulting engineer services received from a foreign service provider. The assessee paid service charges of Rs. 64.56 crore in four installments during the year 2006-07. In respect of first three installments, valued at Rs. 51.89 crore, the assessee did not include the income tax deducted at source of Rs. 5.77 crore in the value of taxable service for the purpose of payment of service tax remitted between August 2006 and December 2006. This resulted in short payment of tax of Rs. 70.58 lakh. On the fourth installment of Rs. 12.67 crore, service tax was, however, paid including the value of TDS.

Similarly, the assessee paid (March 2006) lump sum of Rs. 5.65 crore to the foreign service provider M/s ALSTOM, France, for the service rendered towards consulting engineer service and paid service tax on the value of service excluding the amount of TDS of Rs 56.46 lakh. This resulted in short payment of service tax of Rs. 5.75 lakh.

On these being pointed out (between February 2007 and February 2008), the department reported (May 2007 and February 2008) recovery of service tax of Rs. 76.33 lakh and interest of Rs. 11.34 lakh.

Reply of the Ministry had not been received (December 2008).

## 12.6 Incorrect classification of service

Section 65(39a) of the Finance Act, 1994, stipulates that erection, commissioning or installation means any service provided by a commissioning and installation agency, in relation to erection, commissioning or installation of plant, machinery or equipment. This was made effective from 10 September 2004. The Board clarified on 8 August 2007 that activity of erection of transmission tower would be taxable with effect from 10 September 2004 under erection, commissioning or installation services.

M/s Urja Engineers Ltd., in Vadodra I commissionerate, entered into agreements with various parties (mainly State Electricity Board) for erection of transmission towers. The activities to be performed were excavation, foundation, erection of tower, stringing of conductors and earth wires etc. The assessee obtained registration under commercial or industrial construction service on 12 September 2005. The assessee realised Rs. 6.48 crore as service charges during the period from January 2005 to June 2006 and paid service tax of Rs. 21.81 lakh under commercial or industrial construction service after availing permissible abatement at 33 per cent from the gross value. This was not correct as service tax was leviable under erection, commissioning or installation services and such an abatement was not available under this category of service. Incorrect classification of service resulted in short payment of service tax of Rs. 44.28 lakh.

This was pointed out to the Ministry/department in April 2008; its reply had not been received (December 2008).

## 12.7 Other cases

In 140 other similar cases of short payment of service tax of Rs. 4.10 crore, the Ministry/department had accepted all audit observations and had reported recovery of Rs. 3.81 crore in 137 cases till December 2008.

# SECTION 3 – CUSTOMS

# CHAPTER XIII
# CUSTOMS RECEIPTS

## 13.1 Budget estimates, revised budget estimates and actual receipts

The budget estimates, revised budget estimates and actual receipts of customs duties, during the years 2003-04 to 2007-08, are exhibited in the following table and graph:-

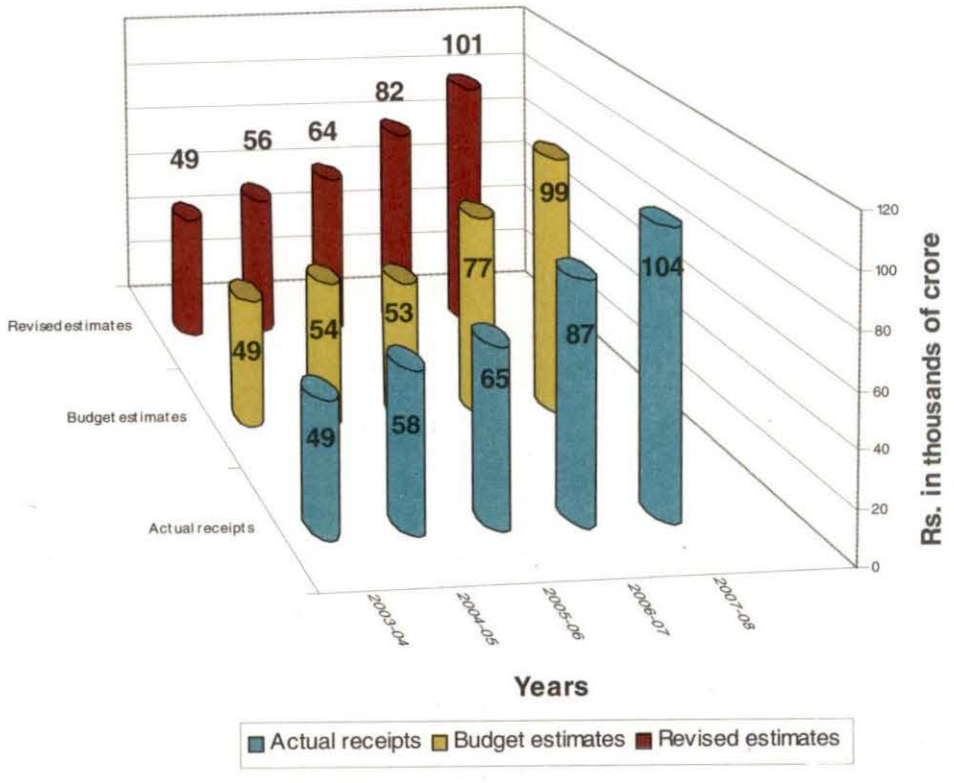
**Table no. 1**

**(Amounts in crore of rupees)**

| Year | Budget estimates | Revised budget estimates | Actual receipts* | Difference between actual receipts and budget estimates | Percentage variation |
|---|---|---|---|---|---|
| 2003-04 | 49,350 | 49,350 | 48,629 | -721 | -1.46 |
| 2004-05 | 54,250 | 56,250 | 57,610 | 3,360 | 6.19 |
| 2005-06 | 53,182 | 64,215 | 65,067 | 11,885 | 22.35 |
| 2006-07 | 77,066 | 81,800 | 86,327 | 9,261 | 12.02 |
| 2007-08 | 98,770 | 1,00,766 | 1,04,119 | 5,349 | 5.42 |

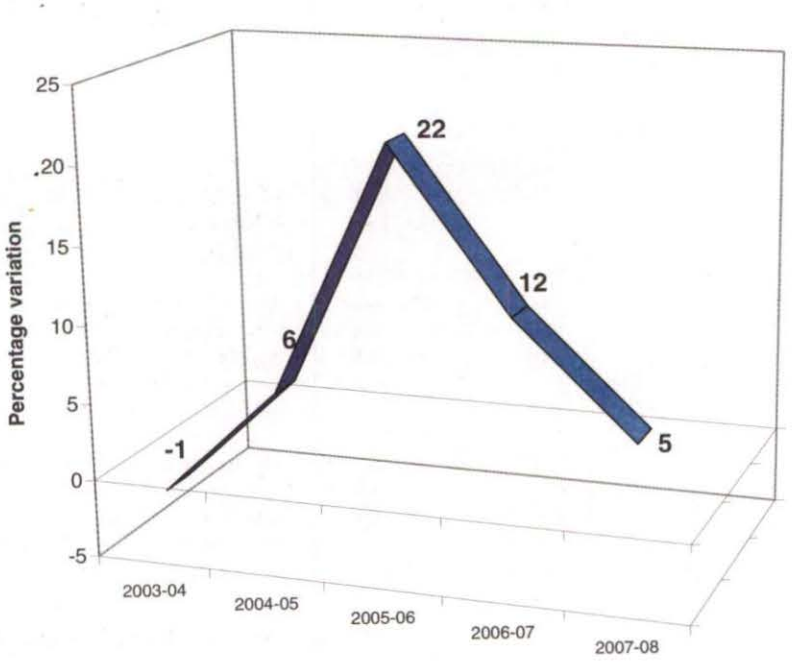
* Figure as per Finance Accounts

**Graph 1: Customs Receipts – Budget, Revised and Actual**



The actual collection was more than both the budget and revised estimates in 2007-08, mainly due to increase in collection of import duty on minerals, fuels and related products, petroleum products, chemicals and related products and machinery and transport equipments. The percentage variation of actual receipts over the budget estimates during the years 2003-04 to 2007-08 are depicted in the following graph:-

**Graph 2: Percentage variation of actual receipts over budget estimates**




## 13.2 Trend of receipts

A comparison of total year-wise imports with corresponding net import duties collected during 2003-04 to 2007-08 has been shown in the following table:-

**Table no. 2**

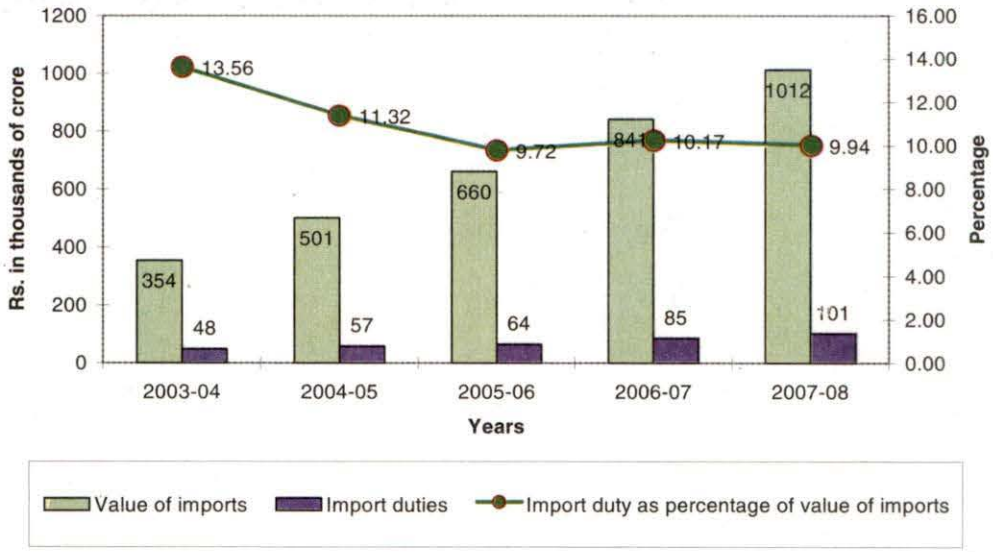
**(Amounts in crore of rupees)**

| Year | Value of Imports* | Import duties** | Import duty as percentage of value of imports |
|---|---|---|---|
| 2003-04 | 3,53,976 | 48,002 | 13.56 |
| 2004-05 | 5,01,065 | 56,745 | 11.32 |
| 2005-06 | 6,60,409 | 64,201 | 9.72 |
| 2006-07 | 8,40,506 | 85,440 | 10.17 |
| 2007-08 | 10,12,312 | 1,00,635 | 9.94 |

Source -* Department of Commerce, Export Import Data Bank
**Directorate General of Export Promotion, New Delhi.

While the value of imports has recorded a growth of 186 per cent over the last five years, the corresponding import duties, had increased by 110 per cent.

**Graph 3 : Import duty as percentage of value of imports**




## 13.3 Major commodities yielding import duties

Commodities which yielded major import duties during the year 2007-08 along with corresponding figures for the year 2006-07 are mentioned in the following table:-

**Table no. 3**

**(Amounts in crore of rupees)**

| Sl. No. | Budget Head No. | Commodities | Import duties realised | | Percentage variation in 2007-08 over 2006-07 | Percentage share in total import duties collected | |
|---|---|---|---|---|---|---|---|
| | | | 2006-07 | 2007-08 | | 2006-07 | 2007-08 |
| 1. | 41 | Machinery excluding machine tools & their parts and accessories & ball or roller bearings | 12,402 | 14,516 | 17.05 | 14.52 | 14.42 |
| 2. | 44 | Electrical machinery | 10,693 | 13,799 | 29.05 | 12.52 | 13.71 |
| 3. | 7 | Petroleum oils & oils obtained from bituminous minerals, crude | 7,583 | 8,946 | 17.97 | 8.88 | 8.89 |
| 4. | 8 | Petroleum oils & oils obtained from bituminous minerals other than crude | 4,680 | 6,824 | 45.81 | 5.48 | 6.78 |
| 5. | 11 | Organic chemicals | 4,832 | 5,185 | 7.31 | 5.66 | 5.15 |
| 6. | 46 | Motor vehicles & parts thereof | 3,161 | 4,352 | 37.68 | 3.70 | 4.32 |
| 7. | 18 | Plastic & articles thereof | 3,287 | 3,832 | 16.58 | 3.85 | 3.81 |
| 8. | 03 | Animal or vegetable fats & oils & their cleavage products, prepared edible fats, animal or vegetable waxes | 4,787 | 3,539 | -26.07 | 5.60 | 3.52 |
| 9. | 48 | Optical, photographic, cinematographic, measuring, medical and surgical instruments | 2,254 | 2,547 | 13.00 | 3.52 | 2.53 |

Source- Directorate General of Export Promotion, New Delhi.

The above table indicates that amongst the major commodities, while 'Petroleum oils & oils obtained from bituminous minerals other than crude' had shown substantial growth (46 per cent) of revenue (compared to previous year), the customs revenue from 'Animal or vegetable fats and oils and their cleavage products, prepared edible fats, animal or vegetable waxes' had dipped by 26 per cent during the year 2007-08.

## 13.4 Duty foregone

### *13.4.1 Export promotion schemes*

The break-up of customs duty foregone on various export promotion schemes viz., advance licence, DEPB, EPCG, EPZ, EOUs and refund of duty under drawback and other schemes, for the period from 2004-05 to 2007-08 is shown in the following table:-

**Table no. 4**

**(Amounts in crore of rupees)**

| Year | Customs duty collected | Advance licence & others* | EOU/ STP | Duty drawback | EPCG | DEPB | SEZ | Total | Duty foregone as a percentage of customs receipts (Col.9 over percentage of Col.2) |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 7 | 8 | 5 | 4 | 6 | 9 | 10 |
| 2004-05 | 57,610 | 11,741 | 8,266 | 12,888 | 4,681 | 10,076 | 2,447 | 41,033 | 71 |
| 2005-06 | 65,067 | 13,361 | 10,278 | 8,886 | 5,333 | 5,651 | 2,471 | 40,329 | 62 |
| 2006-07 | 86,327 | 23,596 | 10,948 | 6,057 | 9,069 | 4,789 | 1,654 | 56,133 | 65 |
| 2007-08 | 1,04,119 | 20,481 | 18,759 | 9,015 | 8,933 | 4,986 | 1,848 | 64,022 | 62 |

*Includes DFRC/DFECC/TPS/VKUY/DFIA/Focus product schemes
Source – Directorate General of Export Promotion, New Delhi

### *13.4.2 Other duty foregone*

Duty foregone under section 25 (1) and (2) of the Customs Act, 1962 (other than for export promotion schemes vide paragraph 13.4.1) during 2004-05 to 2007-08 is shown in the following table:-

**Table no. 5**

**(Amounts in crore of rupees)**

| Year | No. of notifications issued under 25(1)* | No. of total notifications issued under 25(2)** | Total No. of notifications issued | Duty foregone under 25(1)* | Duty foregone under 25(2)** | Total duty foregone |
|---|---|---|---|---|---|---|
| 2004-05 | 32 | 39 | 71 | 19,916 | 16 | 19,932 |
| 2005-06 | 29 | 49 | 78 | 40,667 | 15 | 40,682 |
| 2006-07 | 453 | 7 | 460 | 28,394 | 99 | 28,473 |
| 2007-08 | 317 | 38 | 355 | 28,060 | 505 | 28,565 |

* General exemption ** Adhoc exemption
Source – Directorate General of Export Promotion, New Delhi

## 13.5 Cost of collection of customs receipts

The expenditure incurred on collection of customs duty during the year 2007-08 along with the figures for the previous year are mentioned in the following table:-

Table no. 6

(Amounts in crore of rupees)

| | 2006-07* | 2007-08* |
|---|---|---|
| Expenditure on revenue cum import/export and trade control functions | 152.55 | 165.40 |
| Expenditure on preventive and other functions | 687.06 | 759.71 |
| Transfer to Reserve Fund, Deposit Account and other expenditure | 10.71 | 13.91 |
| Total | 850.32 | 939.02 |
| Customs receipt | 86,327 | 1,04,119 |
| Cost of collection as percentage of customs receipts | 0.98 | 0.90 |

* Figures as per Finance Accounts

## 13.6 Arrears of customs duty*

**13.6.1** The amount of customs duty assessed up to 31 March 2008 which was still to be realised as on 30 June 2008, was Rs. 4,859.77 crore in 34 out of 92 commissionerates.

**13.6.2** Customs revenue of Rs. 2,104.47 crore demanded up to March 2008, was not realised by the department at the end of the financial year 2007-08. Of this, Rs. 898.82 crore was undisputed. However, even this amount had not been recovered for a period of over ten years. There is a need to strengthen the recovery mechanism of the department. The information is abstracted in the following table:-

Table no. 7*

(Amounts in crore of rupees)

| Sl. No. | Commissionerate | Amount under dispute | | | Amount not under dispute | | | Grand Total |
|---|---|---|---|---|---|---|---|---|
| | | Over five years but less than ten years | Over ten years | Total | Over five years but less than ten years | Over ten years | Total | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| 1. | Customs | 432.67 | 122.31 | 554.98 | 337.54 | 49.54 | 387.08 | 942.06 |
| 2. | Central Excise & Customs | 167.63 | 13.69 | 181.32 | 144.64 | 25.06 | 169.70 | 351.02 |
| 3. | Central Excise | 411.99 | 57.36 | 469.35 | 209.25 | 132.79 | 342.04 | 811.39 |
| | **Total** | **1,012.29** | **193.36** | **1,205.65** | **691.43** | **207.39** | **898.82** | **2,104.47** |

*Figures relate to 34 out of 92 commissionerates

Source – Directorate General of Export Promotion, New Delhi

## 13.7 Demands of duty barred by limitation

Demands of Rs. 260.82 crore relating to 34 out of 92 commissionerates which were raised by the department upto 31 March 2008, could not be realised as these were time-barred.

## 13.8 Duty written off

Customs duties written off, penalties waived and ex-gratia payments made during the year 2007-08 have decreased significantly over the last year but is still very high compared to what it was in 2004-05 as shown in the following table:-

**Table no. 8**

**(Amounts in crore of rupees)**

| Year | Amount |
|---|---|
| 2004-05 | 3.01 |
| 2005-06 | 43.41 |
| 2006-07 | 247.73 |
| 2007-08 | 100.54 |

Source – Directorate General of Export Promotion, New Delhi

## 13.9 Contents of the section

This section contains 182 paragraphs featured individually or grouped together, arising from important findings from test check in audit. The revenue implication of these paragraphs was Rs. 96.50 crore. The Ministry/department had accepted (till December 2008), audit observations in 137 paragraphs involving revenue of Rs. 37.83 crore and had reported recovery of Rs. 9.85 crore.

## 13.10 Impact/follow-up of Audit Reports

### *13.10.1 Revenue impact*

During the last five years (including the current year's report), audit through its Audit Reports had pointed out short levy etc. totalling Rs. 1,578.60 crore in 961 audit paragraphs. Of these, the Government had accepted (till December 2008) audit observations in 834 audit paragraphs involving Rs. 868.18 crore and had recovered Rs. 62.14 crore. The details are shown in the following table.

**Table no. 9**

**(Amounts in crore of rupees)**

| Year of Audit Report | Paragraphs included | | Paragraphs accepted | | | | | | Recoveries effected | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Pre printing | | Post printing | | Total | | Pre printing | | Post printing | | Total | |
| | No. | Amt | No. | Amt | No. | Amt | No. | Amt | No. | Amt | No. | Amt | No. | Amt |
| 2003-04 | 251 | 941.10 | 177 | 94.44 | 53 | 533.91 | 230 | 628.35 | 128 | 10.06 | 49 | 4.72 | 177 | 14.78 |
| 2004-05 | 256 | 355.79 | 178 | 45.41 | 76 | 17.41 | 254 | 62.82 | 122 | 4.13 | 68 | 8.40 | 190 | 12.53 |
| 2005-06 | 139 | 63.22 | 74 | 25.92 | 38 | 6.84 | 112 | 32.76 | 49 | 11.69 | 29 | 5.18 | 78 | 16.87 |
| 2006-07 | 133 | 121.99 | 94 | 105.18 | 7 | 2.24 | 101 | 107.42 | 57 | 7.32 | 6 | 0.79 | 63 | 8.11 |
| 2007-08 | 182 | 96.50 | 137 | 37.83 | -- | -- | 137 | 37.83 | 80 | 9.85 | -- | -- | 80 | 9.85 |
| **Total** | **961** | **1,578.60** | **660** | **308.78** | **174** | **560.40** | **834** | **868.18** | **436** | **43.05** | **152** | **19.09** | **588** | **62.14** |

### *13.10.2 Status of action taken notes*

Public Accounts Committee in their ninth report (eleventh Lok Sabha) had desired that remedial/corrective action taken notes (ATNs) on all paragraphs of the reports of the Comptroller and Auditor General, duly vetted by audit, be furnished to them within a period of four months from the date of laying of audit report in Parliament.

Review of outstanding action taken notes on paragraphs included in earlier audit reports indicated that the Ministry had not submitted remedial action notes relating to 78 of these paragraphs. Of these, the earliest paragraph was included in the audit report for the year 1996-97. The pendency of ATNs is abstracted in the following table:

**Table no. 10**

| Sl.No. | Period since when ATN is awaited | No. of paragraphs |
|---|---|---|
| 1 | Up to 1 year | 33 |
| 2 | 1-3 years | 29 |
| 3 | 3-5 years | 8 |
| 4 | More than 5 years | 8 |
| Total | | 78 |

# CHAPTER XIV
# INCORRECT ASSESSMENT OF CUSTOMS DUTIES

A few cases of incorrect assessment of customs duties noticed in test check, involving revenue of Rs. 47.31 crore, are described in the following paragraphs. These observations were communicated to the Ministry through 39 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 31 draft audit paragraphs with money value of Rs. 5.66 crore, of which Rs. 1.54 crore had been recovered.

## 14.1 Non-levy of anti-dumping duty

***Sodium ascorbate***

As per notification no.159/2003-cus dated 24 October 2003, 'vitamin C' or its synonyms falling under customs tariff heading (CTH) 2936, originating in or exported from the People's Republic of China attracts anti-dumping duty (ADD).

**14.1.1** Three consignments of 'sodium ascorbate' imported from China by M/s Nicholas Piramal India Ltd., through Mumbai customs (sea) commissionerate, between December 2006 and April 2007 were correctly classified under CTH 2936 , but cleared without levy of ADD. As 'sodium ascorbate' is a derivative of 'vitamin C', non levy of ADD thereon was incorrect. This resulted in non-levy of ADD of Rs. 22.95 lakh.

On this being pointed out (May 2007), the department issued (May 2007) less charge demand notice in one case and in the remaining two cases the Ministry admitted the audit objection and intimated (September 2008) that the cases had been adjudicated in February 2008. The Ministry further stated that the importer had gone in for appeal (April 2008) in these cases and the Commissioner (Appeal) has upheld the order-in-original in one case. Ministry's response in the third case had not been received (December 2008).

***Steel wheel***

In terms of notification no. 51/2007-cus dated 29 March 2007 "steel wheel" falling under CTH 8708 originating in or exported from the People's Republic of China attracts ADD at the specified rates.

**14.1.2** M/s Ashok Leyland Ltd., Hosur and M/s M.I. Trading, Pune imported five consignments of 'steel wheel' of Chinese origin between May and October 2007 through Chennai customs (sea) commissionerate and Jawaharlal Nehru custom house, Mumbai. The goods were incorrectly classified under CTH 8708 and cleared without levy of ADD. This resulted in non-levy of ADD of Rs. 39 lakh.

On this being pointed out between October 2007 and January 2008, the department stated (January/February 2008) that demand notices had been issued to the importers.

The cases were reported to the Ministry in August/November 2008; its responses had not been received (December 2008).

*Bias tyres, tubes and flaps*

As per notification no.88/2007-cus dated 24 July 2007, 'bias tyres, tubes and flaps' falling under CTH 4011, 4012 and 4013, originating in or exported from the People's Republic of China and Thailand attracts ADD at the specified rates. The ADD imposed under this notification is effective from the date of imposition of the provisional anti-dumping duty i.e. 9 October 2006.

14.1.3 Thirteen consignments of 'non-radial tyres, tubes and flaps' imported by M/s Harsh Commodities Pvt. Ltd. and four others, from China, between October 2006 and July 2007 through MPSEZ, Mundra under Kandla commissionerate and inland container depot, Tuglakabad, Delhi were classified under CTH 4011, 4012 and 4013 and cleared without levy of ADD. This resulted in non-levy of ADD of Rs. 42.61 lakh.

On the observations being pointed out (November/December 2007), the department stated (January 2008), in respect of imports made through the Kandla commissionerate, that as per paragraph 4 of the Board's circular of 23 January 2006, if the final ADD was more than the provisional duty, the difference was not to be collected from the importer. The reply of the department is not acceptable because notification no.88/2007-cus dated 24 July 2007 clearly provided that levy of ADD should be effective from the date of imposition of the provisional anti-dumping duty i.e. 9 October 2006. The Board's circular issued earlier cannot override the provision of a notification. Further, in a similar case, the department had already confirmed (O.I.O no. 151/DC/ICD-Dashrath/Import/2007 dated 27 December 2007) ADD. Reply from the Delhi commissionerate was awaited (December 2008).

The cases were reported to the Ministry in June/November 2008; its responses had not been received (December 2008).

## 14.2 Irregular payment of drawback

According to section 74 (1) (b) of the Customs Act, 1962, drawback of 98 per cent of the duty paid on importation may be refunded, where the goods are entered for export within two years from the date of payment of duty. The said period of two years can be extended by the Board.

M/s LVMH Watch and Jewellery India Pvt. Ltd., New Delhi imported 515 'wrist-watches' between December 2002 and June 2003 through the new custom house, New Delhi, out of which the firm re-exported 175 pieces in August 2006 and the department allowed drawback of Rs. 12.32 lakh claimed thereon. After the stipulated period of two years, extension of one year was granted but the watches were exported after expiry of the extended period. Therefore, payment of drawback was irregular. The omission resulted in incorrect refund of Rs. 12.32 lakh.

On this being pointed out (October 2007), the department reported (October 2008) recovery of the entire amount.

## 14.3 Motorcycle parts and MP-3 players

In terms of serial number 81 of notification no.2/2006-CE (NT) dated 1 March 2006 and serial number 97 of amending notification no.11/2006-CE (NT) dated 29 May 2006, 'MP-3 players' falling under CTH 8519 and 'all parts, components and assemblies of automobiles' falling under any heading respectively are to be assessed to additional duty of customs on the basis of maximum retail sale price (MRP), after allowing the permissible abatement.

M/s Apple Computers Ltd., Bangalore and five others imported eight consignments of MP 3 players and twenty-six consignments of automobile parts comprising motorcycle chains, batteries and various parts, between March 2007 and January 2008, through the air cargo complex, Bangalore and inland container depot, Patparganj, Delhi. The imported goods were classified under CTH 8519/CETH 7315/CETH 8507 but were not assessed on the basis of MRP. This resulted in short levy of duty amounting to Rs. 86.91 lakh.

On the observations being pointed out (November 2007 to March 2008), the department/Ministry reported (January/July 2008) recovery of Rs. 10.81 lakh from two importers in the cases relating to MP-3 players and motorcycle batteries. The department further confirmed a demand of Rs. 25.78 lakh against two importers and issued SCN to the other two importers.

The cases were reported to the Ministry between June and November 2008; its responses in respect of five importers had not been received (December 2008).

## 14.4 Cost recovery charges not realised

In terms of Board's circular no.128/95-cus dated 14 December 1995 the custodian shall bear the cost of customs staff posted at the inland container depots (ICD)/container freight stations (CFS). Such cost is to be paid in advance by the custodian.

Customs officers were posted at different ICDs at Bangalore, Juhi Railway Yard, Kanpur, Patparganj and Tughlaqabad, Delhi and EOU, Nongtrai, Shillong between April 2001 and December 2007 but cost recovery charges were not collected or were short collected by the department from the custodians of M/s Central Warehousing Corporation (CWC), M/s Container Corporation of India Ltd. (CONCOR) and M/s Lafarge Umium Mining Pvt. Ltd. This resulted in non-recovery/short recovery of Rs. 41.85 crore.

On the irregularities being pointed out between November 2006 and April 2008, the department reported (February to July 2008) recovery of Rs. 48.89 lakh. However, in respect of Patparganj and Tughlaqabad ICDs, the department stated that these custodians were exempted from cost recovery charges.

The reply is not acceptable as the ICDs located at Patparganj and Tughlaqabad, Delhi were not amongst the list of exempted ICDs/CFSs.

In respect of ICD, Kanpur, the department stated (February 2008) that cost recovery charges of Rs. 18.04 lakh for the period August to December 2007 was paid by the custodian as per sanctioned strength only. Further, the department stated that excess staff was provided by the commissioner

considering the excess work load at the ICD, Juhi Railway Yard, Kanpur and cost recovery for the staff posted in excess over the sanctioned strength could not be made because the custodian (CONCOR) had not requested for additional staff.

The reply is not satisfactory as the sanction for posting of customs officials is issued by the Board and the commissioner is not empowered to provide additional staff over the sanctioned strength free of charge. The Board's circular of December 1995 stipulates that custodian shall bear the cost of customs staff posted at ICD and that too on the basis of advance payment for three months for the number of staff actually posted at the ICD.

The cases were reported to the Ministry in June /October 2008; its responses had not been received (December 2008).

## 14.5 Non-levy of fees for services rendered

As per customs (Fees for Rendering Services by Customs Officers) Regulations, 1998 overtime fee at the specified rates is leviable for services rendered by customs officers beyond working hours and on holidays. Further, such fee is also leviable during normal working hours for services rendered outside the normal place of work or at a place beyond the customs area.

M/s Komarrah Limestone Mining Corporation and several other exporters/ importers utilised (January 2002 to June 2007) the services of customs officers under the commissionerates of customs (NER), Shillong and Kakinada, Andhra Pradesh within the customs area on holidays and beyond usual office hours and beyond the customs area during normal working hours on working days. Audit observed that in some cases the department did not levy any fees and in other cases it levied fees for services rendered on holidays only. The omissions resulted in short charging of fees amounting to Rs. 18.03 lakh.

On the irregularities being pointed out (December 2006 to April 2008), the department raised demand for Rs. 12.92 lakh (April 2008) in one case and reported (June 2008) partial recovery of Rs. 2.52 lakh in the other case.

The cases were reported to the Ministry in July/November 2008; its responses had not been received (December 2008).

## 14.6 Duty on 'aviation turbine fuel (ATF)'

As per section 87 of the Customs Act, 1962, any imported stores on board an aircraft may be consumed without payment of duty during the period such aircraft is a foreign going aircraft. During domestic flights, ATF falling under CTH 27.10 of the customs tariff used by aircrafts attracts customs duty at the applicable rates.

After termination of international trip at Calicut, M/s Air India Express Ltd., Mumbai converted into domestic flight and flew between Calicut andMumbai. During such domestic flights between March and November 2007, the company had used 838.134 kilolitres of ATF but the department did not levy duty on ATF consumed on domestic flights. This resulted in non levy of duty of Rs. 59.54 lakh.

On this being pointed out (March 2008), the department issued a show cause notice in March 2008. Further progress in the case had not been received (December 2008).

The case was reported to the Ministry in November 2008; its response had not been received (December 2008).

## 14.7 Short levy/non-levy of interest on finalisation of provisional assessment

As per section 15 (1) (b) of the Customs Act 1962, duty on clearance of warehoused goods becomes payable on the date of presentation of ex-bond bill of entry. Further, as per section 18(3) of the said Act, on finalisation of the provisional assessment, the importer/exporter is liable to pay interest at the prescribed rate on the amount of duty payable from the first day of the month in which the duty is provisionally assessed till the date of payment.

Eleven ex-bond bills of entry filed by M/s Indian Oil Corporation Ltd. for clearance of petroleum crude oil were provisionally assessed by the Jamnagar commissionerate between 14 July 2006 and 22 March 2007 and finally assessed in November/December 2007. Although differential duty was paid on final assessment, the department did not levy interest correctly under section 18 (3) of the Act. This resulted in short levy/non-levy of interest of Rs. 26.14 lakh.

On this being pointed out (January 2008), the department reported (February 2008) recovery of Rs. 0.36 lakh in respect of 10 cases and in one case it stated that as the importer filed into bond bill of entry on 9 July 2006, the provisions inserted on 13 July 2006 was not applicable. However, a show cause notice was issued for recovery of interest of Rs. 25.78 lakh at the instance of audit.

The reply is not acceptable because for warehoused goods, the relevant date for payment of duty is the date of presentation of ex-bond bill of entry for home consumption and not the date of filing into bond bill of entry for warehousing. As the importer filed ex-bond bill of entry on 14 July 2006 i.e. after introduction of section 18(3), interest was to be levied on the differential duty finally assessed. Further progress in the case had not been received (December 2008).

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

## 14.8 Other cases

In nineteen other cases involving short levy/non-levy/excess levy of duty/ interest of Rs. 2.39 crore, the Ministry/department had accepted (till December 2008) the audit observations in twelve cases involving Rs. 1.72 crore and had reported recovery of Rs. 78.75 lakh in seven cases.

# CHAPTER XV
# DUTY EXEMPTION SCHEMES

The Government may exempt wholly or part of customs duties for import of inputs and capital goods under an export promotion scheme through a notification. Importers of such exempted goods undertake to fulfil certain export obligations (EO) as well as conditions, failing which the applicable normal duty becomes leviable. A few illustrative cases, where duty exemptions were availed without fulfilling EOs/conditions are discussed in the following paragraphs. The total revenue implication in these cases was Rs. 33.24 crore. These observations were communicated to the Ministry through 51 draft audit paragraphs. The Ministry/department had accepted (till December 2008) the audit observations in 28 draft audit paragraphs with money value of Rs. 19.62 crore, of which Rs. 2.18 crore had been recovered.

## 15.1 Export oriented units (EOU)/Export processing zone (EPZ) scheme

***Incorrect availing of exemption***

As per paragraph 6.2 (b) of the Exim Policy 2002-07, an EOU may import, without payment of duty, all types of goods including capital goods required for its activities. Further, as per paragraph 6.6 (b) of the policy, the 'letter of permission (LOP)' issued to the unit by the concerned authority would be construed as a licence for all purposes. As per paragraph 9.5 of the Exim Policy, the export items mentioned in the LOP alone shall be taken into account for calculation of 'Net Foreign Exchange Earning as a percentage of exports (NFEP)' and export performance.

**15.1.1** M/s Tracmail India Pvt. Ltd., Mumbai, a Software technology park of India (STPI) unit was issued an LOP on 23 June 1999 for manufacturing/export of computer software. Audit observed that the unit was engaged in IT enabled services. The schedule to 'Profit and Loss (P & L)' account of the company revealed that the income was booked under "E-mail and voice management and consulting services – overseas". Further, note IV of schedule 'M' annexed to the P & L account also showed that the income was recognised on the basis of productive/utilised man hours and/or completed engagements for each customer in accordance with the respective service agreements. These activities were not related to manufacture of software but related to call centre activities. Since the LOP was issued for manufacture of software, the unit was not entitled to procure duty free imported or indigenous goods for the call centre activities and accordingly the assessee was liable to pay back the duty concession availed of Rs. 3.30 crore (customs duty) and Rs. 0.53 crore (central excise duty).

On this being pointed out (February 2005), the department stated (March 2008) that the unit had indicated IT enabled services in its application and therefore LOP issued must be construed for 'IT enabled services'. It further stated that the LOP issuing authority, STPI had amended the LOP in May 2005 and January 2007 by incorporating IT enabled services, as at the

time of issue of LOP, the activity 'computer software' also included call centre and software development. Thus, the amendment made to the LOP in May 2005 was clarificatory in nature, and was therefore, applicable retrospectively. However, a protective demand of Rs. 3.83 crore had been issued (September 2006).

The department's reply is not acceptable due to the fact that the LOP was issued to the unit in June 1999 for manufacture of software, while call centre service is an entirely different field of activity which could not be linked with manufacture of software. Moreover, the amendment to the LOP which was made in May 2005 would have prospective effect only. The audit contention was judicially supported by the CESTAT, west zone bench, Mumbai in the case of M/s Bhilwara Spinners Ltd. versus commissioner of customs (EP), Mumbai {2008 (223) ELT 172 (Tri-LB)}. It was held that the licensing authority does not have powers to amend any licence retrospectively.

The case was reported to the Ministry in November 2008; its response had not been received (December 2008).

**15.1.2** M/s Maneesh Exports, an EOU in Mumbai, was granted an LOP in January 2002 for manufacture of capsules/tablets of pharmaceutical formulations. The LOP was amended in May 2006 permitting manufacture of dry syrup, suspension and injections. Audit observed that during the period 2004-05 and 2005-06, the unit had manufactured suspensions and injections worth Rs. 1.14 crore and Rs. 2.14 crore, respectively, exported these goods and availed duty concessions. This was irregular as the manufacture and export took place prior to amendment of the LOP. Thus, duty concession of Rs. 51.54 lakh availed on imports was recoverable. Further, during the period September 2006 to December 2006, the unit had manufactured and exported 'gel/ointments' having FOB value of Rs. 1.75 crore, even though 'gel/ointments' were not specifically covered in the amended LOP. Hence, related duty concession of Rs. 19.71 lakh granted was also irregular and recoverable. The total exemption irregularly availed amounted to Rs. 71.25 lakh.

On this being pointed out (November 2007), the department, while accepting the observations, stated that a demand notice for the recovery of duty foregone had been issued, which was pending adjudication. The Ministry of Commerce and Industry further stated (September 2008) that all the records pertaining to this unit have been transferred to the office of commissioner (LTU), Mumbai, which would take further action.

The case was reported to the Ministry of Finance in July 2008; its response had not been received (December 2008).

**15.1.3** M/s Asian Electronics Ltd., an EOU in Santacruz electronic export processing zone (SEEPZ), Mumbai was issued an LOP in May 2002 for manufacture of 'electric filament or discharge lamps, fluorescent lamps and parts thereof, tube light fittings, retrofit electronic lighting systems and parts thereof'. In June 2003, the development commissioner, SEEPZ, granted approval for disposal of obsolete/surplus capital goods on payment of applicable duties.

Audit observed that the EOU had sold capital goods/machineries worth Rs. 93.13 lakh to a unit in 'domestic tariff area (DTA)' (August 2004) and had claimed exemption from payment of basic customs duty under notification no. 8/2004-cus dated 8 January 2004. The above notification allows exemption to capital goods imported for use in the manufacture of finished goods by the IT/Electronics industry and not for sale of capital goods in DTA. Hence, applicable customs duty of Rs. 38.63 lakh along with interest was recoverable from the unit.

On this being pointed out (December 2007/August 2008), the Ministry of Commerce and Industry stated (December 2008) that the benefit was correctly availed as the goods cleared by the EOU in the DTA were for use in the manufacture of the specified final product and these goods were construed as imported goods at the time of its clearance from the EOU to the DTA unit, thus fulfilling the conditions prescribed in the above notification.

The reply of the Ministry is not acceptable as the benefit of the notification would be available to the DTA unit for goods procured from the EOU and not to the EOU on the clearances made in the DTA, as stated by the Ministry.

*Irregular DTA sale*

In terms of paragraph 6.8 (a) of Foreign trade policy (FTP), an EOU may sell goods up to 50 per cent of FOB value of exports in DTA at concessional rate of duties subject to fulfilment of positive NFEP. As per serial no.2 of notification no. 23/2003-CE dated 31 March 2003, an EOU is liable to pay 50 per cent of aggregate duties of customs for clearance made in the DTA provided that the duty payable shall not be less than duty of excise leviable on the like goods produced and manufactured in India. Further, as per serial no. 3 of the notification, if the goods are produced or manufactured wholly from the raw materials produced or manufactured in India, the duty payable on clearances made in DTA shall be equal to the aggregate of duties of excise leviable under section 3 of the Central Excise Act.

15.1.4 M/s Gujarat Ambuja Export Ltd., an EOU in Ahmedabad III commissionerate of central excise, cleared part quantity of cotton yarn in DTA during March 2004 to March 2007 vide serial no. 3 of above notification and discharged excise duty leviable under section 3 of the Central Excise Act. Audit observed that the unit had used imported furnace oil for generation of power in or in relation to manufacture of final products and accordingly was liable to pay duty as specified under serial no. 2 instead of serial no. 3 of the above mentioned notification, which was 50 per cent of aggregate duties of customs. Failure of the department to levy duty under serial no. 2 of the above notification resulted in short levy of duty of Rs. 3.06 crore for the clearances made between March 2004 and March 2007

On this being pointed out (December 2007), the department admitted the facts (May 2008) and stated that a show cause notice was being issued to the unit.

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

15.1.5 M/s Asian Electronics Ltd., Nasik under SEEPZ, Mumbai was issued an LOP in May 2002 for manufacture of electric filament or discharge lamps, fluorescent lamps and parts thereof, tube light fittings, retrofit electronic

lighting systems and parts thereof. During 2003-04, 2004 -05 and 2005-06, the unit had made DTA clearances at concessional rates of duty. Scrutiny of the annual performance report, for the period 2003 to 2006 filed by the unit, revealed that while the unit had achieved positive NFEP during 2003-04 and 2004-05, it had failed to achieve positive NFEP for the year 2005-06. Accordingly, the DTA clearance of goods at concessional rate of duty during the year 2005-06 was irregular. After considering the accrued eligibility for the previous years, there was a net excess clearance of Rs. 2.01 crore in DTA during 2005-06 on which the duty liability worked out to Rs. 36.61 lakh.

On this being pointed out (October 2007/August 2008), the Ministry of Commerce and Industry stated (October 2008) that the unit had achieved positive NFEP during the period 2002-03 to 2006-07, calculated on a cumulative basis. However, no documentary evidence was provided to enable audit to verify achievement of NFEP. The requisite documents have been called for (December 2008).

*Other cases*

**15.1.6** In two other cases of debonding, short levy of duty of Rs. 19.43 lakh was pointed out. The department did not accept the audit observations. The audit comments were reported to the Ministry in June/ November 2008, its response had not been received (December 2008).

## 15.2 Duty entitlement pass book (DEPB) scheme

*Non-realisation of export proceeds*

As per paragraph 4.45 of the HBP-Volume-I (2002-07), if export proceeds are not realised within six months from date of export or such extended period as may be allowed by the Reserve bank of India (RBI), DEPB credit allowed shall be recovered from the exporter in cash with interest.

**15.2.1** The JDGFT, Jaipur had issued 20 licences to M/s Rochi Ram & Sons, Jaipur and 2 other exporters between June and September 2004. Export proceeds of Rs. 8.60 crore could not be realised by these licensees within the prescribed period. Hence, DEPB credit of Rs. 1.12 crore allowed was recoverable along with interest from the licensees.

On the observations being pointed out (May/June 2005), the JDGFT, Jaipur while accepting the observation reported (June 2007) recovery of Rs. 40.40 lakh in seven cases. It further informed that (i) realisation certificates in 10 cases were submitted, (ii) two licensees (M/s Rochi Ram & Sons, Jaipur and M/s Rochees watch, Jaipur) had been put on 'Denied Entity List (DEL)' and (iii) in the remaining case the RBI had granted extension of time for realisation of export proceeds.

The cases were reported to the Ministry in June 2008; its response had not been received (December 2008).

*Credit for exports made through unspecified ports*

In terms of paragraph 4.40 of the HBP, Volume-I, 2004-09, exports/imports made only through the specified ports are entitled for DEPB credits. The commissioner of customs may, by a special order, and subject to such

conditions as may be specified by him, permit imports and exports from any seaport/airport/ICD/LCS etc.

15.2.2 M/s VTM Ltd., Sulakarai, Tamil Nadu and another exporter were issued eight DEPB licences for Rs.35.83 lakh by the Joint Directors of Foreign Trade, (Madurai: six licences; Chennai: two licences) during 2006-07 for exports made through the unspecified ports namely container freight station (CFS)/ Mulund, inland container depot (ICD)/Sattva-Melpakkam and Arakonam. The exports made through these unspecified ports were not eligible for the DEPB credit. The grant of DEPB credit of Rs. 35.83 lakh was, therefore, not in order and was recoverable.

On this being pointed out (January/October 2008), the Ministry of Commerce and Industry stated (December 2008) that in terms of paragraph 4.19.1 of the HBP, the commissioner of customs may permit imports and exports from any other seaport/airport/ICD/LCS.

The reply is not acceptable as there was no special order notifying the above mentioned ports for the purpose of DEPB credit.

***Excess credit of duty due to adoption of incorrect exchange rate***

As per condition 2 (iii) (a) of the notification no. 104/95-cus dated 30 May 1995, credit shall be allowed on the inputs used in the export products as if the inputs were imported on the 'let export order (LEO)' date. Further, as per paragraph 4.43 of the HBP Volume-I, 2004-09, the FOB value in free foreign exchange shall be converted into Indian rupees as per the exchange rate for exports applicable on the date of LEO.

15.2.3 M/s Falcon Marine Exports Ltd. and two others were granted post-export duty credit by the JDGFT, Kolkata for eleven consignments of 'artificial fur lining & raw silk' imported during the period July to October 2006 against export of 'frozen headless shrimps' under the Pass book scheme. It was noticed that the amount of admissible credit was calculated with reference to the exchange rate prevailing on the date of realisation of sale proceeds of the export product as against the rate prevailing on the date of order for clearance (LEO). This resulted in grant of excess credit of Rs. 12.72 lakh.

On this being pointed out (January 2007), the JDGFT, Kolkata stated (February 2007) that no specific provision was laid down in the relevant 'Exim Policy' regarding adoption of rate of exchange in respect of allowing credit under Pass book scheme and therefore the exchange rate that was prevalent on the date of realisation of export proceeds, as followed in the of DEPB scheme, was adopted.

The contention of the department is not acceptable in view of the paragraph 4.43 of the HBP Volume-I, which clearly states that the relevant date will be the date of order of 'let export' by the customs.

The cases were reported to the Ministry in July 2008; its response had not been received (December 2008).

***Other irregularities***

**15.2.4** In six other cases of clearance of ineligible goods, time barred claims, non-imposition of late cut and incorrect application of credit rate, grant of excess DEPB credit etc. amounting to Rs. 36.29 lakh was pointed out. The department accepted audit observation in five of these cases involving excess credit of Rs. 29.92 lakh and reported recovery of Rs. 7.97 lakh in two cases.

These cases were reported to the Ministry in July/November 2008; its responses had not been received (December 2008).

## 15.3 Duty free replenishment certificate (DFRC) scheme

***Inadmissible imports***

As per paragraph 4.2.3 of the Exim Policy 2002-07, DFRC shall be issued only in respect of products covered under the 'Standard input output norms (SION)' as notified by the DGFT. Further, paragraph 4.2.4/4.3.1 of the policy stipulates that DFRC shall be issued for import of inputs indicated in the shipping bills, as per the SION. SION norms are subject to amendment by the DGFT vide public notice issued from time to time.

**15.3.1** SION for export item 'glass bottles,' mentioned at serial no. A3016 of the HBP, Volume-2 was amended by the DGFT vide public notice no. 58 dated 12 April 2004 incorporating 'Formers relevant to the export product' and 'packing materials'.

M/s Gujarat Glass Pvt. Ltd., Mumbai had exported empty glass bottles covered under SION A3016 and applied for DFRC licences. DGFT, Mumbai issued 14 licences between June 2004 and September 2005 for a total c.i.f. value of Rs. 91.16 crore. Audit observed that against these licences, the licensee had imported 'titanium dioxide', worth Rs. 31.95 crore between August 2004 and August 2005 but claimed these imports as 'formers relevant to the export product'. The 'former' is a key component in making the structure of a glassy material, the most commonly used formers being silica, boric oxide, phosphorous pentaoxide etc. 'titanium dioxide' on the other hand is widely used as a white pigment, for providing reflective optical coating and also used as a pigment to provide whiteness and opacity to products such as paints, coatings plastics, papers etc. Hence, the imported item was not 'former' covered under SION and accordingly was not eligible for exemption of duty. Thus, the total duty foregone amounting to Rs. 4.85 crore was recoverable from the licensee.

On this being pointed out (October 2007 to April 2008), the department reported (July 2008) issue of demand notices/refusal orders for eight licences and called for submission of specification of the 'former' used in the manufacture of the export product in respect of remaining licences.

The cases were reported to the Ministry between September/November 2008; its responses had not been received (December 2008).

**15.3.2** In terms of public notice no. 10 dated 30 May 2003 issued by the 'Department of Commerce', import of chemicals, reagents, etc, under SION

serial no. E-79 (white sugar), were to be permitted in quantities subject to an overall cap of 6.2 per cent of FOB value of the export of 'white sugar'.

M/s Cauvery Coffee Traders, Mangalore exported 'white sugar' under SION serial no. 79 valued at Rs. 3.87 crore and applied for DFRCs. The RLA, Bangalore issued two DFRCs with c.i.f. value of Rs. 5.40 crore and Rs. 2.49 crore without applying the prescribed value cap. This resulted in excess grant of DFRC to the extent of Rs. 2.87 crore, which was recoverable from the importer.

The case was reported to the department and the Ministry in November 2007/ June 2008; its responses had not been received (December 2008).

**15.3.3** M/s Tanna Agro Impex Pvt. Ltd., Mumbai and M/s Indian Sugar Exim Corporation Ltd., Delhi had exported (February/March 2003) 'white sugar' covered under SION at serial no. E-79 and were issued a DFRC licences in April/May 2003 for a c.i.f. value of Rs. 7.33 crore and Rs. 31.34 crore respectively by the RLA, Mumbai. Audit observed that the licensees had imported spare parts for manufacturing relay, capacitor, copper wire, bracket, 'chick peas' and 'black matpe' etc, which were not covered under serial no. E-79 of SION. As these items were not entitled for import against the DFRC licence issued for export of 'white sugar,' the duty foregone on these imports amounting to Rs. 73.41 lakh was recoverable.

On this being pointed out (April 2008), the RLA, Mumbai stated (July 2008) that no import of 'chick peas' and 'black matpe' were allowed under the DFRC and the matter regarding imports pertains to the customs department. The matter was taken up with the commissioner of customs (Import), Mumbai in July 2008, its response had not been received (December 2008). The reply in respect of other case had not been received (December 2008).

The cases were reported to the Ministry in July 2008/September 2008; its response had not been received (December 2008).

**15.3.4** The Zonal JDGFT, Kolkata issued (August 2002) two DFRC licences to M/s Durgapur Steel Plant for duty free imports worth Rs.7.76 crore. Scrutiny of the concerned licence files revealed that the unit imported (August 2003), through the commissionerate of customs (port), Kolkata, a consignment of 7,545.10 MT 'coking coal' although the Zonal JDGFT did not allow the item for import, as it was not mentioned in the input-declarations of the relevant shipping bills. The department allowed clearance of 1,546.64 MT of the goods on payment of appropriate duty but on the remaining 5,998.46 MT, benefit of duty-free clearance was erroneously allowed on the basis of the two licences. Irregular extension of the benefit resulted in duty forgone along with interest amounting to Rs. 25.76 lakh not being recovered.

On this being pointed out (February 2008), the department issued (November 2008) show cause notice to the importer. The case was reported to the Ministry in September 2008; its response had not been received (December 2008).

**15.3.5** Note 3 of public notice no. 23 (RE-03) dated 10 September 2003, prescribes that the exporter of 'soyabean extraction', is eligible to import 'coal', as input, subject to the condition that the 'coal' is allowed as a process

material essentially for heating purpose in the manufacture of 'soyabean extraction' and not for power generation for running the plant.

Scrutiny of records of customs house, Visakhapatnam, revealed that five DFRC licences were issued to M/s Murali Agro Products Ltd. by the RLA, Mumbai between March and August 2004 against export of 'soyabean extraction'. These DFRCs were transferred to M/s Raipur Alloys & Steel Ltd. who in turn imported 5,000 MTs of Steam (non cooking) coal (April 2005) for a c.i.f. value of Rs. 1.63 crore which was cleared without payment of duty of Rs. 8.47 lakh. Similarly eight DFRCs were issued to M/s Suraj Impex Ltd. for export of 'soyabean extraction,' which were transferred to M/s Birla Corporation Ltd. who imported 7,057 MTs of 'coal' for a c.i.f. value of Rs. 3.89 crore without payment of duty of Rs. 15.91 lakh. As neither M/s Raipur Steel Ltd. nor M/s Birla Corporation Ltd. was a manufacturer of 'soyabean extraction,' the actual user condition for import of coal was not fulfilled. Further, no evidence was produced to audit to the effect that the imported coal would be used essentially for heating purpose in the manufacture of 'soyabean extraction' as prescribed in SION. Thus, permitting import of coal without paying applicable customs duty of Rs. 24.38 lakh was irregular.

On this being pointed out (January/March 2008), the department stated (May 2008) that the SION norms were only for the purpose of 'Advance licensing scheme' wherein the import took place prior to exportation and that it was not legal and proper to hold the items permitted for import just because the same was mentioned in the SION. It further stated that the licences were transferable and there was no actual user condition prescribed in the licences issued.

The department's reply is not acceptable in view of the provisions of paragraph 4.31 of the HBP, Volume-I, which prescribes that specific inputs under a SION are subject to actual user condition. Further, it was not established that the imported coal was used for the purpose prescribed in the SION, despite the fact that DFRCs were transferable.

The cases were reported to the Ministry in October 2008; its response had not been received (December 2008).

**15.3.6** As per SION serial no. J331 of HBP Vol-2, for export of one piece of textile item 'ladies midi', duty free import of 4 square meters of fabric is allowed.

The RLA, Chennai granted, between September 2004 and April 2006, 14 DFRC licences to M/s. Rich Source International under SION serial no. J331 for import of 'denim/polyester fabric' worth Rs. 1.52 crore. In six cases, the exporter had declared the fabric consumption involved in the export product as per the normative quantity allowed under SION J331 without reference to the actual consumption of fabric which was less than the norms. The excess import allowed was 47,159 square meters of denim and 36,592 square meters of 100 per cent polyester fabric valued at Rs. 20.13 lakh. The duty forgone amounting to Rs. 22.77 lakh was, therefore, recoverable.

On this being pointed out (January/October 2008), the Ministry of Commerce and Industry stated (December 2008) that a demand notice had been issued to the firm.

***Other cases***

**15.3.7** In two other cases, irregularities like excess import of inputs and issue of DFRC for DTA clearances, involving duty of Rs. 14.64 lakh were pointed out to the department in October 2007. The department had reported recovery of Rs. 9.43 lakh in one case.

The cases were reported to the Ministry in October 2008; its responses had not been received (December 2008).

***Incorrect grant of DFRC***

As per paragraph 4.2.1 of the Exim Policy 2002-07, DFRC shall be issued on minimum value addition of 33 per cent which was amended to 25 per cent with effect from 1 April 2003 vide notification no. 1 (RE-2003)/2002-07) dated 31 March 2003. Further, paragraph 4.2.4 of the policy stipulates that DFRC shall be issued for import of inputs as per SION as indicated in the shipping bills.

**15.3.8** M/s Shree Tatyasaheb Kore Warana Sahakari Sakhar Korkhana Ltd., Kolhapur and two others exported (January to March 2003) 'white sugar' covered under food products and SION at serial no. E-79. The FOB realised on the exports was Rs. 23.97 crore. The RLA, Mumbai issued five licences between April and August 2003 for a c.i.f. value totaling Rs. 19.08 crore. Audit observed that DFRC licences were issued by allowing value addition of 25 per cent, which was irregular, as at the time of exports the value addition required under the 'Exim Policy' was 33 per cent. This resulted in loss of customs duty of Rs. 2.98 crore on the imports effected by the licensees under DFRC issued.

On this being pointed out (September 2007 to April 2008), the department in respect of three licences stated (January/May 2008) that the matter was referred to the DGFT, New Delhi (Exim policy cell) for clarification regarding value addition of DFRC issued after 1 April 2003. The department also reported that value addition was reckoned with reference to the date of issue of licence authorisation only and not from the date of export as per the general practice followed by the office and this applied prospectively while issuing DFRCs.

The reply is not acceptable as at the time of exports, the prescribed value addition was 33 per cent. The policy provisions amending the value addition to 25 per cent was made effective subsequent to exports made. The reply in respect of remaining licences had not been received (December 2008).

The cases were reported to the Ministry in September/November 2008; its responses had not been received (December 2008).

***Non-imposition of late cut***

Paragraph 4.34 of the HBP Volume-I, (2002-07) provides that the application for DFRC shall be filed within six months from the date of realisation in respect of all shipments or supplies for which DFRC is being claimed.

Paragraph 9.3 of the HBP further provides that whenever any application is received after the expiry of the last date for submission of such application but within six months from the last date, such application may be considered after imposing a late cut at the rate of 10 per cent on the entitlement.

**15.3.9** Audit observed that M/s EID Parry India Ltd. and 43 other exporters were issued 68 DFRC licences by the RLAs (Bangalore: 22 licenses, Chennai: 31 licences; Jaipur: 1 licence, Coimbatore: 2 licences; Madurai: 1 licence and Puducherry: 11 licences) for a total c.i.f. value of Rs. 22.81 crore without imposing the applicable late cut of 10 per cent though these applications were filed after the expiry of the prescribed period. The omissions resulted in grant of excess credit of Rs. 2.20 crore.

On these irregularities being pointed out between July 2007 and January 2008, the RLAs Coimbatore and Madurai stated (November 2007/April 2008) that the importers had been directed to refund the excess credit in respect of licences issued. The RLAs, Bangalore and Jaipur stated (November 2007/ October 2008) that one licensee each, under their jurisdiction, had submitted un-utilised licence for adjustment of excess credit issued. Replies from the RLAs, Chennai and Puducherry had not been received (December 2008).

In reply to the audit comments issued in November 2008, the Ministry of Commerce and Industry stated (December 2008) that demand notices had been issued in all 31 cases pertaining to the RLA, Chennai. Its responses in the remaining cases had not been received (December 2008).

***Time barred claims***

In terms of paragraph 4.34 of the HBP Volume-I, read with paragraph 9.3 of the HBP, if an application is not received within 12 months from the prescribed last date of submission, the importer would not be entitled for DFRC licence.

**15.3.10** Scrutiny of DFRC licences issued by the JDGFT, Jaipur revealed that DFRC licences were issued to M/s Jaipur Silver Jewels, Jaipur and two others in deviation of the above provisions. Three DFRCs issued by the RLA, Jaipur incorrectly included five time barred shipping bills (SBs) and, 10 per cent late cut was not imposed on two SBs. This resulted in grant of excess credit of Rs. 74 lakh.

On this being pointed out (February 2008), the department intimated (March to May 2008) adjustment of Rs. 63.29 lakh along with interest of Rs. 11.80 lakh. Recovery/adjustment of the balance excess credit of Rs. 10.71 lakh had not been intimated (December 2008).

The cases were reported to the Ministry in November 2008; its response had not been received (December 2008).

**15.3.11** Three DFRC licences for a value of Rs. 46.69 lakh were issued by the RLA, Chennai to M/s Kumarran Silks Exports and two others for which the applications were filed after expiry 12 months from the prescribed last date. The grant of DFRC licences on the time barred applications were, therefore, not in order and the duty of Rs. 9.40 lakh with interest of Rs. 4.18 lakh was required to be recovered.

On this being pointed out (January/October 2008), the Ministry of Commerce and Industry stated (December 2008) that demand notice had been issued to the firms.

***Excess import made due to excess quantity sanctioned in telegraphic release advice (TRA)***

In terms of paragraph 4.32 of the HBP Volume-I, 2004-09, export shipment under DFRC can be effected from any port mentioned in paragraph 4.19 of the HBP. DFRC is issued with a single port of registration which will be the port from where export and import can be effected. Import from a port other than the port of export is allowed by the customs authorities at the port of export through TRA to the port of import.

**15.3.12** Four TRAs were issued by the deputy commissioner of land customs station, Raxaul for clearance of 1,320.77 tonnes of 'steel billets' valued at US$ 2,35,765 to four transferees, against the DFRC licence no.0210028000 dated 30 October 2001 issued to M/s. Tata Iron and Steel Company Ltd., Kolkata for import of 783.08 tonnes of 'Steel Billets' valued at US$ 1,40,765. Audit observed that the quantity of 1,320.77 tonnes of 'steel billets' valued at US$ 2,24,545 was cleared through Chennai Sea customs between June 2002 and April 2003 at concessional rates of duty. The excess clearance of 537.69 tonnes of 'steel billets' valued at US$ 83,780, should have been taxed at the rate applicable at the time of import. The duty of Rs. 13.53 lakh foregone on account of irregular issue of TRA was recoverable from the transferees along with interest.

The case was reported to the department and the Ministry in November 2007/October 2008; its responses had not been received (December 2008).

***Short levy of additional duty***

In terms of the customs notification no. 46/2002-cus dated 22 April 2002 as amended, materials imported under DFRC are exempted from 'basic customs duty (BCD)' and the special additional duty of customs (SAD), subject to the debiting of the DFRC licence with these duties, at the time of clearance. Further, for calculation of the 'additional duty (CVD)', the value of the imported article shall be the aggregate of the value of the imported article and any duty of customs (including BCD) chargeable on that article, but does not include SAD, safeguard duty or anti-dumping duty.

**15.3.13** M/s Steel Authority of India and two others imported (July 2004 to April 2007) goods valued at Rs. 78.27 crore under DFRC scheme through New Custom House, Mangalore. Audit observed that the department had levied additional duty (CVD) on the assessable value of the goods without taking the element of basic customs duty into account. This resulted in short levy of Rs. 29.82 lakh.

On this being pointed out (December 2007), the department stated (March 2008) that the basic customs duty was exempted under DFRC scheme and therefore the department had levied additional duty of customs, on the assessable value of the goods without taking the element of basic customs duty into account.

The reply of the department is not acceptable as the CVD is to be calculated after adding applicable BCD, without considering the fact that BCD was exempt through debit in DFRC licence.

The case was reported to the Ministry in October 2008; its response had not been received (December 2008).

## 15.4 Target plus scheme (TPS)

***Duty free credit despite negative growth***

As per paragraph 3.7.2 of the FTP read with Appendix 17 D of the HBP Volume I, all star export houses which have achieved a minimum export turnover of Rs. 5 crore in the previous licensing year are eligible for consideration under the TPS. However, it shall be necessary that the free on board (FOB) value of exports during the licensing year 2004-05 does not fall below the FOB value of exports in the previous licensing year to avail the benefit under the TPS.

**15.4.1** Duty free credit of Rs. 1.56 crore was issued (March 2007) to M/s Apex Exports under the TPS by the Zonal JDGFT, Chennai, taking the eligible export for 2003-04 and 2004-05 as Rs. 11.55 crore and Rs. 23.88 crore respectively. Audit observed that the total export turnover (US$ 53,15,034) for the year 2004-05 was less than the total export turnover (US$ 56,07,680) for the year 2003-04. This resulted in incorrect issue of duty free credit of Rs. 1.56 crore which was recoverable.

On this being pointed out (January 2008), the RLA, Chennai stated that final reply would be sent after examining the audit observation.

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

**15.4.2** Duty free credit of Rs. 40.64 lakh under the TPS for 2004-05 was issued (February 2007) to M/s Ayshwarya Sea Food Pvt. Ltd. by the Zonal JDGFT, Chennai. Scrutiny of the profit and loss account of the firm for the years 2003-04 and 2004-05 indicated that the total export turnover for 2004-05 (Rs. 22.94 crore) was less than the total export turnover for 2003-04 (Rs. 33.59 crore). This resulted in incorrect grant of duty free credit of Rs. 40.64 lakh.

On this being pointed out (November 2007), the Zonal JDGFT, Chennai, stated that the final reply would be sent after examining the audit observation.

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

**15.4.3** As per paragraph 9.28 of the FTP, for grant of benefit under the TPS, the export of group company could be taken into consideration only if the group company is in existence during the previous two years.

Audit observed that M/s B.K.S. Textiles Pvt. Ltd. came into existence in 2004-05 and the total export turnover was Rs. 28.35 lakh for the year 2004-05. However, the RLA, Chennai issued a duty free credit of Rs.30.78 lakh under the TPS for 2005-06 in contravention of the above provisions, as the licensee

had neither achieved the minimum eligible export turnover of Rs. 5 crore during 2004-05 nor was it in existence during the previous two years for considering the export turnover of its sister firm M/s B.K.S. Mills, as a group company. This resulted in incorrect grant of duty free credit of Rs. 30.78 lakh.

On this being pointed out (October 2008), the Ministry of Commerce and Industry stated (December 2008) that a demand notice had been issued to the licensee to surrender the un-utilised TPS or else, to pay the customs duty along with interest.

***Time barred supplementary claim***

As per Note 8 of Appendix 17D, HBP, Volume-.I, the supplementary claim for duty free credit under the TPS could be made within three months from the date of last realisation of exports.

**15.4.4** The Zonal JDGFT, Chennai had issued (September 2005) duty free credit of Rs. 1.76 crore under the TPS to M/s Leather India for the year 2004-05. Based on a supplementary claim, duty free credit of Rs. 30.07 lakh was subsequently issued in January 2007 for the same year, even though the exporter had filed the supplementary claim on 13 July 2006 which was beyond the prescribed time limit of three months from the date of last realisation of exports (29 August 2005). This resulted in incorrect issue of duty free credit of Rs. 30.07 lakh.

On this being pointed out (November 2007), the RLA, Chennai stated that final reply would be sent after examining the audit observation.

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

***Incorrect computation of duty***

As per Appendix 17D of the HBP, Volume-I, the export turnover for determining the eligibility for duty free credit under the TPS should be based on the 'let export order (LEO)'date.

**15.4.5** The JDGFT, Chennai issued a duty free credit of Rs. 2.73 crore to M/s T.V.S Motor Company Ltd. for the year 2005-06 under the TPS. Audit observed that while computing the eligible export turnover for the year 2005-06, nine shipping bills for an FOB value of Rs. 2.06 crore, which were not relating to the year 2005-06, were erroneously taken into account. This resulted in excess grant of duty free credit of Rs. 20.42 lakh.

On this being pointed out (January 2008), the RLA, Chennai stated that final reply would be sent after examining the audit observation.

The case was reported to the Ministry in July 2008; its response had not been received (December 2008).

## 15.5 Export promotion capital goods (EPCG) scheme

***Non-fulfilment of export obligation***

Paragraph 6.2 of the Exim Policy 1997-02, allows import of capital goods at concessional rate of customs duty subject to fulfilment of the prescribed export obligation. Further, as per paragraph 6.11 of the HBP, Volume-I, the

export obligation shall be fulfilled block wise in the prescribed proportions. If the licence holder fails to discharge a minimum of 25 per cent of the export obligation prescribed for any particular block of two years for two consecutive blocks, he is liable to pay forthwith, the whole duties of customs plus leviable interest.

**15.5.1** M/s Sree Satyanarayana Spinning Mills Ltd. was issued an EPCG licence (March 2000) by the RLA, Hyderabad for import of capital goods worth Rs. 1.54 crore with an obligation to export cotton year/blended yarn worth Rs. 9.24 crore within a period of six years. The licensee was also required to maintain an annual average export performance of Rs. 47.67 lakh. Against import (July 2000) of capital goods worth Rs. 1.37 crore, the licensee could export only Rs. 3.05 crore of cotton yarn up to expiry of the export obligation period (till March 2006). The duty saved on the imported capital goods was Rs. 69.99 lakh. As the licensee failed to fulfil the pro-rata export obligation, he was liable to pay the customs duty of Rs. 44.17 lakh and interest of Rs. 53 lakh (up to March 2008). The licensee's request (June 2006) for extension of export obligation period by one year was turned down by the department, but no action was initiated to recover the customs duty on the un-fulfilled export obligation even after a lapse of two years.

On this being pointed out (September 2007/February 2008), the RLA, Hyderabad, while confirming the facts stated (April 2008) that action was being initiated.

The case was reported to the Ministry in October 2008; its response had not been received (December 2008).

**15.5.2** M/s Lotus Cables Pvt. Ltd. was issued an EPCG licence (December 2000) by the RLA, Hyderabad for import of capital goods worth Rs. 67.97 lakh with an obligation to export goods worth Rs. 3.40 crore. The licensee imported (December 2000) capital goods valued at Rs. 70.57 lakh. The duty foregone on the imported goods was Rs. 32.93 lakh. Although the third block of years expired on 7 December 2006, the licensee failed to export any goods. The EO period is due to expire in December 2008. The RLA failed to initiate any action (January 2008) except for calling (December 2006) for documents in proof of EO fulfilment. Thus, for failure to fulfil export obligation block wise, for two consecutive blocks, the licensee was liable to pay forthwith the duty foregone amounting to Rs. 32.93 lakh and interest of Rs. 34.58 lakh.

On this being pointed out (January 2008), the RLA stated (March 2008) that a show cause notice sent to the firm's factory was returned undelivered and was being re-dispatched to the firm's office and that follow up action would be taken to impose penalty.

The case was reported to the Ministry in October 2008; its response had not been received (December 2008).

**15.5.3** M/s Visakha Industries Ltd., Secunderabad was issued (July 2001) an EPCG licence by the RLA, Hyderabad for import of capital goods worth Rs. 79.64 lakh with an obligation to export goods valued at Rs.3.98 crore. Against the import of capital goods (September 2001) of Rs. 81.29 lakh the licensee failed to furnish any evidence for exports made till the expiry of the

third block in July 2007. The duty foregone on the imported capital goods was Rs. 37.24 lakh. The RLA failed to initiate any action to recover customs duty from the licensee except for calling (November 2006) for documents in proof of EO fulfilment. As the licensee failed to fulfill any export obligation block wise till the end of the third block, it was liable to pay the duty of Rs. 37.24 lakh together with the interest of Rs. 36.31 lakh.

On this being pointed out (January/April 2008), the RLA stated (May 2008) that a show cause notice was issued (February 2008) and as the firm had not submitted export obligation documents, a reminder had been issued to recover the dues.

The case was reported to the Ministry in October 2008; its response had not been received (December 2008).

**15.5.4** Paragraph 5.5 (i) of the Exim Policy, stipulates that the export obligation may be fulfilled by the export of same goods manufactured in different manufacturing units of the licensee/specified supporting manufacturer. However, if the exporter is processing further to add value to the goods manufactured, the export obligation shall stand enhanced by 50 per cent.

The JDGFT, Mumbai issued (April 2002 to June 2003) three EPCG licences to M/s Virender Processor Pvt. Ltd. for import of capital goods viz. 'chenille machine' for production of 'chenille' yarn from any fabric and other machines like EJC 16, 'tender load wheel', 'discharge/hour meter' and winding/wrapping machine for production of spools of chenille yarn, valued at Rs. 4 crore for export of synthetic textile fabrics worth Rs. 19.98 crore. The licensee exported goods between April and September 2003 through third party and the licences were redeemed by the department in 2004. Audit observed that the imported capital goods were used for production of yarns spools which were further processed to synthetic fabrics and exported. Since the licensee had processed the yarn and made value addition for production of synthetic fabric, the EO should have been enhanced by 50 per cent as per the above provision of the Exim policy. Non-enhancement of EO by 50 per cent resulted in short fulfilment of export obligation and incorrect redemption which led to loss of revenue to the tune of Rs. 41.76 lakh.

On this being pointed out (April 2008), the department reported (May 2008) that three demand notices had been issued to the importer.

The case was reported to the Ministry in November 2008; its response had not been received (December 2008).

## 15.6 Advance licensing scheme

***Non-fulfilment of export obligation***

Paragraph 4.1.1 of the 'EXIM Policy 2002-07', allows duty free import of inputs against advance licence subject to fulfilment of the prescribed export obligation, within a period of 18 months. According to paragraph 4.28 of the HBP Volume-I, in case of bonafide default in fulfilment of export obligation, the licensee is required to pay to customs authority, customs duty on unutilised imported material along with interest.

**15.6.1** The JDGFT, Bangalore issued three advance licences to M/s Vinayaka Metal Extrusions, Bangalore and 2 others for duty free imports valued at Rs. 57.14 lakh for export of goods worth Rs. 1.47 crore. The licensees imported goods through inland container depot, Bangalore availing duty benefits but failed to fulfil the prescribed export obligation. As the licensees failed to fuflil the export obligation, the total duty foregone of Rs. 36.90 lakh was recoverable along with the interest.

On this being pointed out (November 2006), the department reported (December 2007) that show cause notices had been issued. Further progress in the case had not been received (December 2008).

The case was reported to the Ministry in November 2008; its response had not been received (December 2008).

### 15.6.2 Other cases

Two other cases of unutilised/inadmissible imports involving duty benefit of Rs. 11.10 lakh were pointed out. While the department admitted the observation in one case, the reply in the other case had not been received (December 2008).

The cases were reported to the Ministry in September 2008; its responses had not been received (December 2008).

## 15.7 Vishesh krishi upaj yojana (VKUY)

As per customs notification no. 41/2005 dated 9 May 2005, goods including capital goods which are freely importable, when imported under VKUY licence are exempted from duties subject to the prescribed conditions. Import of all oil seeds classifiable under chapter 12 of ITC (HS) are not allowed under VKUY scheme.

M/s Synthite Industrial chemicals Ltd.., Kochi imported (December 2006) a consignment of mustard seeds of Canadian origin through Cochin (sea) customs commissionerate. The department classified the goods under the 'customs tariff heading (CTH)' 1207 and cleared the goods without levy of duty under the above notification, even though, the imports of oil seeds classified under chapter 12 of the Customs Tariff Act, 1975, were not permissible. The incorrect exemption resulted in non- levy of Rs. 5.51 lakh along with interest leviable thereon.

On this being pointed out (March 2007/January 2008) including the suggestion to review similar other cases, the department stated (February 2008) that mustard seeds are also classifiable as spices under chapter 9 of the customs tariff and spices leviable to duty of not more than 30 per cent, are allowed under VKUY licence. The department, however, reported recovery of Rs. 77.70 lakh and interest of Rs. 7.48 lakh for imports made between November 2006 and February 2007 by M/s Synthite Industrial chemicals Ltd. and M/s Sijmak Oils Ltd.

The department's reply is contradictory to the assessment of the import made under CTH 1207. Chapter 12 of the Customs Tariff Act, 1975, covers oil

seeds, while spices are covered under chapter 9 of the Customs Tariff Act, 1975. Further, the CTH 1207 covers mustard seeds of seed quality, imports of which were not allowed under VKUY licence.

The cases were reported to the Ministry in June 2008; its response had not been received (December 2008).

# CHAPTER XVI
# CLASSIFICATION

A few cases of incorrect classification of goods resulting in short-levy/non-levy of customs duties of Rs. 5.70 crore noticed in test check are described in the following paragraphs. These observations were communicated to the Ministry through 22 draft audit paragraphs. The Ministry/department had accepted (till December 2008), the audit observations in 16 draft audit paragraphs with money value of Rs. 4.30 crore, of which Rs. 39.57 lakh had been recovered.

## 16.1 Jackets and other garments

Women's or girls' suits, jackets, trousers and shirts are classifiable under customs tariff heading (CTH) 6104/6204/6206, while men's or boys' suits, jackets and shirts are classifiable under CTH 6103/6201/6205. However, as per note 9 under chapter 61 and note 8 under chapter 62 of the Customs Tariff Act, 1975, garments not identifiable as either men's or boys', or women's or girls' are to be classified under the sub-heading numbers 6104 /6204/6206 covering women's or girls' garments.

M/s Dutta Trading, Siliguri and seven others imported 31 consignments of synthetic jackets and cotton trousers, shirts, shorts etc (not identifiable as either men's or boys' garments/women's or girls' garments) between January 2004 and June 2007 through the Changrabandha land customs station under West Bengal (preventive) and Chennai (sea) customs commissionerates. The department classified the goods as 'jackets meant for men or boys under CTH 6201 and under CTH 6103 and CTH 6205 as garments meant for men or boys. The incorrect classification resulted in short levy of duty of Rs. 2.55 crore.

On this being pointed out (June 2005 and October 2007), the department accepted the objection (August 2007/January 2008) and issued demand notices to the importers.

The observations were reported to the Ministry in July 2008; its response had not been received (December 2008).

## 16.2 Household water filters/purifiers

Household type filters for filtering or purifying water falling under CTH 8421 attract 'basic customs duty (BCD)' at the rate of 10 per cent ad valorem. Further, in terms of notification no. 2/2006-CE (NT) dated 1 March 2006 (serial no. 69), water filters and water purifiers used for domestic purposes and falling under the central excise tariff heading (CETH) 8421 2120 are to be assessed on the basis of their maximum retail price (MRP) for the purpose of countervailing duty (CVD).

Four consignments of 'water purifiers' imported by M/s Luminous Power Technologies Pvt. Ltd. and M/s Whirlpool of India Ltd. through inland container depot, Tughlakabad during September and December 2007 were

classified under CTH and CETH 8421 2190 as 'machinery for filtering or purifying water' and assessed to BCD at the rate of 7.5 per cent, CVD at 'nil' rate as per notification no. 21/2007-cus dated 1 March 2007 and notification no. 6/2006-CE dated 1 March 2006 (serial no. 8B). The mis-classification resulted in short levy of duty of Rs. 75.55 lakh.

On the observations being pointed out between November 2007 and February 2008, the department stated (April 2008) that there was distinction between water filters and water purifiers. It further stated that domestic type water/pressure filters designed for fitting to the main pipes or to the tap and were classifiable under CTH/CETH 8421 2120, while water purifiers used ultra filtration/reverse osmosis (RO) technologies and were rightly classified under CTH 8421 2190 as machinery for filtering or purifying water in line with serial no. 8B of the notification no. 6/2006-CE dated 1 March 2006.

The reply of the department is not acceptable because the heading number 8421 2190 of CTH is merely a residual heading whereas the equipments being filters/purifiers merited classification under CTH 8421 2120. Further, the department's action is inconsistent as it had correctly classified a similar consignment in one case {M/s Hyundai Water Solution} and in another case upon being pointed out, had recovered the short levied amount {M/s Liquatec (BE no. 620443 dated 16 August 2007)}.

The observation was reported to the Ministry in October 2008; its response had not been received (December 2008).

## 16.3 Non-inclusion of value of goods in the assessable value

Rule 9 of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 provides for addition of certain costs and services to the transaction value. Rule 9 (1) (e) of the said Rules covers all other payments actually made or to be made as a condition of sale of imported goods by the buyer to the seller. In the case of M/s Mukund Ltd. {1999 (112) ELT 479 (Tribunal)} dated 7 October 1997, the CESTAT held that payment towards supervision charges/services during design, erection and commissioning as per agreement made in foreign exchange for setting up of imported plant will form part of the imported goods and the value thereof will include not only the price paid for design and engineering but also for supervision charges.

M/s Nilachal Ispat Nigam Ltd. imported (August 1999) a consignment of 'sinter plant' equipment through the Paradeep port under Bhubaneswar commissionerate. The basic engineering drawings and documents of the said sinter plant were imported subsequently (November 1999, May and November 2000) in three consignments through Bhubaneswar (air) commissionerate. The department classified the same under sub heading 4901 99 as 'printed material' and allowed clearance without payment of duty in terms of notification no.16/2000-cus (serial no.132), 18/2000-cus and 19/2000-cus all dated 1 March 2000. The technical documents were imported from the same foreign supplier as part of the aforesaid agreement for setting up of the sinter plant, and were to be classified under sub heading 8419. Accordingly, payment made for such documents was also includible in the

transaction value of the 'sinter plant'. The incorrect classification resulted in non-realisation of duty of Rs. 64.54 lakh.

On this being pointed out (August 2006), the department accepted the observation and confirmed the demand (August 2008).

Response of the Ministry had not been received (December 2008).

## 16.4 Inputs for perfumery products classified as wood waste and scrap

In terms of note 1 (a) to chapter 44 of the Customs Tariff Act, 1975, wood, in chips, shavings, crushed, ground or powdered form, of a kind used primarily in perfumery, inter-alia, is excluded from the purview of chapter 44 of the Customs Tariff Act, 1975 and is classifiable under chapter heading 1211 of the said Tariff Act.

M/s Jaya Perfumery Works, Kolkata imported 746 ton 'joss powder' (bark of Litsea tree in powdered form) in twenty-six consignments between March and November 2006 through the Kolkata (port) commissionerate. The department classified the goods as sawdust and wood waste and scrap under sub heading 4401 30 00 of the customs tariff. However, the imported goods being raw material for making 'agarbatti (perfumery product)' was correctly classifiable under sub heading 1211 90 39, as per the aforesaid chapter note. The incorrect classification resulted in short levy of duty of Rs. 19.51 lakh.

On this being pointed out in October 2007, the department issued a demand in December 2007. Thereafter, it justified (May 2008) the classification under heading 4401 stating that 'joss powder' did not have perfume of its own and, therefore, it could not be used primarily or directly in perfumery. It further added that the products in dust/powdered form were applied to the blank incense sticks and thereafter perfumes of different aroma were spread over it.

The contention of the department is not acceptable in view of the fact that joss powder was used in the process of producing perfumed stick and hence classifiable under tariff heading 1211.

The observation was reported to the Ministry in October 2008; its response had not been received (December 2008).

## 16.5 Dish antenna classified as machines and apparatus for electroplating, electrolysis or electrophoresis

As per the Customs Tariff Act, 1975, parts suitable for use with dish antenna are classifiable under CTH 8529, attracting 'basic customs duty (BCD)' at the rate of 10 per cent ad valorem.

M/s Dish TV India Ltd. imported 5,26,500 pieces of 'universal single low noise block down converter' between July and November 2007 through the inland container depot, Tughlakabad. The goods were classified under sub heading 8543 as "machines and apparatus for electroplating, electrolysis or electrophoresis" and assessed to BCD at the rate of 7.5 per cent by extending benefit under the notification no. 21/2007-cus dated 1 March 2007 (serial

no.396) and other applicable duties. Audit observed that only "electrical machines and apparatus having individual functions not elsewhere specified or included elsewhere in chapter 84" merit classification under CTH 8543. As the imported goods were parts of dish antenna, these merited classification under CTH 8529 'dish antenna–other'. The misclassification resulted in short levy of Rs. 15.41 lakh.

On being pointed out (October/December 2007), the department reported (May 2008) recovery of Rs. 13.40 lakh. Recovery particulars of the remaining amount had not been received (December 2008).

The observation was reported to the Ministry in July 2008; its response had not been received (December 2008).

## 16.6 PVC coated Polyester sun screens

As per note 1 (h) of section XI of the Customs Tariff Act, 1975, woven, knitted or crocheted fabrics, felt or non-woven, impregnated, coated, covered or laminated with plastics or articles thereof are classifiable under Chapter 39 and not under chapter 63 as 'textiles and textile articles'.

Eighteen consignments of "100% polyester PVC coated sun screen/blinds" imported between May and September 2007 through Chennai (sea port) commissionerate by M/s Pragathi Inc. Bangalore and two others were incorrectly classified under CTH 6303 99 90 as 'other made up textile articles' instead of under CTH 3918 90 90. This resulted in short levy of duty of Rs. 16.20 lakh.

On this being pointed out (November 2007), the department issued (January 2008) demand notices to the importers. Further progress in the case had not been received (December 2008).

The observation was reported to the Ministry in June 2008; its response had not been received (December 2008).

## 16.7 Ice cream candy making machine

'Milking machines and dairy machinery' classifiable under CTH 8434 are exempt from additional duty of customs (countervailing duty) in terms of central excise notification no.6/2006-CE dated 1 March 2006 (serial no.11). However, ice cream making machinery/equipment classifiable under CTH 8438 is not exempted from the countervailing duty.

A consignment of 'ice cream candy making machine' imported (June 2007) by M/s Payodhi Foods Pvt. Ltd. through the Kolkata customs (port) commissionerate was classified under CTH 8434 as 'dairy machine'. Audit observed that the imported machinery was an ice cream candy-making machine classifiable under CTH 8438 and thus not eligible for exemption from levy of countervailing duty under the above said notification. The mis-classification and incorrect grant of exemption resulted in short levy of duty amounting to Rs. 24.67 lakh.

The observation was pointed out to the department/Ministry (February/ August 2008); its replies had not been received (December 2008).

## 16.8 Classification of goods without chemical testing to allow concessional rate

As per CTH 3823, industrial mono carboxylic fatty acid, acid oils from refining and industrial fatty alcohols such as oleic acid/stearic acid etc are classifiable under 3823 and leviable to concessional rate of customs duty vide notification no. 21/2002-cus dated 1 March 2002, as amended (serial no. 139 and 291). As per 'Harmonised system of nomenclature (HSN)' explanatory note below chapter heading 38, oleic acid of purity of 85 per cent or more is classifiable under CTH 2916 and other fatty acids of purity of 90 per cent or more are classifiable under 2915, 2916 or 2918 and leviable to concessional BCD at 7.5 per cent under above notification (serial no. 553).

M/s Ultima Chemicals and 15 others imported twenty-four consignments of oleic acid/stearic acid (other fatty acids) through JNCH commissionerate, Mumbai, between July 2007 and March 2008. Audit observed that the goods were classified under CTH 2915 and assessed to lower rate of BCD of 7.5 per cent without drawing and analysing test samples to determine the purity of the item as the concentration of the item should be 90 per cent or more for classification under CTH 2915 and thus be eligible for lower rate of BCD. In the absence of test reports, these were classifiable under CTH 3823 and chargeable to 15 per cent BCD instead of 7.5 per cent levied. This resulted in short levy of duty of Rs. 13.01 lakh.

On this being pointed out (April/May 2008), the department accepted the observation and reported (August 2008) recovery of Rs. 2.32 lakh. Recovery particulars of the remaining amount had not been received (December 2008).

The observation was reported to the Ministry in August 2008; its response had not been received (December 2008).

## 16.9 Zirconium silicate

Ceramic pigments, additives and soluble salt are classifiable under sub heading number 3207 10 90 of the customs tariff, attracting 'basic customs duty (BCD)' at 7.5 per cent ad valorem.

M/s Sukaso Ceracolors Pvt. Ltd. and five others imported (May 2007 to January 2008) fifteen consignments of 'ceramic pigments additives, soluble salt and zirconium silicate' through Chennai (sea) customs commissionerate. Eleven consignments of ceramic pigments additives and soluble salt were classified under sub heading number 3207 10 40 and BCD was levied at 5 per cent under notification no. 21/2002-cus serial no. 556. Two consignments of zirconium silicate were classified under sub heading number 2505 and assessed to BCD at 5 per cent and additional duty of customs (ADC) at 'nil' rate. However, the department had earlier assessed similar goods (zirconium silicate) imported in October 2007 (BE no. 590282 dated 31 October 2007) to BCD at 7.5 per cent and ADC at 16 per cent. In the two remaining consignments, while the goods were correctly classified under CTH 3207 , BCD was incorrectly levied at five per cent instead of 7.5 per cent. The incorrect classification and incorrect adoption of rate of duty resulted in short levy of duty of Rs. 12.66 lakh.

On this being pointed out (October 2007/February 2008), the department reported (February 2008) recovery of Rs. 1.19 lakh in three consignments and stated (April 2008) to have issued demand notices in two cases. Further progress in the cases had not been received (December 2008).

The observation was reported to the Ministry in October 2008; its response had not been received (December 2008).

## 16.10 Other cases

In eleven other cases of misclassification, resulting in short levy of duties of Rs. 72.78 lakh, the department had accepted (till December 2008) short levy of Rs. 53.01 lakh in eight cases and recovered Rs 22.66 lakh in five cases.

# CHAPTER XVII
# EXEMPTIONS

A few cases of non-levy/short levy of duties aggregating Rs. 5.52 crore due to grant of exemptions incorrectly, noticed in test check are described in the following paragraphs. These observations were communicated to the Ministry through 22 draft audit paragraphs. The Ministry/department had accepted (till December 2008), the audit observations in 15 draft audit paragraphs with money value of Rs. 3.64 crore, of which Rs. 2.08 crore had been recovered.

## 17.1 Incorrect grant of exemption

***Leased machinery***

In terms of notification no. 27/2002-cus dated 1 March 2002, temporary import of leased machinery on re-export basis, is subjected to basic customs duty at the concessional rate of 15 per cent or 30 per cent of the total duty payable as the case may be, subject to fulfillment of certain stipulated conditions.

**17.1.1** M/s Leighton Contractors (India) Pvt. Ltd., imported (October 2007) one consignment of 'used barge' through Jamnagar customs commissionerate and availed concessional rate of duty under the above notification. Although it was not a case of temporary import of 'leased machinery' and was brought into India on 'inter company settlement' basis for execution of a project, yet the department levied 15 per cent basic customs duty under the above mentioned notification and allowed its clearance. This resulted in incorrect grant of exemption of Rs. 1.67 crore.

On this being pointed out (December 2007/February 2008), the Ministry reported (December 2008) recovery of the entire amount of Rs. 1.67 crore along with interest of Rs. 8.39 lakh.

***Aircraft parts***

As per serial no. 347 of notification no. 21/2002-cus dated 1 March 2002 read with notification no. 6/2006-CE. (serial no. 54 B) dated 1 March 2006, parts of aeroplanes, helicopters etc. falling under chapter 88 or any other chapter of the Customs Tariff are exempt from payment of basic customs duty and countervailing duty. However, note 2 (e) below section XVII of the Customs Tariff Act specifically excludes machines or apparatus of heading 8401 to 8479 as 'parts'.

**17.1.2** M/s Hindustan Aeronautics Ltd., Bangalore and M/s Kingfisher Airlines Ltd., imported (between November 2005 and June 2007) three consignments of cargo sling, 'borescope injection kits' for helicopter engines and tow bar through Bangalore and Mumbai (air) customs, commissionerates. The department incorrectly classified cargo sling under CTH 8803 as parts of helicopter and tow bar (used as ground equipment) under CTH 8803 as parts of aircraft and granted exemption under the foregoing notification. Similarly, 'borescope injection kits' falling under CTH 8409 although not eligible for exemption as per the note 2 (e) of Section XVII of the Customs Tariff Act,

were also granted exemption. The incorrect grant of exemptions resulted in non-levy of duty of Rs. 1.16 crore.

On the irregularities being pointed out between May 2006 and July 2007, the Ministry/department accepted the audit observations involving duty of Rs. 1.11 crore in two cases and reported (May 2008) recovery of Rs. 8.61 lakh in one case. Further progress on the recovery and response on the observation relating to the third case had not been received (December 2008).

***Disposable spinal needles***

As per notification no.21/2002-cus (serial no.370) dated 1 March 2002 read with notification no.6/2006-CE dated 1 March 2006, import of specified goods including 'spinal instruments' intended for use as 'assistive devices, rehabilitation aids and other goods for disabled' are exempt from duty.

**17.1.3** M/s Surgiplus, Puducherry and three others imported (between March 2005 and March 2007) 13 consignments of 'disposable spinal needle' through the commissionerate of customs (port), Kolkata. The department allowed clearance of the goods at 'nil' rate of duty by extending the benefit under the above notifications. Audit observed that the goods imported were in the nature of general surgical instruments for enabling smooth penetration for spinal anasthesia and cerebrospinal fluid collection, and not the spinal instruments meant for use as assistive devices/rehabilitation aids by the disabled/handicapped, and accordingly the incorrect grant of exemption resulted in non-levy of duty of Rs. 79.01 lakh.

The observations were pointed out to the department and Ministry in December 2007/July 2008; its responses had not been received (December 2008).

***Bulk drugs***

As per serial no. 43 of central excise notification no. 4/2006 dated 1 March 2006, bulk drugs specified in list 1 thereunder, when imported into India, would be exempted from whole of the duty of central excise namely, countervailing duty (CVD).

**17.1.4** The Chief Controller of Government Opium and Alkaloid Factories, New Delhi imported 'codeine phosphate' from Iran at an assessable value of Rs. 2.99 crore. The department classified the goods under CTH 2939 'alkaloids of opium-codeine and salts thereof' and cleared the goods by exempting CVD under the above notification, although the imported goods were not specified in the list 1 attached to the said notification. Accordingly, the imported goods should have been assessed to CVD at the rate of 16 per cent. The mistake resulted in short levy of duty of Rs. 56.65 lakh.

On being pointed out (November 2007 and January 2008), the department stated (May 2008) that codeine and its salts were defined as narcotic drugs under section 2 of the narcotic drugs and psychotropic substances Act, 1985 and has been excluded from levy of central excise duty under article 246 (1), item no. 84 (b) of the Constitution of India. The reply of the department is not acceptable as the above Constitutional provision excludes opium, Indian hemp and other narcotic drugs but clearly includes 'medicinal and toilet preparations containing substance like alcohol, opium or Indian hemp and other narcotic

drugs and narcotics' for levy of central excise duty. The fact that 'codeine phosphate' is a medicinal preparation was also supported by the department's own admission that it was used as a drug for pain management of cancer and HIV patients.

The observations were reported to the department and Ministry in May 2008/ September 2008; its further responses had not been received (December 2008).

***Fire detection and fire safety equipment***

Notification no. 52/2003-cus dated 31 March 2003 exempts certain categories of goods, specified in Annexure-I thereto, from import duty when imported by a unit of Software technology parks of India (STPI) for development and export of software. Fire detection and alarm system/fire safety equipment (Heading 8531) were not covered by the said notification.

17.1.5 M/s HSBC Electronic Data Processing Pvt. Ltd., an STPI unit under the commissionerate of customs (airport), Kolkata, was allowed to import 'fire alarm system with accessories' between August 2005 and January 2007 for a total value of Rs. 76.58 lakh, free of duty, in terms of the aforesaid notification. Since the item was not included in the list of goods specified in the notification, the exemption granted was incorrect. The applicable duty of Rs. 26.54 lakh was recoverable along with interest.

The observations were reported to the department and the Ministry in March 2008/July 2008; its responses had not been received (December 2008).

## 17.2 Delayed re-export

As per notification no.104/94-cus dated 16 March 1994, containers of durable nature, when imported are exempted from customs duties provided the importer executes a bond to re-export these containers within six months from the date of its import and to pay the duty leviable thereon in the event of failure to do so.

M/s Haldia Petrochemicals Ltd., imported two consignments of 'tetra isobutyl aluminum (TIBAL)' contained in twelve portable tanks, in November and December 2004, through customs (port), Kolkata commissionerate. The department cleared the goods allowing the benefit of the above notification by obtaining bonds. Audit observed that the importer had re-exported the empty tanks in January and February 2007, after lapse of more than two years from the date of import. As the condition for exemption from duty was not fulfilled, the department should have demanded the duty of Rs. 14.41 lakh by enforcing the bond, on the expiry of the prescribed period of six months. As the department did not initiate any action, customs duty of Rs. 14.41 lakh remained un-recovered.

On this being pointed out (October 2007), the department stated (December 2007) that a demand notice had been issued (November 2007) to the importer under Section 124 of the Customs Act, 1962.

The observation was pointed out to the Ministry in August 2008; its response had not been received (December 2008).

## 17.3 Failure to monitor quantity variations

Melting imported scrap of iron or steel (other than stainless steel or heat resisting steel), is entitled to concessional rate of BCD subject to the condition that importer shall furnish copy of the certificate issued by the deputy commissioner or assistant commissioner of central excise, to the effect that the goods have been duly used within six months or such extended period (notification no. 21/2002-cus dated 1 March 2002, serial no. 200) as may be authorised.

Audit scrutiny of end-use certificates revealed discrepancy in the quantity of imported scrap in five consignments assessed by the department as per bill of entry and that reported by M/s. Rathi Ispat Ltd. and four other importers in their end-use certificates. In these five end use certificates, quantities mentioned were less by 238.18 metric tonnes than the quantity that was imported. Accordingly, duty of Rs. 11.72 lakh was due from the assessees.

The observations were reported to the department and the Ministry in November 2006/June 2008; its responses had not been received (December 2008).

## 17.4 Other cases

In eleven other cases of incorrect exemptions, resulting in short levy of Rs. 80.25 lakh, the department had accepted (till December 2008) short levy of Rs. 69.27 lakh in ten cases and had reported recovery of Rs. 24.04 lakh in five cases.

# CHAPTER XVIII
# NON-LEVY/SHORT LEVY OF ADDITIONAL DUTY

According to section 3 of the Customs Tariff Act, 1975, any article which is imported into India will also be liable to additional duty equal to the central excise duty for the time being leviable on a same article produced in India.

A few cases of non-levy/short levy of additional duties totaling Rs. 93 lakh, noticed in test check in goods imported by 52 importers are described in the following paragraphs. These observations were communicated to the Ministry through nine draft audit paragraphs. The Ministry/department had accepted (till December 2008), the audit observation in eight draft audit paragraphs with money value of Rs. 83.03 lakh, of which Rs. 23.24 lakh had been recovered.

## 18.1 Application of incorrect rate of additional duty

'Sunglasses' (other than sunglasses for correcting vision and goggles) falling under sub-heading 9004 of the central excise tariff attract additional duty at 16 per cent ad valorem.

M/s Sterling Meta-Plast India Pvt. Ltd. and six others imported 13 consignments of 'Sunglasses' between May 2006 and March 2007 through the Kolkata (sea) customs commissionerate. The department cleared nine consignments without levying additional duty in terms of notification no. 6/2006-CE (serial no. 57) dated 1 March 2006 and for the remaining consignments levied additional duty at 8 per cent ad valorem in terms of notification no. 10/2006-CE (serial no. 27) dated 1 March 2006 treating the goods as 'sunglasses for correcting vision and goggles'. This resulted in short levy of additional duty of Rs. 19.94 lakh.

On this being pointed out (November 2007), the department reported (June 2008) recovery of Rs. 19.78 lakh from three importers. Further reply in respect of the remaining importers had not been received (December 2008).

The observation was reported to the Ministry in July 2008; its response had not been received (December 2008).

## 18.2 Non-recovery of special CVD in cash

In terms of the Board circular no.20/2006-cus dated 21 July 2006, special CVD of four per cent leviable on goods imported against Duty Free Entitlement Credit Certificate Scheme (DFECC) is required to be paid in cash against which cenvat or drawback could be availed.

M/s MICO Ltd., Bangalore cleared (August and September 2006) various goods valuing Rs. 3.31 crore under DFECC Scheme by debiting special CVD amounting to Rs. 17.41 lakh to the DFECC instead of paying it in cash.

On this being pointed out (December 2007), the department reported (March 2008) that the importer had been directed to pay the amount in cash. Further progress in the case had not been received (December 2008).

The observation was reported to the Ministry in June 2008; its response had not been received (December 2008).

## 18.3 Non-levy of additional duty

18.3.1 As per notification no.19/2006–cus dated 1 March 2006, additional duty of customs in lieu of State taxes/VAT at the rate of 4 per cent ad valorem is leviable on all goods imported into India other than those goods which are exempted under notification no.20/2006–cus dated 1 March 2006. In terms of the latter all goods specified in the first schedule to the Additional Duties of Excise (Goods of Special Importance) Act 1957 (58 of 1957) are exempted from this additional duty of customs.

Thirty four consignments of 'fabric, lining materials and printed bed sheets' were imported by 15 importers through Chennai sea customs commissionerate during September 2007 and January 2008 and classified under the customs tariff heading (CTH) 5309, 5401, 5510, 5602, 5603, 6006, 6203 and 6304. The additional duty was incorrectly exempted in all the cases under serial no. 50 of notification 20/2006–cus dated 1 March 2006, though the cases were not covered under the above schedule to the Act. This resulted in non levy of additional duty of customs of Rs. 14.77 lakh.

On this being pointed out (February/March 2008), the department reported (March/April 2008) recovery of duty along with interest of Rs.0.94 lakh from three importers. Further reply in respect of the remaining importers had not been received (December 2008).

The observation was reported to the Ministry in July 2008; its response had not been received (December 2008).

18.3.2 As per customs notification no. 32/03 dated 1 March 2003, additional duty (CVD) at the rate of 75 per cent ad valorem is leviable on import of liquors classifiable under CTH 2203, 2204, 2205, 2206 and 2208 put up in bottles or cans or any other packing for ultimate sale in retail and having a 'cost, insurance, freight (c.i.f.)' price not exceeding USD 25 per case (each case containing a total volume of nine litres). The notification further prescribes that the c.i.f. price of any goods put up in packings of a size other than nine litres shall be determined on a pro-rata basis.

M/s Spring Fields (India) Distilleries, Margao, Goa imported (February 2007) 10,000 litres (1666 cases, each unit containing 6 litres) of wine valued at Rs. 6.29 lakh through Goa (Sea) customs. The department classified the goods under CTH 2204 and incorrectly cleared it without levying CVD. Audit scrutiny revealed that the c.i.f. value on pro-rata basis for each case was less than USD 25. Thus, the goods were leviable to CVD at the rate of 75 per cent. The incorrect exemption resulted in non levy of CVD of Rs. 10.21 lakh.

The observation was reported to the department and the Ministry in February 2008/June 2008; its response had not been received (December 2008).

## 18.4 Other cases

In five other cases of short levy of additional duty of Rs. 30.91 lakh, the department had accepted (till December 2008), the entire short levy of Rs. 30.91 lakh and recovered Rs. 2.52 lakh in two cases.

Jayanti Prasad

New Delhi
Dated : 24 APR 2009

(JAYANTI PRASAD)
Principal Director (Indirect Taxes)

Countersigned

V. Rai

New Delhi
Dated : 24 APR 2009

(VINOD RAI)
Comptroller and Auditor General of India