Report of the Comptroller and Auditor General of India

for the year ended March 1998

Union Government
(Indirect Taxes - Central Excise)
No.11 of 1999

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PREFATORY REMARKS

This Report for the year ended 31 March 1998 has been prepared for submission to the President under Article 151 of the Constitution, based on the audit of Central Excise Receipts of the Union of India, in terms of Section 16 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971.

The cases mentioned in the Report are among those which came to notice in the course of audit during the year 1997-98 and early part of the year 1998-99, as well as those which came to notice in earlier years but were not reported earlier.

OVERVIEW

This report contains 221 paragraphs, featured individually or grouped together and one review involving total revenue of Rs 27,769.24 crore. Some of the more significant findings are summarised below:

I. General

The net receipts from excise duty during the year 1997-98 was Rs 47,763 crore against the budget estimates of Rs 52,200 crore, resulting in shortfall of Rs 4,437 crore.

(Paragraph 1.1)

While the value of production had increased by 11.5 times between 1980-81 and 1997-98, the central excise receipts went up by only 7.4 times during the corresponding period. The central excise receipts were 11.2 *per cent* of the value of production in 1980-81 but had decreased to 7.2 *per cent* in 1997-98.

(Paragraph 1.3)

The central excise receipts had grown by 3.12 times during the decade 1986-87 to 1996-97, the increase in Modvat availed during the relevant period had been 17.88 times. It would also be seen that the percentage of Modvat availed to duty paid by cash had been increasing consistently from 13.30 *per cent* to 76.35 *per cent.*

The increasing trend in availing Modvat credit could be attributed to the expansion of the scheme to cover most of the excisable goods including capital goods and to a certain degree is indicative of misuse of Modvat credit facility as brought out in paragraphs 3.1, 9 and 10 of this Audit Report.

(Paragraph 1.4)

The cost of collection as a percentage of the central excise receipts had shown a rising trend. While the revenue growth had averaged around 9.42 *per cent*, the expenditure had risen at an average rate of 19.58 *per cent.*

(Paragraph 1.5)

II. System appraisal

Delay in finalisation and collection of demands

An appraisal of the system in vogue for raising demands for duty where it was not levied or levied short, adjudication/finalisation of these demands and subsequent recoveries in the Central Excise Commissionerates, revealed that demands involving duty of Rs 8,850.32 crores in 94691 cases had

not been recovered by the end of March 1998 which involved a further revenue implication of Rs 4,014.37 crore by way of non recovery of interest. Some of the major deficiencies noticed were as follows:

⇒ While the existing Act/Rules do not provide for any time limit to finalise adjudication of demand notices even the executive instructions of the Board to finalise adjudication cases within six months of issue of show cause-cum demand notices were not implemented in a large number of cases, leading to financial accommodation to the assessees.

(Paragraph 2.6)

⇒ Time limit of six months for issue of show cause-cum demand notice, in normal cases was found to be short, resulting in many demands getting time barred and issue of show cause cum-demand notices without proper examination.

(Paragraph 2.8)

⇒ Levy of interest after three months from the date of determination (finalisation of adjudication proceedings) of duty instead of from the relevant dates of clearance of goods, acted as an incentive to the assessees, to delay speedier disposal of these cases, as any delay therein was to the advantage of the assessees.

(Paragraph 2.6)

⇒ In the absence of adequate action from the department, revenue of Rs 5,270.51 crore in 55928 cases of confirmed demands could not be realised till March 1998 with further non-realisation of around Rs 2,317.62 crore by way of interest.

(Paragraph 2.5)

⇒ 36868 cases involving central excise duty of Rs 3,387.33 crore were pending for adjudication which further entailed non-collection of Rs 1,696.75 crore by way of interest.

(Paragraph 2.6)

⇒ Revenue of Rs 58.48 crore could not be realised due to inaction on the part of the department as the demands had become time barred.

(Paragraph 2.8)

⇒ 133 demand cases with a duty effect of Rs 81.93 crore were lost sight of as they were incorrectly transferred to call book resulting in non-adjudication of these demands with consequential non-realisation of revenue.

(Paragraph 2.9)

⇒ In 1622 cases ineffective certificate action had resulted in non-recovery of Rs 134 crore.

(Paragraph 2.10)

III Extension of modvat credit

⇒ The Government, through notifications, extended the benefit of Modvat credit to certain additional excise duties, which was violative of the enabling provisions of the Excise Act/Rules. Eighty three *per cent* of the revenue realised from such additional excise duties was from those levied in lieu of Sales tax, whereas the Modvat scheme does not cover Sales tax. An amount of Rs 13,582.56 crore was collected on account of these duties between April 1994 and March 1998 which can be utilised as Modvat credit by downstream manufacturers.

(Para 3.1)

IV Non-levy/short levy of duty

- Short levy/underassessment of central excise duty amounting to Rs 1,321.99 crore (excluding those in system appraisal and extension of Modvat credit) were noticed. The more significant of these findings were as follows:

(Paragraph 3 to 11)

⇒ Certain petroleum products were allowed to be consumed captively without any duty, overlooking a specific notification levying duty thereon which resulted in non levy of duty of Rs 128.53 crore.

(Para 3.2)

⇒ Levy of duty on Pan masala either on MRP value or on Tariff value resulted in revenue of Rs 26.84 crore being foregone and consequent benefit to established large scale manufacturers.

(Paragraph 3.3)

⇒ Failure to identify the producers of crude sandal wood oil (red oil), resulted in evasion of revenue of Rs 16.87 crore in six cases alone.

(Paragraph 3.4)

⇒ Rebate of duty of Rs 417.18 crore on aviation turbine fuel was incorrectly taken by the assessees themselves in clear violation of the applicable notification and the Rules.

(Paragraph 4.1)

⇒ Clearance of liquified petroleum gas at a price lower than that fixed by the Government resulted in short collection of Rs 194.98 crore as duty.

(Paragraph 5.1)

⇒ Production of steam and its utilisation in the manufacture of non-dutiable final products without payment of any duty, resulted in non-levy of duty of Rs 54.93 crore.

(Paragraph 6.1)

⇒ Incorrect classification of motor vehicle bodies as motor vehicles resulted in avoidance of duty of Rs 78.70 crore.

(Paragraph 7.1 (i))

⇒ Application of exemption notifications on goods not correctly entitled to these exemption, resulted in short collection of duty of Rs 68.09 crore.

(Paragraph 8)

⇒ Incorrect availment of credit under Modvat scheme resulted in the Government being deprived of Rs 68.62 crore.

(Paragraph 9 and 10)

⇒ Four public oil companies collected excise duty of Rs 55.36 crore on sale of petroleum products but did not remit it to Government.

{Paragraph 11.1 (i)}

⇒ For achieving the revenue collection targets, revenue of Rs 11.77 crore was created fictitiously even in the absence of events leading to payment of duty.

(Paragraph 11.2)

⇒ Inconsistent approach of the Ministry in classifying certain cosmetic products resulted in loss of revenue of Rs 51.15 crore.

(Paragraph 11.3)

CHAPTER 1 : CENTRAL EXCISE RECEIPTS

1.1 Budget estimates, revised budget estimates and actual receipts

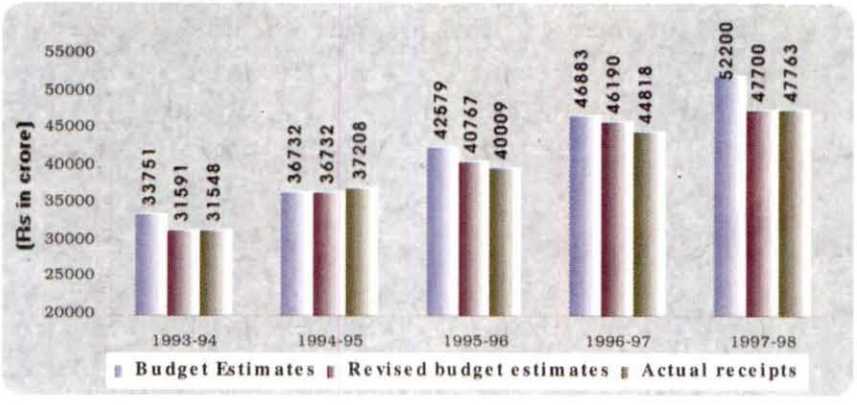
(a) The budget estimates, revised budget estimates and actual receipts of central excise duties during the year 1993-94 to 1997-98 are exhibited in the table and the graph:-

(Amount in crore of rupees)

Year	Budget Estimates	Revised budget Estimates	Actual Receipts	Difference between actual receipts and budget estimates	Percentage Variation
1993-94	33,751	31,591	31,548	(-) 2203	(-) 6.53
1994-95	36,732	36,732	37,208	(+) 476	(+) 1.30
1995-96	42,579	40,767	40,009	(-) 2570	(-) 6.04
1996-97	46,883	46,190	44,818	(-) 2065	(-) 4.40
1997-98	52,200	47,700	47,763	(-) 4437	(-) 8.50

Note : Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs)

CENTRAL EXCISE RECEIPTS
BUDGET, REVISED AND ACTUALS



(b) The overall shortfall of 8.5 *per cent* between actual realisation of central excise revenue and budget estimates was mainly due to shortfall in actual realisation from budget estimates in (i) 'Tyres, tubes and flaps' by 31 *per cent*, (ii) 'Motor vehicle other than for transport of persons' by 27 *per cent*, (iii) 'Synthetic yarn' by 25 *per cent*, (iv) 'Refined diesel oil' by 19 *per cent* and (v) 'Iron and steel' by 10 *per cent* (Paragraph 1.6).

1.2 Break-up of receipts

The receipts during the year 1997-98 from levy of basic excise duties and from other duties levied as excise duties are given in the table below, alongside the corresponding figures for the preceding year:-

(Amount in crore of rupees)

		Receipts from Union Excise Duties	
		1996-97	1997-98
A.	**Shareable duties :**		
	Basic excise duties	38222.91	41310.98
	Auxiliary duties of excise	0.03	0.00
	Special excise duties	8.08	13.81
	Additional excise duties on mineral products	0.03	0.00
	Total (A)	**38231.05**	**41324.79**
B.	**Duties assigned to states :**		
	Additional excise duties in lieu of sales tax	2840.50	2918.50
	Excise duties on generation of power	0.05	18.65
	Total (B)	**2840.55**	**2937.15**
C.	**Non-shareable duties :**		
	Additional excise duty on T.V. sets	0.05	--
	Special excise duties	1.64	0.02
	Additional excise duties on textiles and textile articles	590.99	528.65
	Other duties	0.03	0.02
	Auxiliary duties of excise	26.45	0.02
	Total (C)	**619.16**	**528.71**
D.	**Cess on commodities**	**2869.78**	**2814.57**
E.	**Other receipts**	**257.44**	**158.01**
	Total : (A to E)	**44817.98**	**47763.23**

Note : Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs)

1.3 Value of output* *vis-à-vis* central excise receipts

(a) The value of production from manufacturing sector vis-a-vis receipt of central excise duties through PLA[1] (cash collection) during the years 1980-81 and 1986-87 to 1997-98 are given below :

(Amount in crore of rupees)

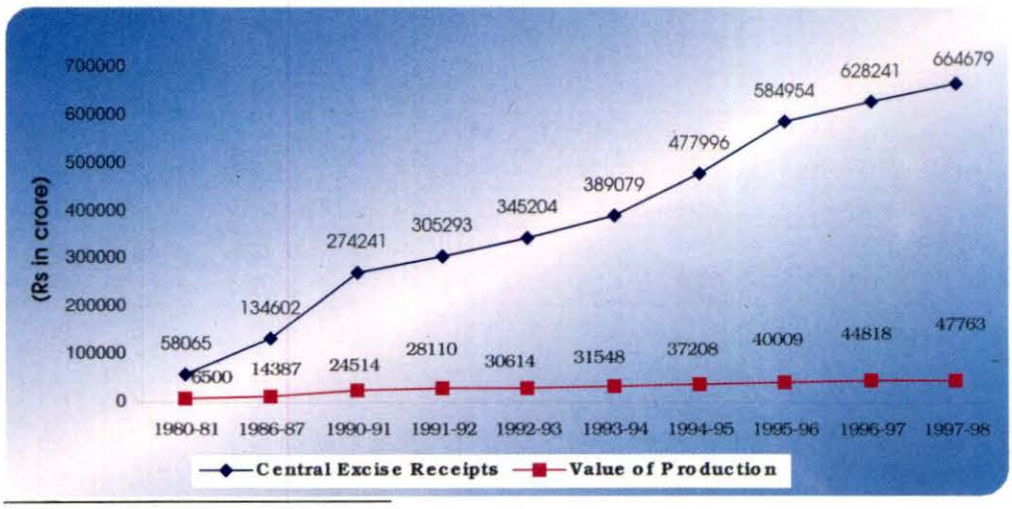
Year	Value of production	Central excise	Percentage of central Excise receipts to value of production
1980-81	58065	6500	11.19
1986-87	134602	14387	10.69
1990-91	274241	24514	8.94
1991-92	305293	28110	9.20
1992-93	345204	30614	8.87
1993-94	389079	31548	8.11
1994-95	477996	37208	7.78
1995-96	584954	40009	6.84
1996-97	**628241	44818	7.13
1997-98	**664679	47763	7.18

* Includes the value of all goods produced during the given period including net increase in work-in-progress and products for use on own account. Valuation is, at producers values, that is the market price at the establishment of the producers.

** Estimated by audit on the basis of figure published by Central Statistical Organisation. As separate figure of value of production by SSI[2] units and for export production were not available, these have not been excluded from the value of production indicated.

The above table and graph below reveal that while value of output had increased by a factor of 11.45 during the period 1980-81 to 1997-98, the corresponding increase in the central excise receipts was by a factor of 7.35 only.

CENTRAL EXCISE RECEIPTS AND PRODUCTION

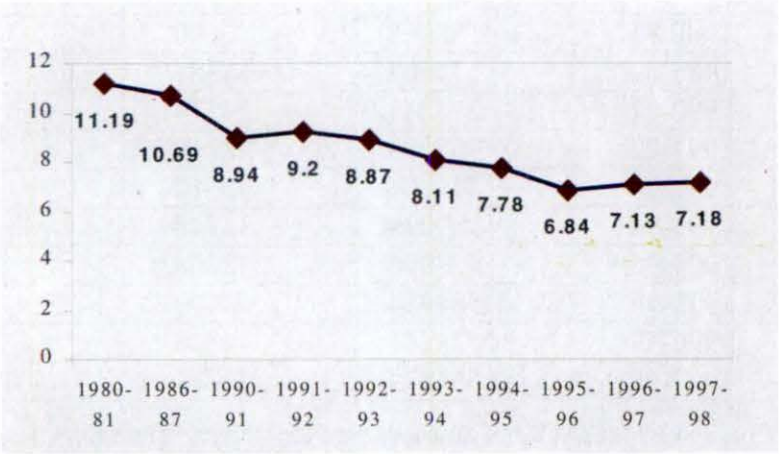


[1] Personal Ledger Account

[2] Small Scale Industry

(b) The graph below shows a declining trend in percentage of central excise receipts to value of output from 11.19 during 1980-81 to 6.84 during 1995-96 with a marginal increase to 7.13 in 1996-97 and 7.18 in 1997-98.

PERCENTAGE OF CENTRAL EXCISE RECEIPTS TO VALUE OF PRODUCTION



1.4 Central excise receipts vis-a-vis Modvat availed

A comparative statement showing the details of central excise duty paid through PLA, the amount of Modvat availed during the year 1986-87 to 1997-98 is given in the table below:

(Amount in crore of rupees)

Year	Central excise duty paid through PLA		Modvat availed		Percentage of Modvat to duty paid through PLA
	Amount	Percentage increase	Amount	Percentage increase	
1986-87	14387	--	1914	--	13.30
1987-88	16345	13.60	2820	47.30	17.25
1988-89	18749	14.70	3809	35.07	20.31
1989-90	22307	18.97	5279	38.59	23.66
1990-91	24514	9.89	6496	23.05	26.49
1991-92	28110	14.66	7965	22.61	28.33
1992-93	30614	8.91	10840	36.09	35.40
1993-94	31548	3.05	11896	9.74	37.70
1994-95	37208	17.94	21687	82.30	58.28
1995-96	40009	7.53	29951	38.10	74.86
1996-97	44818	12.01	34222	14.25	76.35
1997-98	47763	6.57	N.A	N.A	N.A

(N.A - Not made available by the Ministry of Finance)

The above table shows that while the central excise receipts had grown by 3.12 times during the decade 1986-87 to 1996-97, the increase in Modvat availed during the relevant period had been 17.88 times. It can also be seen that the percentage of Modvat availed to duty paid by cash had been increasing consistently from 13.30 *per cent* to 76.35 *per cent*.

The increasing trend in availing Modvat credit can be attributed to the expansion of the scheme to cover most of the excisable goods including capital goods and to a certain degree is also indicative of misuse of Modvat credit facility as brought out in paragraphs 3.1, 9 and 10 of this Audit Report.

1.5 Cost of collection

The expenditure incurred during the year 1997-98 in collecting central excise duty alongwith the corresponding figures for the preceding four years is given below:-

(Amount in crore of rupees)

Year	Receipts from excise duty		Expenditure on collection		Cost of collection as percentage of receipts
	Amount	Percentage increase over previous year	Amount	Percentage increase over previous year	
1993-94	31547.61	3.05	221.65	17.48	0.70
1994-95	37207.84	17.94	249.10	12.38	0.67
1995-96	40008.59	7.52	285.47	14.60	0.71
1996-97	44817.98	12.02	333.82	16.93	0.77
1997-98	47763.23	6.57	455.68	36.50	0.95

Note: Figure furnished by Principal Chief Controller of Accounts (Central Board of Excise and Customs)

The table above shows that excepting for the year 1994-95, the cost of collection as a percentage of the central excise collection had a rising trend. Further, while the revenue growth had averaged around 9.42 *per cent*, the expenditure on collection had risen at an average rate of 19.58 *per cent*.

1.6 Major revenue yielding commodities

The commodities (as per budget heads) which yielded revenue of more than Rs 1000 crore during 1997-98 alongwith corresponding figure for 1996-97 are as under:

(Amount in crore of rupees)

Sl. No.	Budget Head	Description	1996-97 (Actual)	1997-98 (Budget estimates)	1997-98 (Actual)	Percentage variation of actual over budget	Percentage share in total collection
1.	27	Cigarettes, cigarillos or tobacco substitutes	3982.66	3238.45	4492.44	(+) 39	9.40
2.	102	Iron and steel	3894.80	4495.60	4037.58	(-) 10	8.45
3.	31	Cement clinkers, cement all sorts	2281.12	2457.10	2326.31	(-) 5	4.87
4.	34	Motor spirit	2116.79	2319.00	2941.95	(+) 27	6.15
5.	36	Refined diesel oil	1961.97	2544.35	2052.42	(-) 19	4.29
6.	128	Motor cars and other motor vehicles for transport of persons	1472.22	1586.30	1659.84	(+) 5	3.47
7.	61	Plastics and articles thereof	1442.82	1771.20	1776.20	(+) 0.2	3.71
8.	62	Tyres, tubes and flaps	1427.10	1693.30	1166.87	(-) 31	2.44
9.	79	Synthetic filament yarn and sewing thread including synthetic monofilament and waste	1383.51	1433.25	1074.07	(-) 25	2.24
10.	130	All other goods falling under chapter 87 (Motor vehicles other than at Sl. No.6)	1225.74	1624.15	1192.61	(-) 27	2.49
11.	119	All other goods falling under chapter 84 (Machinery, Mechanical appliances, Nuclear Reactors)	1207.47	1499.20	1501.40	(+) 0.2	3.14
12.	45	Organic chemicals	1049.55	1183.20	1109.24	(-) 6	2.32

The above table shows that there were wide variations in the actual central excise receipts which ranged from (-) 31 *per cent* in case of 'tyres, tubes and flaps' to 39 *per cent* in case of 'cigarettes'.

1.7 Revenue remitted or abandoned*

Amount of central excise duty remitted/abandoned or written off due to various reasons for the year 1996-97 and 1997-98 is shown below:

(Amount in lakh of rupees)

		1996-97		1997-98	
	Remitted due to :	**Number of cases**	**Amount**	**Number of cases**	**Amount**
(a)	Fire	31	6.18	16	28.35
(b)	Flood	03	1.89	01	01.12
(c)	Theft	--	--	09	0.64
(d)	Other reasons	25	1.28	16	35.88
	Total	**59**	**9.35**	**42**	**65.99**
	Abandoned or written off due to :				
(a)	Assessees having died leaving behind no assets	01	0.05	01	0.06
(b)	Assessees untraceable	09	0.09	01	0.27
(c)	Assessees left India	--	--	--	--
(d)	Assessees incapable of payment of duty	06	0.05	04	9.07
(e)	Other reasons	27	0.22	06	6.77
	Total	**43**	**0.41**	**12**	**16.17**

* Figure relates to 29 out of 60 commissionerates

1.8 Provisional assessments*

The number of cases of provisional assessments and amount involved therein, as on 31 March 1997 and 31 March 1998 is depicted below:

(Amount in crore of rupees)

		As on 31 March 1997		As on 31 March 1998	
		Number of cases	**Duty involved**	**Number of cases**	**Duty involved**
(a)	Pending decision by Court of Law	49	417.99	45	62.56
(b)	Pending decision by Government of India or Central Board of Excise and Customs	14	735.59	21	780.51
(c)	Pending adjudication with the Commissioners	316	111.89	277	255.09
	Total	**379**	**1265.47**	**343**	**1098.16**

* Figure relates to 29 out of 60 commissionerates

1.9 Fraud/presumptive fraud cases*

The position of fraud/presumptive fraud cases detected by the department alongwith the action taken against the defaulting assessees during the period 1995-96 to 1997-98 is depicted below:-

(Amount in lakh of rupees)

Year	Cases detected		Demand of duty raised	Penalty imposed		Duty collected	Penalty collected	
	Number	Amount	Amount	Number	Amount	Amount	Number	Amount
1995-96	145	3691.57	2051.18	93	45.03	345.02	65	23.18
1996-97	173	2436.28	1091.60	54	772.81	109.58	30	03.78
1997-98	430	11453.24	2721.22	43	1348.82	72.05	11	03.25
Total	**748**	**17581.09**	**5864.00**	**190**	**2166.66**	**526.65**	**106**	**30.21**

* Figure relates to 29 out of 60 commissionerates

The above data reveals that while a total of 748 cases only of fraud/ presumptive fraud were detected during the years 1995-1998 by the department, involving duty of Rs 175.81 crore, the department raised demands of Rs 58.64 crore only and recovered Rs 5.27 crore (8.99 *per cent*) out of it. Similarly, out of the imposed penalty of Rs 21.67 crore, the department recovered Rs 0.30 crore only.

1.10 Contents of Report

This Report includes 221 paragraphs featured individually or grouped together and one review on 'Delay in finalisation and collection of demands', arising from important findings from test check in audit involving total revenue of Rs 27,769.24 crore. This includes allowance of Modvat credit in respect of ineligible duties aggregating Rs 13,582.56 crore, non collection of Rs 12,864.69 crore due to delay at various stages of finalisation and collection of demands and short levy of duty of Rs 1,321.91 crore attributable to various lapses. The Ministry of Finance/department had till November 1998 accepted audit observations included in 91 paragraphs involving Rs 149.68 crore.

CHAPTER 2 : DELAY IN FINALISATION AND COLLECTION OF DEMANDS

2.1 Introduction

Excise duty is paid by the assessees under self-assessment scheme. Accordingly, assessees submit monthly returns with the department. Based on these and any other information, which the department may have, any short payment of duty is to be recovered by issuing a show cause notice and following it up with its adjudication and recovery proceedings.

Section 11A of the Central Excise Act, 1944, provides that when any duty of excise has not been levied or has been short levied or short paid or erroneously refunded, a Central Excise Officer may, within six months from the relevant date, serve notice on the person chargeable with the duty which has not been levied or paid or which has been short levied or short paid or erroneously refunded, requiring him to show cause why he should not pay the amount specified in the notice. The period of six months stands extended to five years where duty has been short paid due to fraud, collusion, wilful mis-statement or suppression of facts with the intention to evade duty. The Central Excise Officer shall, after considering the representation, if any, made by the person on whom show cause notice has been served, determine the amount of duty due from such person and thereupon such person shall pay the amounts so determined.

As a major share of the excise duty is being realised through self-assessment system, speedy and timely action to issue show cause notice, adjudicate and recover dues, is of primary importance and is an important parameter on the basis of which the efficiency of the department can be judged.

2.2 Scope of audit

The review covered a period of three years from 1995-96 to 1997-98. Out of 309 divisions in 60 commissionerates, the records of 110 divisions in 58 commissionerates i.e., 35 percent of the divisions were test checked to evaluate the efficiency of the system covering issue of show cause notices in cases where duty was not levied or short levied, adjudication of show cause notice and collection of demands.

2.3 Results of audit

Test check of records in audit disclosed the following system deficiencies:

- While the existing Act/Rules do not provide for any time limit to finalise adjudication of demand notices, even the executive instructions of the Central Board of Excise and Customs to finalise adjudication cases within six months of issue of show cause-cum demand notices were not implemented in a large number of cases, leading to financial accomodation to the assessees.

(Paragraph 2.6)

- Time limit of six months for issue of show cause-cum demand notice, in normal cases was found to be inadequate, resulting in many demands getting time barred and issue of show cause cum-demand notices without proper examination.

(Paragraph 2.8)

- Levy of interest only after three months from the date of determination (finalisation of adjudication proceedings) of duty instead of from the dates of clearance of goods, acted as an incentive to the assessees, to delay speedier disposal of these cases, as any delay therein was to the advantage of the assessees.

(Paragraph 2.6)

- In the absence of adequate action from the department, revenue of Rs 5270.51 crore in 55928 cases of confirmed demands could not be realised till March 1998 with further non-recovery of Rs 2317.62 crore by way of interest.

(Paragraph 2.5)

- 36868 cases involving central excise duty of Rs 3387.33 crore were pending for adjudication which further entailed non-recovery of Rs 1696.75 crore by way of interest.

(Paragraph 2.6)

- In 2217 cases duty of Rs 417.29 crore could not be realised due to stay orders granted by different courts and such stay orders not being got vacated.

(Paragraph 2.7)

- Revenue of Rs 58.48 crore could not be realised due to inaction on the part of the department as the demands had become time barred.

(Paragraph 2.8)

- 133 demand cases with a duty effect of Rs 81.93 crore were lost sight of as they were incorrectly transferred to call book resulting in non-adjudication of these demands with consequential non-recovery of revenue to the government.

(Paragraph 2.9)

- In 1622 cases ineffective certificate action had resulted in non-recovery of Rs 134 crore.

(Paragraph 2.10)

- Monitoring system was found to be deficient.

(Paragraph 2.12)

2.4 Macro analysis

The overall position regarding demands (confirmed as well as pending adjudication) which had not been recovered as on 31 March 1998, was as under:

(Amount in crore of rupees)

		No. of commiss-ionerates	Number of cases	Duty involved
(i)	Demands confirmed but still not recovered	52	55928	5270.51
(ii)	Demands for which SCN[3]s issued but still not adjudicated	37	36868	3387.33
(iii)	Demands outstanding due to non-- vacation of stay orders	25	2217	417.29
(iv)	Revenue lost due to demands having become time barred	33	273	58.48
(v)	Ineffective and obsolete certificate action leading to non- recovery of confirmed demands	30	1622	134.00

[3] Show Cause Notice

Some of the important cases are discussed in the following paragraphs:

2.5 Inordinate delay in recovery of confirmed demands

On confirmation of demands by the adjudicating authority for duty not levied or paid or erroneously refunded, the assessees are required to pay the due amounts so determined. In case the assessee fails to make the payment, section 11 of the Central Excise Act, 1944, provides provisions for recovery of the dues by the officer empowered by the Central Board of Excise and Customs by (i) deducting the amount so payable from any money owing to the person; or (ii) recovering the amount by attachment and sale of excisable goods belonging to such person. If the amount is not so recoverable, he may prepare a certificate signed by him specifying the amount due from the person and send it to the Collector of the District where such person resides or conducts his business, for recovery of dues as 'arrears of land revenue'.

Review of the records in audit revealed that 55928 cases of confirmed demands were pending for recovery in 52 commissionerates, which involved a revenue of Rs 5270.51 crore with consequential non-recovery of interest of Rs 2317.62 crore till March 1998. This constituted about 17 *per cent* of the central excise receipts of Rs 44818 crore for the year 1996-97. This huge pendency indicates that concrete efforts were not made by the department for recovery of the outstanding demands, notwithstanding the provisions of section 11 of the Central Excise Act, 1944, related rules and the instructions of the Central Board of Excise and Customs.

Even the control mechanism did not function effectively in as much as (i) the control registers for tracking outstanding demands were not maintained in proper proforma; (ii) the monthly abstract giving the summary of pendency of demands did not disclose the details of opening balance, additions and disposals, thus exhibiting incomplete position; (iii) the pendency position were not being reviewed by the authorities concerned; (iv) incorrect/suppressed data of pendency was being reported to the higher authorities viz., Division/ Commissionerate/ Board; (v) internal audit did not comment on the pendency of demands; (vi) the defaulting officials were not made accountable, and no effective system of data collection and follow up action existed in the commissionerate and even in the Central Board of Excise and Customs. Thus, there is an urgent need for the department to take prompt action to realise these confirmed demands and the Central Board of Excise and Customs to enforce effective control mechanisms. The overall data for outstanding demands was not provided by the Central Board of Excise and Customs even after a delay of six months though requested by Audit in April 1998.

Some of the important cases are given below:

(i) Non- recovery due to inaction

(a) Calcutta II Commissionerate of Central Excise issued a show cause cum demand notice for Rs 34.05 crore to an assessee on 4 August 1992 for incorrect availment of exemption on railway wagons by violating provisions of exemption notification of November 1986. The demand was confirmed on 29 December 1992. However, no action was taken subsequently to realise the dues of Rs 34.05 crore, which also led to non-recovery of interest of Rs 34.05 crore from April 1993 to March 1998, though the assessee, continued with his business.

(b) An assessee, in Calcutta II Commissionerate of Central Excise, took credit of central excise duty amounting to Rs 8.71 crore incorrectly on the inputs lying in stock on 31 March 1994. The department issued a show cause cum demand notice for Rs 8.71 crore in August 1994. The demand was confirmed in December 1995 along with a penalty of Rs 22,000. Though more than 2 years had lapsed, the department could not enforce recovery of the demand of Rs 8.71 crore. Further an amount of Rs 3.48 crore was also recoverable as interest till March 1998.

(c) Nine show cause notices for Rs 7.53 crore were issued to an assessee, manufacturing 'Petroleum products' in Ahmedabad I Commissionerate of Central Excise, between September 1994 and January 1997, on the grounds of non-inclusion of State surcharge, Retail pump outlet charges, Railway siding charges etc. in the assessable value and the demand was confirmed in September 1997 along with a penalty of Rs 8 lakh. Though more than 14 months had lapsed, recovery of Rs 7.53 crore was not made from the assessee. Further an amount of Rs 1.78 crore was also recoverable as interest till March 1998.

(d) An assessee, in Jamshedpur Commissionerate of Central Excise, was served with three show cause cum demand notices between November 1993 and April 1996, demanding duty of Rs 9.49 crore on the grounds of (i) incorrect exemption of duty on the product 'Hot metal or molten iron' used captively in the final product 'Ingot mould and bottom stool' during the period November 1990 to February 1994 and (ii) incorrect availment of Modvat credit during October 1995 to February 1996. The cases were adjudicated in January and November 1997 confirming demands with penalty of Rs 3 lakh. The duty had not been recovered till March 1998. This resulted in non-recovery of the confirmed demand and penalty of Rs 9.52 crore. Further an amount of Rs 4.51 crore was also recoverable as interest till March 1998.

(e) A show cause cum demand notice for Rs 3.68 crore was issued to an assessee, in Patna Commissionerate of Central Excise in June 1983, on the ground that the assessee availed incorrect proforma credit during the period January 1977 to March 1980. The demand was confirmed with a personal penalty of Rs.20 lakh by the Commissioner of Central Excise, Patna in January 1993 after a lapse of 10 years. While there was an abnormal delay in confirming the demand leading to financial accommodation of Rs 7.04 crore by way of non-recovery of interest till the time of adjudication, the amount had still not been recovered. This also led to non-recovery of further interest of Rs 10.74 crore till March 1998.

(f) An assessee, in Calcutta I Commissionerate of Central Excise, manufacturing 'Petroleum products' was served with a show cause cum demand notice in August 1994 for incorrect availment of Modvat credit of Rs 2.78 crore on inputs lying in stock on 1 March 1994. The demand was confirmed by the Assistant Commissioner of Central Excise on 12 December 1995. The department did not take any action to realise the Government money to the tune of Rs 2.78 crore which had further led to non-recovery of interest of Rs 1.11 crore from April 1996 to March 1998.

(ii) ***Non- recovery of demands notwithstanding favourable decisions from the courts***

(a) Consequent upon the Supreme Court Judgement {1995(57)ECR-417(SC)}, 'Block boards' were correctly classifiable under sub heading 4408.90. The department issued show cause cum demand notices to 53 assessees in Shillong Commissionerate of Central Excise, between May 1995 and February 1996, involving duty of Rs 30.38 crore for the period 28 February 1986 to 30 April 1993, on grounds of non-payment/short payment of duty due to misclassification of the 'Block boards'.

On adjudication, demand of Rs 30.31 crore was confirmed during 1995-96 out of which a meagre Rs 2.97 crore had only been realised till December 1997, leaving an unrealised balance of Rs 27.34 crore on which an amount of Rs 10.94 crore was also recoverable as interest from April 1996 to March 1998.

(b) An assessee, in Surat Commissionerate of Central Excise, engaged in the manufacture of items of man made filament, was served with a show cause cum demand notice on 28 December 1983 on grounds of clandestine removal of goods involving duty liability of Rs 9 crore during the period November 1979 to 31 July 1983. Aggrieved with this, the assessee went in appeal to Gujarat High Court/ Supreme Court. Finally, the Supreme Court dismissed the appeal of the assessee in January 1995 and directed him to pay duty along with interest at 18 *per cent* per annum from the date of issue of show cause notice to date

of payment. Accordingly, the department adjudicated the case on 16 May 1995 confirming duty of Rs 9 crore and penalty of Rs 1 crore alongwith interest at 18 percent per annum from 28 December 1993 to date of payment which worked out to Rs 30 crore. Though 3 years had lapsed since the demand was confirmed, recovery of Rs 30 crore had yet to be effected, resulting in the Supreme Court judgement being made ineffective.

(c) An assessee, in Hyderabad I Commissionerate of Central Excise, engaged in the manufacture of 'Iron and steel products' was served with a show cause cum demand notice on 2 April 1990 for Rs 1.85 crore for mis-statement of facts with the intention of evading duty, covering the period March 1986 to December 1989. The case was adjudicated after a delay of 7 years, in July 1997, confirming the demand of Rs 1.85 crore with a penalty of Rs 1. crore as also confiscation of land, building, plant and machinery. Till date even the revenue of Rs 2.85 crore due had not been recovered. Further, an amount of Rs 4.42 crore was also recoverable by way of interest on Rs 2.85 crore which Government should have received by December 1989.

(iii) Non- recovery despite being free from litigation

(a) An assessee, in Delhi I Commissionerate of Central Excise, was served with a show cause cum demand notice in March 1994 demanding duty of Rs 28.55 crore for the period 1989-90 to 1993-94, on the ground that he cleared alloys of non- ferrous metal without payment of duty, without the cover of gate pass and without filing any classification and price list.

The demand was confirmed by the concerned Commissioner of Central Excise only after 21 months in December 1995, alongwith a penalty of Rs 50 lakh. However, this order was served on the assessee on 9 February 1996. The demand of Rs 29.05 crore inclusive of penalty of Rs 50 lakh had not been recovered despite the fact that the assessee had not appealed against the order. Further, an amount of Rs 19.98 crore by way of interest was recoverable on Rs 28.55 crore not realised.

(b) Another assessee, in the same Commissionerate of Central Excise, was served with a show cause cum demand notice in June 1993 for Rs 1.08 crore for the period 1989-90 to 1992-93 on the ground of manufacturing and clearing products of nickel, tin and lead alloys of non- ferrous metals without payment of duty. While the demand was confirmed by the Commissioner of Central Excise, in February 1996 with a penalty of Rs 10 lakh on the assessee after a lapse of 31 months, the department took another 6 months to communicate it to the assessee, on 18 September 1996. The amount of Rs 1.08 crore had not yet been recovered, notwithstanding the fact that the assessee had not appealed against the order dated February 1996.

There was a further non-recovery of Rs 0.92 crore, by way of interest on Rs 1.08 crore from the period since when this amount had actually become due.

(c) The Commissioner of Central Excise, Vadodara had confirmed a demand of Rs 5.80 crore on 23 February 1995 against an assessee for the period December 1992 to December 1994, on account of differential duty on 'Naphtha'. Aggrieved with this, the assessee filed an appeal before Tribunal. Though no stay order was granted, the department did not take action to recover the amount of Rs 5.80 crore in addition to an interest of Rs 3.48 crore accrued thereon for the period March 1995 to March 1998.

(d) An assessee, manufacturing 'Liquified petroleum gas (LPG)' in Visakhapatnam Commissionerate of Central Excise, cleared goods without payment of duty during the period March 1994 to March 1996. Five show cause cum demand notices were issued to him demanding duty of Rs 4.47 crore between October 1994 and July 1996 and these were confirmed in adjudication in a single order on 6 November 1996 by the Assistant Commissioner of Central Excise, directing therein that assessee should pay the amount within 10 days. Though the order was not appealed against by the assessee, the department failed to recover the confirmed demand of Rs 4.47 crore in addition to an interest of Rs 1.49 crore upto March 1998.

2.6 Non-adjudication of demands

There is no statutory time limit for finalisation of the adjudication proceedings after issue of a 'Show cause notice (SCN)' for determination of duty. This coupled with the fact that interest is leviable, in normal cases, only after 3 months of duty being determined (there was no provision to levy interest prior to June 1995), any delay in the 'SCN' being adjudicated and duty being so determined, is to the financial advantage of assessee and detrimental to revenue. Audit has been consistently recommending statutory time limits for finalisation of adjudication proceeding or in its absence to bring in a provision to levy interest from the relevant date of clearances.

The Public Accounts Committee in its 84th Report (1981-82 7th Lok Sabha) while discussing para 2.54(a) of Audit Report 1979-80, had adversely commented upon the inordinate delay in finalisation of adjudication proceedings in demand cases. Accordingly, the Central Board of Excise and

Customs issued (May 1984) the instructions for the expeditious adjudication of the demand cases as under:

(a) The demand cases should be decided within a maximum period of six months from the date of issue of the show cause cum demand notices.

(b) A list of all cases which cannot be adjudicated within six months should be sent to the Commissioner of Central Excise monthly with precise reason for non- adjudication;

(c) A suitable time limit should be fixed by Commissioner of Central Excise/Additional Commissioner of Central Excise or the Deputy Commissioner of Central Excise for each case within which the Assistant Commissioner of Central Excise should adjudicate the demand cases; and

(d) If the cases are still not decided within the extended time limit, the matter should be further examined to consider the reasons for the delay.

Test check in audit revealed that as on 30 September 1997, in 37 out of 60 commissionerates, 28989 cases involving duty of Rs 2038.08 crore was pending relating to the period prior to 1995-96. The pendency increased to 32177 cases with duty involvement of Rs 2713.94 crore till 1996-97 and to 36868 cases with duty involvement of Rs 3387.33 crore till September 1997. The non-collection of revenue by way of interest upto March 1998 was Rs 1696.75 crore, and consequential financial accommodation to the assessees.

This indicates number of show cause notices pending adjudication and the amount of duty involved had been on the rise. Thus, there is an urgent need for speeding up the adjudicating process considering the substantial revenue involved. **It is recommended that a reasonable statutory time limit for finalisation of show cause notices should be introduced to avoid any loss including interest which is leviable only after three months of the SCN having been adjudicated. Alternatively, a provision to levy interest from the relevant date of clearances of goods may be introduced.**

Some of the important cases are given below:

(i) A leading multi national company, in Bangalore II Commissionerate of Central Excise, engaged in the manufacture of branded cigarettes was found guilty of mis-declaration of the retail sale price of cigarettes resulting in short payment of duty during April 1980 to February 1983. Accordingly, a show cause cum-demand notice for Rs 143.22 crore was issued to its Bangalore unit on 25 September 1987. The jurisdiction of the adjudicating officer was changed thrice between 1987 and January 1990. Notwithstanding these, the show cause cum demand notice of Rs 143.22 crore had not yet been adjudicated even

after a delay of more than 11 years of its issue and 14 years from the last clearance of the goods. This also resulted in non-collection of revenue by way of interest of Rs 415.34 crore till March 1998.

(ii) An Oil Refining Company, in Cochin I Commissionerate of Central Excise, cleared some of their products to warehouses of other marketing companies without payment of duty under bond. On non-receipt of the original copies of AR3 from the consignees, within the stipulated time, 65 show cause cum demand notices, demanding duty of Rs 68.19 crore, on products cleared without payment of duty, were issued during January to July 1995. These show cause cum demand notices were adjudicated by the Assistant Commissioner of Central Excise confirming demand in March and April 1996. On an appeal by the assessee, the Commissioner of Central Excise (Appeals), in his orders issued in October 1996, set aside the orders of the Assistant Commissioner of Central Excise and ordered re-examination of the case.

However, till date the case had not been re-examined and adjudicated finally. Due to non- adjudication of the case, for the last 23 months, besides Rs 68.19 crore due for recovery, interest of Rs 26.14 crore accrued thereon from May 1996 to March 1998 could also not be recovered.

(iii) Two assessees, manufacturing 'Petroleum products', in Mumbai II Commissionerate of Central Excise, were served with show cause cum demand notices during January 1995 to March 1997 for Rs 250.07 crore, on account of shortages in receipt of material treated as 'transit loss'. Though demand notices were issued as early as in January 1995 and onwards, these cases were yet to be adjudicated as of March 1998.

The delay in confirming the demand had resulted in non- recovery of Rs 250.07 crore with a further non-recovery of Rs 37.51 crore by way of interest upto March 1998.

(iv) An assessee, in Vishakhapatnam Commissionerate of Central Excise, engaged in the manufacture of 'Iron and steel products' was served with 72 show cause cum demand notices for Rs 34.99 crore during October 1991 to January 1996 objecting to the availment of Modvat credit on various grounds like (i) incorrect credit taken on goods other than inputs (ii) goods not covered under the definition of 'Capital goods' and (iii) goods not covered under the Modvat scheme. The demands had not been adjudicated so far though a period of more than 6 years had lapsed since the first show cause cum demand notice was issued in October 1991 followed by 71 show cause cum demand notices issued on the same issue. This inordinate delay in adjudication resulted in non-recovery of Rs 34.99 crore, besides non-recovery of interest of Rs 15.16 crore till March 1998.

(v) An assessee, engaged in the manufacture of 'Talcum powder' on job work basis in Mumbai VI Commissionerate of Central Excise, was selling his entire production to a company with their brand name. The price declared by the assessee for duty liability and MRP[4] printed on powder tins showed wide variation. Hence, the assessee was served with 14 show cause cum demand notices during the period June 1994 to September 1997, for a total duty of Rs 28.98 crore on account of under-valuation. None of the demand notices had been adjudicated till date. This inordinate delay in adjudication resulted in non- recovery of Rs 28.98 crore and financial accommodation to the assessee of Rs 16.42 crore by way of interest recoverable from 1 June 1995 to 31 March 1998.

(vi) An assessee, in Jamshedpur Commissionerate of Central Excise, engaged in the manufacture of 'Motor vehicles and parts thereof' removed 'dies and fixtures' without payment of duty by availing exemption which was not admissible. A show cause cum demand notice for Rs 5.13 crore was issued to the assessee by the Commissioner of Central Excise on 5 August 1996. No action was taken thereafter to finalise the SCN, resulting in non- recovery of Government money besides non-recovery of interest of Rs 0.59 crore till March 1998.

(vii) The Supreme Court in the case of M/s Coromandal Fertilizer Limited {1984 (17) ELT 607)} held that commission paid to selling agents is not a trade discount within the meaning of explanation to section 4 of the Central Excise Act, 1944 and does not qualify for deduction from the assessable value, accordingly.

An assessee, in Calcutta II Commissionerate of Central Excise, manufacturing 'Motor vehicles' sold their products through the authorised dealers and were allowing commission to them from the wholesale prices. Such dealer's commission was provided to meet after sales service charges. The commission was not a permissible deduction and was, therefore, includible in the assessable value of the product. The department issued eight show cause cum demand notices for Rs 40.40 crore between September 1990 and October 1997 but these demands had not been adjudicated by the department despite there being no ambiguity on the issue. This resulted in non- recovery of Government dues of Rs 40.40 crore besides non-recovery of interest of Rs 12.04 crore till March 1998.

(viii) The Central Board of Excise and Customs in its circular dated 21 June 1996 clarified that amounts collected by oil companies in the form of State surcharge, Octroi, Retail pump outlet (RPO) surcharges etc. from the buyer, on the sale of petroleum products, were liable to be included in the assessable value.

[4] Maximum retail price

Though the Central Board of Excise and Customs had clarified the position in June 1996, demand notices for the period March 1994 to July 1996 for Rs 20.68 crore in respect of six units in Mumbai I Commissionerate of Central Excise were issued as late as in September 1997. These demand notices had further not been adjudicated till March 1998 despite the issue involved being absolutely clear. The delay in issue of show cause cum demand notices and their non-adjudication so far resulted in non-recovery of Rs 20.68 crore and non-collection of interest of Rs 4.82 crore accrued till March 1998.

(ix) Cess on jute products at multiple point was leviable prior to 8 November 1996. Accordingly, on the basis of audit objections, the department issued 88 show cause notices of Rs 13.79 crore to different jute manufacturers in Calcutta II Commissionerate of Central Excise, during December 1990 to August 1996. The demands were not taken up for adjudication till September 1997. This resulted in non- recovery of Rs 13.79 crore besides non-collection of interest of Rs 8.32 crore accrued thereon till March 1998.

(x) An assessee, in Bhubaneswar I Commissionerate of Central Excise, was served with five show cause cum demand notices aggregating to Rs 71.15 crore during the period July 1993 to September 1993 on ground of differential duty on finalisation of monthly returns. These demands were adjudicated and confirmed by Assistant Commissioner of Central Excise, Rayagada, in December 1993. Being aggrieved, the assessee appealed before the Appellate Commissioner of Central Excise on 17 January 1994, who directed the adjudicating authority without any clear written reasons, to proceed for de-novo adjudication of the aforesaid demand. The demand was still awaiting adjudication (March 1998). The delay of more than 4 years in adjudication resulted in non- recovery of Rs 71.15 crore, besides non-recovery of interest of Rs 55.83 crore accrued thereon till March 1998.

2.7 Non-recovery due to non-vacation of stay orders from the courts

After discussing Para 2.69 of Audit Report 1980-81, Public Accounts Committee (7th Lok Sabha), in para 1.37 of its 170th Report, had recommended that there should be a separate 'Directorate' in the Central Board of Excise and Customs and also 'Cells' in all the major commissionerates, to pursue and monitor all cases of litigation relating to excise and customs. The 'Directorate' and these 'Cells' were to further ensure that departmental cases did not fall through in courts due to ineffective presentation.

Subsequently, the Committee in para 1.9 of its 9th (Action Taken) report desired that Government should review all cases pending in courts and take all steps to get the stay orders vacated and recoveries effected immediately.

Test check in audit revealed that central excise duty of Rs 417.29 crore in 2217 cases (as on 31 March 1998) in 25 commissionerates remained unrealised due to failure to initiate action by the department to get the relevant stay orders vacated for periods ranging from one to sixteen years.

Some of the cases are mentioned below:

(i) The Commissioner of Central Excise Surat II, confirmed a demand for Rs 6.42 crore on 30 August 1989 against an assessee for undervaluation of goods between April 1988 and June 1989. However, the amount could not be recovered as the demand was stayed by the Bombay High Court on 5 March 1990. A notice of motion filed by the department was rejected in 1993. On 5 September 1995, after a lapse of 2 years, the Deputy Commissioner of Central Excise directed the Assistant Commissioner of Central Excise to file a fresh notice of motion. However, no further progress in the case was noticed. Failure on the part of the department to get the stay order vacated resulted in non- recovery of Rs 6.42 crore for more than 8 years, in addition to non-recovery of interest of Rs 10.91 crore accrued upto 31 March 1998.

(ii) Jurisdictional Assistant Commissioner of Central Excise in Ahmedabad I Commissionerate of Central Excise, rejected the application of an assessee for availing proforma credit of Rs 5.30 crore on 4 February 1985. Aggrieved with this, the assessee filed an application with the Gujarat High Court which restricted the department for refusal of proforma credit along with a direction to the assessee to furnish a Bank Guarantee for Rs 25 lakh. Assessee again sought permission from the department on 24 May 1985 to avail proforma credit of Rs 86.92 lakh for the period 4 February 1985 to 24 May 1985 but department refused the permission on the grounds that assessee did not fulfill the eligibility conditions. Assessee again approached the High Court on 28 August 1985 and the High Court allowed the proforma credit of Rs 38.52 lakh from 10 April 1985 to 25 May 1985 and the assessee took the credit in September 1986. The Gujarat High Court on 8 August 1986, dismissed the petition and directed the assessee to furnish a Bank Guarantee for Rs 25 lakh to Assistant Commissioner of Central Excise and directed that interest on all arrears should be paid before 29 September 1986 at 13 *per cent* per annum. In the meanwhile, the assessee had filed an application with the Supreme Court which passed an order on 1 February 1995 that High Court's interim order of 8 August 1986 would continue. Except filing a counter affidavit on 9 December 1986, no further action was taken by the department to get the stay order vacated during the last 11

years, resulting in non- recovery of Rs 5.30 crore for over 10 years besides non-recovery of interest of Rs 10.60 crore till March 1998.

(iii) Demands for Rs 5.26 crore in respect of 16 assessees, in Rajkot Commissionerate of Central Excise, confirmed between 1981 to 1996, could not be recovered so far as all these assessees were granted stay by Tribunal/High Courts/Supreme Court between 1981 and 1996. Even though a period of four to sixteen years had lapsed, the department did not initiate any action either to get these stay order vacated or for early hearing and finalisation of the cases. This resulted in non- recovery of Rs 5.26 crore, besides non-collection of interest of Rs 1.93 crore accrued till 31 March 1998.

(iv) Demand for Rs 1.18 crore, for recovery of excise duty for the period from March 1987 to December 1990, on account of Modvat credit availed on inadmissible packaging materials which included paper, aluminium foil, printing ink and chemicals for lamination, was raised by Mumbai IV Commissionerate of Central Excise against an assessee. The assessee preferred an appeal before Tribunal, which in it's order dated 22 October 1990, disallowed credit on chemicals for lamination and printing ink and directed the department to re-quantify the demand. Accordingly, the demand was re-quantified by the department for the period from 4 March 1987 to 3 December 1990 for Rs 37.30 lakh on 31 January 1991. The assessee, filed writ petitions before High Court against the above show cause cum demand notice and obtained interim stay. The High Court in its interim order directed the assessee to furnish bank guarantee for the amount of demand and also directed the department to raise demand every six months in respect of disputed items, with instructions to the assessee to furnish necessary bank guarantee within six weeks of receiving such demand. The demand in respect of disputed items for the period March 1987 to September 1996 worked out to Rs 1.72 crore. No action had been taken by the department even after a lapse of six years to get the stay vacated which resulted in non- recovery of Rs 1.72 crore besides a loss of interest of Rs 0.84 crore thereon till March 1998.

(v) An assessee, in Raipur Commissionerate of Central Excise, was served with a show cause notice demanding duty of Rs 8.13 crore on 12 December 1990 for the period March 1986 to September 1990, on account of mis-classification of the product and the same was adjudicated by Commissioner of Central Excise after delay of more than four years, on 30th June 1995, confirming the above demand, alongwith a penalty of Rs 30 lakh. Aggrieved with this adjudication order, the assessee preferred an appeal before Tribunal, which granted (August 1996) stay for recovery, with the condition to deposit a sum of Rs 1.01 crore. The said amount was deposited by the assessee on 15 October 1996. However, the department did not initiate any action to get the stay order vacated though a considerable period of twenty one

months had lapsed which resulted in non- recovery of Rs 7.42 crore, besides a non-recovery of interest of Rs 4.08 crore till March 1998.

(vi) A show cause notice was issued on 19 April 1982 to an assessee in Indore Commissionerate of Central Excise, to pay duty on certain manufacturing expenses claimed by him from the customers on ex-factory sales and depot sales. The assessee filed a writ petition in May 1982, in Delhi High Court and obtained the interim stay in May 1982 to restrain the department from taking any steps or proceedings and to permit the petitioner to clear the products on provisional basis by furnishing a bond for differential duty, supported by a bank guarantee for 25 *per cent* of the bond within four weeks from the date of order. The department filed a counter affidavit against the writ petition on 7 October 1982. The amount of duty involved was Rs 1.52 crore upto December 1983, against which bonds for Rs 38.40 lakh were executed which left a balance of Rs 1.14 crore not covered by bond. Thereafter, an application for vacation of said interim stay was moved by the department only on 27 January 1997 i.e., after lapse of fourteen years. The amount of Rs 1.14 crore was yet to be recovered. There was also non-recovery of interest of Rs 3.52 crore from November 1982 to March 1998.

2.8 Loss of revenue due to time limitation

As per provisions of section 11A of the Central Excise Act, 1944, the Central Excise Officer is required to issue show cause cum demand notice for recovery of duty not levied or short levied or erroneously refunded within a period of six months from the relevant date. This limitation period of six months stands extended to five years where fraud, collusion or any willful misstatements or suppression of facts is involved.

The Supreme Court in the case of Madhumilan Syntex Pvt. Ltd. and others {1988(35) ELT(SC)}, held that unless the show cause notice was issued under section 11A of the Central Excise Act, 1944, the department was not entitled to recover any dues. Accordingly, the Central Board of Excise and Customs through its letter dated 18 August 1988, issued instructions directing the field officers to take recourse to section 11A only and issue legal notices wherever required in order that the department did not suffer due to SCN becoming time barred or on account of faulty SCN. It was also emphasised that if cases were lost by the department and revenue suffered because of non- compliance of laws, the concerned Commissioner of Central Excise would be held responsible for such lapses and such cases would be dealt with seriously.

Test check in audit revealed that Rs 58.48 crore, in 273 cases in 33 commissionerates, could not be recovered due to the cases having become time barred as the department failed to issue SCN in time or did not issue SCN or ineffective SCN was issued.

Some of the cases are given below:

(i) An assessee, in Chandigarh II Commissionerate of Central Excise, engaged in the manufacture of 'Writing and printing paper' cleared their products from November 1988 to 30 April 1993 on payment of duty at an inadmissible concessional rate. The department issued three show cause cum demand notices belatedly to the assessee on 27 May 1993, 3 December 1993 and 27 April 1994, for a total amount of Rs 9.59 crore. The aforesaid demands were adjudicated and dropped in November 1997 by the Commissioner of Central Excise, on the grounds that the demands were time barred as extended period of limitation could not have been invoked in these cases as the reason for the short levy was well known to the department all the while through the mandatory returns and there was no suppression of facts. Had the demands been issued within time, a revenue loss of Rs 9.59 crore could have been avoided.

(ii) Show cause cum demand notice for Rs 3.44 crore was issued to an assessee, in Calcutta I Commissionerate of Central Excise, for availing incorrect exemption under a notification dated 16 March 1976, since the notification was applicable for batteries having metal jacket whereas the assessee was manufacturing 'Dry cell batteries'. The demand could not be confirmed as the concerned Commissioner of Central Excise decided (8 August 1996) that the demand was hit by limitation of time. Had the demand been issued in time, based on information which the department had through the usual periodic returns, an amount of Rs 3.44 crore could have been realised.

(iii) An assessee, in Mumbai I Commissionerate of Central Excise, engaged in the manufacture of various grades of 'Lubricating oils' availed Modvat credit on inputs viz., base lubricating oil. As per provisions of clause (v) of sub rule (2) of rule 57B, effective from 1 March 1997, 'Lubricating oil' was not eligible for Modvat credit. Accordingly, the department served a show cause notice for the period April 1997 to August 1997 for Rs 5.67 crore but failed to issue show cause for the incorrect Modvat credit of Rs 1.62 crore availed during 1 March 1997 to 15 April 1997. Thus, non-issue of show cause notice to the assessee within time led to loss of Rs 1.62 crore as the case had become time barred.

(iv) A show cause cum demand notice involving duty of Rs 44.93 lakh for the period from September 1985 and March 1986, was issued by the Range Superintendent on 1 July 1987 to an assessee under Bhubaneswar II, Commissionerate of Central Excise on the basis of

shortage of finished goods detected by Range Superintendent himself. The case was adjudicated on 31 July 1990 after a lapse of 3 years and the demand of Rs 44.93 lakh was confirmed by the Commissioner of Central Excise. However, the assessee did not pay the amount and the department attached the amount of PLA of the assessee. Being aggrieved, the assessee appealed before Tribunal which allowed the appeal on 14 June 1996 and set aside the impugned order observing that the show cause-cum demand notice invoking longer period of limitation and allegation of wilful mis-statement and suppression of facts could only be made by the Commissioner of Central Excise and not by Range Superintendent.

The issue of show cause notice by an authority not competent to do so resulted in a loss of revenue of Rs 44.93 lakh.

2.9 Irregular transfer of demand cases to Call Book

A Call Book is a document maintained by the department in which cases which have reached a stage when no action can or need be taken to expedite its disposal for at least 6 months (e.g., cases held up in Law Courts), may be transferred thereto with the approval of the competent authority.

As per the Central Board of Excise and Customs circular dated 14 December 1995 only those cases in which (i) department has gone in appeal to the appropriate authority; (ii) where injunction has been issued by the Supreme Court/ High Court/Tribunal; (iii) cases where audit objections are contested; and (iv) Board have specifically ordered for keeping such cases in Call Book, can be transferred to Call Book with the approval of the concerned Commissioner of Central Excise.

The Public Accounts Committee, while discussing Para 1.03 of Audit Report for the year ending 31 March 1995 (Number 4 of 1996), in its 14th Report (11th Lok Sabha) recommended that Ministry should review the system of transfer of cases to the Call Book and ensure that all such cases are transferred strictly in terms of the instructions and are properly subjected to the prescribed periodical review both by the commissioners as well as the Central Board of Excise and Customs.

Test check in audit revealed that 133 demand cases involving duty effect of Rs 81.93 crore and pending adjudication in six commissionerates, were improperly transferred to Call Book, in violation of the Central Board of Excise and Customs orders/ PAC recommendations. This resulted in non-adjudication of these cases with consequential non-realisation of revenue of Rs 81.93 crore to the Government. These cases were also not reviewed to see whether these merited continuance in the call book and hence no action.

Two such cases are given below:

(i) An assessee, in Mumbai I Commissionerate of Central Excise, engaged in the manufacture of 'Soap products' was served with show cause cum demand notices in November 1994 demanding duty of Rs 11.73 crore on account of misclassification and Rs 72.47 lakh on account of wrong availment and utilisation of money credit during the period. These show cause cum demand notices had been shown as disposed off, by transferring them to Call Book without assigning any reasons, whatsoever. These were subsequently not reviewed also and the cases were still under adjudication.

(ii) Similarly, another assessee in the same commissionerate, was served with 11 show cause cum demand notices from August 1995 to May 1997 for an amount of Rs 62.20 lakh for clearance of his products, without payment of duty. These demand notices were transferred to Call Book with the remarks 'reference made to chief chemist in November 1997'. The department should have resorted to provisional assessment in this case, instead. Further, there was nothing on record to show that the case was reviewed and monitored or the report of the chief chemist obtained.

The above two cases were not adjudicated till date resulting in non-realisation of Rs 13.08 crore besides non-recovery of interest of Rs 5.49 crore till March 1998.

2.10 Ineffective certificate action

On confirmation of demand by an adjudicating authority, the assessee is required to pay the dues so determined. In case the assessee fails to make the payment, the procedure laid down in section 11 of the Central Excise Act, 1944, for recovery of the dues provides for, as a last resort, preparing a certificate specifying the amount due from the person and sending it to the District Collector, where such person resides or conducts his business, for recovery of dues, as 'arrears of land revenue'.

Test check in audit disclosed that in 30 commissionerates in 1622 cases, central excise duty of Rs 134 crore (upto 30 September 1997) could not be recovered by taking recourse to the procedure of sending such cases to District Collector concerned by way of certificate action. Audit examination disclosed that the above procedure did not seem to be effective at all, as a meagre amount of Rs 5000 in a single case alone had been recovered during the last five years through this method. The system does not appear to be effective.

Two such cases are illustrated below:

(i) An assessee, in Calcutta III Commissionerate of Central Excise, engaged in the manufacture of 'Cigarettes' was served with 20 show cause notices demanding a total duty of Rs 20.49 crore. These SCNs were adjudicated and the demands were confirmed between August 1987 and June 1991. The department however, did not take any positive action to realise the duty due and certificate action was instead resorted to. However, dues of Rs 20.49 crore had still not been recovered even after 7 to 10 years of demand having been confirmed. This also resulted in non-recovery of interest Rs 40.63 crore for the period April 1988 to March 1998.

(ii) An assessee, in Hyderabad I Commissionerate of Central Excise, was engaged in the manufacture of 'Cigarettes' on job work basis for and on behalf of some other companies. On 12 August 1986, the officers of the Director General of Anti Evasion raided the factory premises and seized the accounts, as the assessee had removed 'Cigarettes' clandestinely. A show cause cum demand notice was issued to the assessee for an amount of Rs 1.34 crore on 14 September 1987 by the Jurisdictional Assistant Commissioner of Central Excise. The case was adjudicated in January 1992 and the department initiated action (February 1992) by issuing a certificate to State Revenue Authorities. However, amount had not been recovered till date. In the absence of the relevant details, audit could not verify whether the 'certificate action' was initiated only after exhausting all other channels of recovering excise dues. This had further led to a non-recovery of Rs 3.15 crore by way of interest from September 1986 to May 1998.

2.11. Loss of revenue due to non- execution of bond

According to rule 9B of the Central Excise Rules, 1944, the Central Excise Officer is permitted to allow clearance of the goods provisionally assessed, on execution of a bond with adequate security, binding the assessee for payment of difference between the duty provisionally assessed and that which would be finally assessed. For fixing the value of the bond, the proper officer considers the differential duty payable on these goods for three months. Twenty five percent of the bond value is fixed as security payable in cash/Government securities/ bank guarantees etc. The bank guarantee executed are valid for the period mentioned therein.

Test check in audit revealed that excise duty of Rs 8 crore could not be recovered in 25 cases even after confirmation of demands as bonds were not executed in provisional assessment cases, in 5 commissionerates.

An illustrative case is given below:

An assessee, in Mumbai VI Commissionerate of Central Excise, engaged in the manufacture of 'Pharmaceutical preparations' manufactured a product "Alprovit". The goods were classified by the assessee under chapter 30 and price list was also filed with effect from 1 March 1992. This was approved by the proper officer provisionally by making a remark "price approved provisionally under rule 9B" on the body of the price list itself though earlier price list with effect from July 1991 stood approved finally. All subsequent price lists filed by the assessee were approved provisionally in the same manner. However, it was noticed in audit that the assessee was not asked to and he did not also execute any bond or furnish any bank guarantee to cover the differential duty. The price lists for the period July 1991 to 9 March 1994 were finally approved by the proper officer on 25 March 1996 fixing the assessable value by more than 100 *per cent* of the value that was claimed for approval by the assessee. However, the amount of differential duty of Rs 1.59 crore could not be recovered as there was no bank guarantee available to be encashed or bonds to be enforced.

2.12 Inadequate monitoring and non-maintenance of control registers

The Central Board of Excise and Customs issued instructions on 28 July1980 that a register of show cause cum demand notices for unconfirmed demands and confirmed demands should be maintained in the prescribed proforma to keep a watch over the speedy finalisation of show cause cum demand notices and realisation of confirmed demands. The register is required to be maintained both at the range and division level and within four days of the close of a month, an abstract is to be put up to the Superintendent of Central Excise/Assistant Commissioner of Central Excise for scrutiny of the pendency and indicating further follow up action, if required.

A scrutiny of relevant records in test check revealed:-

(i) that the registers were not maintained in the proper proforma,

(ii) that no monthly abstracts giving the summary of pendency with opening balances, additions, disposals and closing balances were drawn and submitted to the Superintendent of Central Excise/ Assistant Commissioner of Central Excise for scrutiny.

(iii) that there was no indication in the register indicating scrutiny by the supervisory officers during their course of inspection/visit to division/range offices.

(iv) that cross references of unconfirmed demands were not recorded against each item in the confirmed demand register and vice versa.

(v) that there were wide variations in figures reported to higher authorities when compared to figures available at division/commissionerate level.

Some cases are mentioned below:

(i) Scrutiny of the register of unconfirmed demands in a Division of Chandigarh I Commissionerate of Central Excise and its co-relation with one of the Range records revealed that 56 demand cases involving duty of Rs 3.58 crore pertaining to years 1995-96 to 1997-98 were strangely missing from the register of unconfirmed demands maintained in the range. This is indicative of the fact that there was no monitoring and subsequent follow up action on these demands at the Range level.

(ii) Monthly technical reports (MTRs) submitted by the Assistant Commissioner of Central Excise to the Commissioner of Central Excise Chandigarh I, indicated that 206, 439 and 397 SCNs were issued during 1995-96, 1996-97 and 1997-98 respectively as against the actual figures of 358, 411 and 371 as shown in SCN register maintained by the commissionerate for the respective years. Similarly, cases adjudicated during 1995-96, 1996-97 and 1997-98 were reported in MTR as 162, 316, 375 as against the actual figures of NIL, 266, 205, respectively. In Delhi I Commissionerate of Central Excise while an amount of only Rs 73.35 crore was shown as pending recovery for confirmed demand cases as on 30 September 1997, the actual amount pending recovery as furnished to Audit was Rs 342.40 crore. This shows that the figures reported were inconsistent and wide variation was there in cases reported to the higher authorities through MTR and actual cases appearing in their own records.

Summing Up

Outstanding demands constitute a very significant portion of Central Excise revenues. The rising trend in outstanding demands both for confirmed as well as those pending adjudication are indicative of inadequate monitoring by the higher authorities and observance of the Central Board of Excise and Customs orders and recommendations of the PAC, more in breach than in practice. In the absence of statutory time limits for finalisation of adjudication of a SCN, coupled with the fact that interest is also not leviable from the relevant date of clearances, any delay in finalisation of a SCN is to the advantage of assessee and detrimental to Government revenue. Audit strongly recommends that these two loopholes need to be plugged. Strengthening of the existing monitoring mechanism could also significantly reduce outstanding demands.

The above points were reported in November 1998, reply of the Ministry of Finance had not been received.

CHAPTER 3 : TOPICS OF SPECIAL IMPORTANCE

3.1 Issue of notification beyond delegated powers

To implement the Modvat scheme, section 37(2) (xvia) of the Central Excise Act, 1944, was inserted vide section 51 of the Finance Act, 1986. This empowers Government to make rules providing for the credit of duty paid or deemed to have been paid on the goods used in, or in relation to the manufacture of excisable goods. Accordingly, with effect from 1 March 1986, rule 57 A was introduced allowing credit of duty paid on excisable goods used as inputs. Whereas, sub rule (1) of rule 57A provides for taking credit of any duty of excise (under the Central Excise Act) or additional duty under the Customs Tariff Act, 1975 paid on inputs used in or in relation to the manufacture of final products, sub rule (2) ibid provides for utilisation of the credit allowed under sub rule (1) towards payment of duty of excise leviable on the final products, whether under the Excise Act or any other Act as may be notified by the Government.

The term 'duty' has been defined under rule 2(7) of the Central Excise Rules, 1944 as duty payable under section 3 of the Central Excise Act, 1944. However, the Government, through notifications dated 1 March 1994 and dated 16 March 1995, in exercise of powers conferred under rule 57A, allowed credits of 'additional duties' leviable under the Additional Duty of Excise (Textiles and Textile Articles) Act, 1978 from 1 March 1994 and Additional Duty of Excise (Goods of Special Importance) Act, 1957 from 16 March 1995. This was violative of the aforesaid provisions of the Central Excise Act, 1944/Rules.

Further more, the additional duties of excise under the Additional Duty of Excise (Goods of Special Importance) Act, 1957 which constituted around 83 *per cent* of the duties collected under the aforesaid two Acts, are levied in lieu of 'Sales tax' imposed by the States by declaring certain goods to be of special importance in the course of inter-state trade or commerce. The entire collections from these duties are also assigned to the States. The major commodities on which this additional duty of excise in lieu of 'Sales tax' are levied are Sugar, Tobacco, Cigarettes, Woven fabrics of different compositions etc. Under the present Modvat system, no credit is allowed on account of Sales tax.

The total duty collected under these two Acts during the period April 1994 to March 1998 was Rs 13582.56 crore which was available to the downstream manufacturers for utilisation as Modvat credit subject to observance of specified procedure thereby reducing net collections from central excise duty part of which is assigned to the States. Had the amount been collected as Sales Tax directly by the States no such credits would have been admissible

thereby enchancing the revenue of State Governments by way of increased central excise collection and accordingly increased allocation to the States.

On this being pointed out, the Ministry of Finance contended (January 1999) that they had not exceeded the powers vested in them in terms of section 37(2)(xvia) since additional duties levied under the Additional Duties of Excise (Goods of Special Importance) Act, 1957 and Additional Duties of Excise (Textiles and Textile Articles) Act, 1978 are duties of excise in terms of section 3(1) of these Acts and all provisions of the Central Excise Act/ Central Excise Rules also apply to these duties in terms of section 3(3) of these Acts. They argued that the Government has powers to provide for allowing credit "of any duty of excise as may be specified" under rule 57A(1) and that there is nothing in the Central Excise Rules to suggest that the powers are limited to providing for credit of duty of excise levied under the Central Excise Act, 1944 only.

The Ministry's reply is not tenable on the following grounds:

(i) While provisions of the Central Excise Act and Central Excise Rules pertaining to levy and collection are applicable in respect of these additional duties, the benefit of Modvat credit as envisaged in section 37(2)(xvia) of the Central Excise Act, 1944 and rule 57A(1) of the Central Excise Rules, 1944 for duties of excise under the Central Excise Act cannot be automatically extended in respect of such duties. If this was not so then the Government would not have to separately notify extension of the benefit of Modvat credit to these additional duties. For instance, whereas Modvat credit was extended to chapter 17 which interalia includes Sugar vide notification 83/87 CE dated 1 March 1987, the benefit of Modvat credit on additional duties of excise on Sugar was specifically and separately notified with effect from 16 March 1995.

(ii) The additional duties under the 1957 and the 1978 Acts are different from the additional duties leviable under section 3 of the Customs Tariff Act, 1975 on which Modvat credit is specifically allowed under rule 57A(1). These latter duties, being in the nature of countervailing duty, are levied at the rates specified under the Central Excise Tariff Act, 1985. The additional duties in question are, however, levied at different rates as specified under the respective Acts.

Moreover, whereas the countervailing duties are levied on imports to exactly offset the disadvantage faced by domestically produced goods on account of levy of excise duty, the additional duties of excise leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957 is levied in lieu of Sales tax. While the benefit of Modvat credit has been extended progressively to excise duties on various commodities, it has not so far been extended to Sales tax.

(iii) The intention of the Central Excise Act/Rules can also be gauged from comparison of the wording of rule 57A(1) and 57A(2). The rule 57A(2) clearly stipulates that the credit of specified duties shall be utilised towards payment of duty of excise leviable on the final products, whether under the Central Excise Act, 1944 or under any other Act. The rule 57A(1) however, does not extend this benefit to excise duties leviable under other Acts. Moreover, rule 57A has to be read in conjunction with section 37(2)(xvia), section 3 (the charging section) and rule 2(7) of the Central Excise Rules wherein the term 'duty' has been specifically defined as duty levied under the Central Excise Act. The word "any duty of excise" has to be interpreted accordingly.

3.2 Non cognizance of specific notification-incorrect exemption to certain petroleum products

As per notification dated 1 March 1994, excisable goods falling under chapter 27, manufactured in a factory and used for the manufacture of goods falling under chapter 27, are exempt from the whole of the duty leviable thereon provided that the said intermediate products as well as final products are specified in the table of the notification, ibid. The sub-heading 2710.19 (except natural gasoline liquid) as input had been excluded from the specified goods under this notification.

Four oil refineries, in four commissionerates, manufacturing motor spirit and high speed diesel oil (sub-heading 2710.19) which also manufactured intermediate products like LGO, heavy naphtha, light reformate and vis-breaker naphtha (all falling under sub-heading 2710.19), were allowed to clear the products within the refineries without payment of duty for manufacture of motor spirit. Duty on the intermediate products, therefore, ought to have been levied since the exemption notification dated 1 March 1994 was not applicable for input items of sub-heading 2710.19. The omission resulted in non-levy of duty of Rs 128.53 crore on the clearances between March 1994 and June 1998.

On being pointed out (between July 1995 and July 1998), the department contended (April 1996 and July 1998) that duty was not levied on such intermediate products as per para 91 of the departmental instructions on excisable manufactured products (Petroleum products).

The reply of the department is not tenable in view of the specific exclusion of products of sub-heading 2710.19 from the notification of March 1994. Further verification (January 1998) showed that show cause cum demand notices for Rs 5.86 crore were issued in June 1997 in one case.

Reply of the Ministry of Finance had not been received (November 1998).

3.3 Restrictive introduction of 'MRP' system based assessment on 'Pan masala - benefit to established large scale manufacturers

According to the notification dated 1 March 1997, 'Pan masala' was chargeable to duty on the basis of tariff value of Re 0.80 per pack of contents not exceeding 2 grams and Rs 1.70 per pack of contents exceeding 2 grams but not exceeding 4 grams. For the remaining packs, duty was to be charged on the assessable value under section 4.

With the introduction of MRP system of valuation through Budget 1997, duty on 'Pan masala' was to be charged on the value equivalent to the 50 *per cent* of MRP vide notification dated 7 May 1997. The notification was, however, restrictive in nature as it was made applicable to 'Pan masala' packs with contents not exceeding 2 grams with a MRP of upto Rs 1.25 per pack; and packs with contents exceeding 2 grams but not exceeding 4 grams with a MRP of upto Rs 2 per pack. This notification did not cover cases where MRP was more than Rs 1.25 or Rs 2.00 per pack for 2 grams and 4 grams packs, respectively.

The restrictive nature of the notification resulted in the manufacturers of 'Pan masala' selling their products at much higher (MRP) value, continuing to opt for the notification dated 1 March 1997 (on the basis of tariff value where duty payable would be less) instead of the 7 May 1997 notification based on MRP. The rationale behind issue of the notification dated 1 March 1997 and allowing it to operate simultaneously could not be verified as the files leading to issue of the notifications were not made available to Audit by the Central Board of Excise and Customs despite repeated requisition.

The simultaneous operation of the two notifications resulted in a manufacturer selling his product at lower MRP (Rs 1.25/2.00) paying higher percentage of duty in terms of MRP, and the manufacturer selling his product at MRP, higher than Rs 1.25/2.00 paying lower percentage of duty in terms of MRP by opting to pay duty under notification of 1 March 1997.

(a) Test check of records of nine assessees, in seven commissionerates, engaged in the manufacture of 'Pan masala' revealed that the assessees cleared pan masala/gutkha not exceeding 2 grams pack (MRP ranging from Rs 1.75 to Rs 2 per pouch) and more than 2 grams but not exceeding 4 grams (MRP ranging from Rs 3.50 to Rs 4 per pouch) on payment of duty at the rate of 40 *per cent* on the tariff value of Re 0.80 and Rs 1.70 per pack of 2 grams and 4 grams pack, respectively under notification dated 1 March 1997. As the MRP of the product was more than that prescribed under notification dated 7 May 1997, the clearances were made adopting tariff value fixed under notification dated 1 March 1997, taking benefit of the anomaly between the two notifications. The duty payable with reference to 50 *per cent* of value of MRP for the said periods would have been more if the actual MRP was taken into account. Thus the defective notification resulted in duty

of Rs 26.84 crore being foregone on the clearances made from May 1997 to May 1998 and unintended benefit being given to the established large scale manufacturers selling their products at much higher price but paying duty on tariff value.

This was pointed out in May and June 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(b) Another assessee, in Pune II Commissionerate of Central Excise, cleared 'Pan masala' during the period 1 March 1997 to 21 May 1997 by adopting tariff value. From 22 May 1997, he claimed exemption under notification dated 7 May 1997 by marginally increasing the net contents of pouch from 2.00 grams to 2.10 grams. By increasing the net contents, the duty was paid by adopting value of Re 0.75 (50 *per cent* of MRP of Rs 1.50) whereas the tariff value thereof was Re 0.80. This resulted in duty of Rs 35.32 lakh for the period 22 May 1997 to 31 March 1998 being foregone.

This was pointed out in August 1998; reply of the Ministry of Finance/department had not been received (November 1998).

3.4 Persistent irregularity - non-levy of duty on red oil (sandal wood oil)

Sandal wood oil is an essential oil falling under heading 33.01 of the Central Excise Tariff. Aqueous distillates and aqueous solutions of essential oils are also dutiable under the same heading. SSI exemption is not available for the manufacture of sandal wood oil.

Production of crude sandal wood oil (red oil) and its clearance without payment of duty involving probable evasion of duty of Rs 6.90 crore upto March 1995 by the producers of 'red oil' noticed in test check of the accounts of seven assessees who were purchasing such crude sandal wood oil (red oil) from undisclosed sources was highlighted in para 3.31 (i) of Audit Report for the year ended 31 March 1995. The department had contended (August 1995) that if red oil was treated as excisable product, the final product (sandal wood oil) would not be charged to duty since red oil was incapable of being marketed. Audit was of the opinion that as red oil satisfied the specifications of essential oil of heading 33.01, and was marketable (bought and sold by producers), duty had to be paid at every stage of manufacture unless specifically exempted. Therefore, the department was urged to conduct investigations to identify the producers of red oil and to devise some mechanism to plug the possibility of leakage of revenue.

Subsequent scrutiny of the records of six including four out of the said seven assessees revealed that no proper action had been taken even thereafter by the department to identify the producers and levy excise duty on red oil. The purchase of red oil by the assessees from undisclosed sources continued, which involved a further duty of Rs 16.87 crore during April 1995 to December 1997 which was not paid. Total duty involved in respect of all such producers would be much more.

This was again pointed out in June and August 1998; reply of the Ministry of Finance/department had not been received (November 1998).

CHAPTER 4 : REBATE AND REFUND OF DUTY

Rebate of duty paid on excisable goods if exported outside India or supplied as stores for use on board a ship/aircraft meant for a foreign run is governed by rule 12 of the Central Excise Rules, 1944 whereas refund of duty of excise is permissible under section 11 B of the Central Excise Act, 1944.

Some of the illustrative cases of incorrect grant of rebate and refund of duty noticed in audit are given in the following paragraphs:

4.1 Incorrect availment of rebate at the time of clearance

According to notification dated 22 September 1994, issued under rule 12 of the Central Excise Rules, 1944, rebate of duty paid on 'Mineral oil products' exported as stores for consumption on board an air-craft on foreign run is admissible subject to certain conditions prescribed in the notification and observance of the procedure laid down under rule 12. The conditions and the procedure prescribed, interalia, require that (i) the proper officer of Customs shall certify the quantity of products left on board for determining the quantum of rebate; (ii) the submission of claim of rebate within six months from the date of export in the prescribed form alongwith original copy of AR 4 duly endorsed by the Customs officer for sanction of rebate by the Maritime Commissioner of Central Excise or Jurisdictional Assistant Commissioner of Central Excise; and (iii) the rebate so claimed was to be reduced by Rs 24.94 per kilo litre in respect of aviation turbine fuel. Further, the benefit of this notification was not available to aircraft on foreign run to Nepal.

(a) Fourteen assessees, {in Bangalore (2), Calcutta III (1), Chennai (1), Cochin I and II (4), Delhi I (3) and Mumbai IV (3) Commissionerates of Central Excise}, cleared aviation turbine fuel as sale to aircrafts on international flights, on payment of duty at Rs 24.94 per kilo litre at the time of clearance. The prescribed procedure regarding submission of rebate claim in prescribed form with the proper authority alongwith the required documents and certificate of the quantity eligible for rebate was not followed. Instead of paying the duty first at 10 *per cent* ad valorem and then claiming the rebate, the assessees themselves availed the rebate. The rebate so claimed was in clear contravention of the provisions of the enabling notification, ibid and the rule 12. This resulted in incorrect availment of rebate of Rs 413.82 crore between April 1994 and March 1998. Further, in the absence of the claim for refunds having been filed and other procedures like certification of the quantities on board an aircraft before reversion to foreign run after completion of internal flight, the amount of incorrect availment of rebate of duty paid on ATF consumed in sectors internal to India, could not be ascertained in audit.

On being pointed out (between July 1995 and August 1998), the department in one case admitted (November 1995) the procedural deviation by the assessee and stated that there was no revenue implication. The department had, however, issued show cause notices demanding duty of Rs 171.14 crore in four cases. Reply in the remaining cases had not been received (November 1998).

The reply of the department is not tenable as the authority to grant the rebate vests with the department subject to fulfilment of specific conditions specified in the Act, Rules and the notification.

Reply of the Ministry of Finance had not been received (November 1998).

(b) An assessee, in Delhi I Commissionerate of Central Excise, was allowed to export aviation turbine fuel (ATF) as stores for consumption on board for aircrafts on foreign run to Nepal under bond under rule 13. Duty of Rs 24.94 per kilo litre only was paid by the assessee by self availing of the rebate under notification dated 22 September 1994 issued under rule 12. Since rebate under this notification was not applicable to ATF exported to Nepal, grant of rebate of duty of Rs 3.36 crore during April 1995 to March 1998 was incorrect.

This was pointed out in July 1998; reply of the Ministry of Finance/department had not been received (November 1998).

4.2 Incorrect refund of duty without claim

Under section 11 B of the Central Excise Act, 1944, an assessee can claim refund of duty of excise by making an application for refund in the prescribed form (Form-R) to the Assistant Commissioner of Central Excise before the expiry of six months, from the relevant date. Such application has to be accompanied by documentary evidence of payment of duty for which refund is being claimed and further that the duty incidence has not been passed on by him to another person.

An assessee, in Pune I Commissionerate of Central Excise, engaged in the manufacture of 'Polyster chips', had paid duty of Rs 46.16 lakh through Modvat credit account on 16 February 1996 in discharge of duty liabilities on account of shortages in stock (RG1). Subsequently, the assessee voluntarily took the credit of Rs 46.16 lakh in his Modvat credit account on 20 February 1997 after more than six months of duty having been paid and intimated this to the Divisional Assistant Commissioner of Central Excise on 21 February 1997. As refund was clearly not admissible, the refund taken suo moto by the assessee, by credit to Modvat account was incorrect. Department did not take any action to recover the duty.

On being pointed out in August 1997, the department accepted the objection and stated (January 1998) that a show cause notice for recovery of duty had since been issued.

Reply of the Ministry of Finance had not been received (November 1998).

4.3 Incorrect grant of refund

An assessee, in Cochin II Commissionerate of Central Excise, claimed refund of duty of Rs 22.01 lakh and was granted the refund also by the department, notwithstanding the fact that the burden of excise duty had already been passed on to the customers. The Ministry of Finance, while accepting (November 1998) the objection, stated that an amount of Rs 13.28 lakh had since been recovered and the show cause notice for the balance amount of Rs 8.73 lakh was pending adjudication.

CHAPTER 5 : VALUATION OF EXCISABLE GOODS

A wide range of the excisable commodities are leviable to ad valorem rates of duty. The valuation of excisable goods is governed by section 4 of the Central Excise Act, 1944 read with the Central Excise (Valuation) Rules, 1975.

Some of the illustrative cases of short levy due to undervaluation are mentioned below :

5.1 Price fixed by the Government - adoption of incorrect value

As per section 4(1)(a)(ii) of the Central Excise Act, 1944, where excisable goods are sold in the course of wholesale trade at a price fixed under any law, then the price so fixed shall be deemed to be the assessable value of these goods.

The Supreme Court in the case of Pyrites Phosphate and Chemicals Limited upheld the Tribunal's decision that when a price is fixed under Control Order, the assessable value shall be determined on the basis of the price fixed under that Control Order {1996 (88) ELT - A 131}.

(a) Ministry of Petroleum and Natural Gas had been fixing from time to time different prices for LPG packed domestic, LPG packed non domestic and LPG bulk. The price fixed for LPG bulk was Rs 11601.78 per tonne in March 1994 whereas the price for LPG packed domestic was Rs 5309.19 per tonne. Thus, there was a wide variation in the price of the two categories from time to time.

Eleven assessees, in eight Commissionerates of Central Excise, manufactured and cleared LPG (bulk) to the various depots for refilling. Though the goods were cleared in bulk condition, the assessees paid excise duty on the price applicable to LPG packed domestic, where the price was much lower as compared to LPG bulk, in which condition the goods were actually cleared. The goods were undervalued to that extent. By virtue of the fact that at the time of clearance from the place of manufacture and at the time of paying duty the goods were in bulk condition, the duty should have been paid on the price fixed for LPG bulk. Thus the product was undervalued and resulted in short collection of duty of Rs 194.48 crore between March 1994 and June 1998.

The department issued show cause cum demand notices for Rs 55.11 crore to four assessees out of which, demand of Rs 43.43 crore relating to one assessee had been confirmed in November 1997. Action taken for recovery of duty in the remaining cases was awaited (October 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(b) The Ministry of Chemicals and Fertilisers fixed maximum price for bulk drug "Ciprofloxacin-HCL" from time to time under Drugs (Price Control) Order,1995.

An assessee, in Hyderabad-I Commissionerate of Central Excise, manufactured and cleared the bulk drug at prices lower than the maximum price fixed and paid duty at the lower price. This was incorrect because as per the provisions of the Central Excise Act, 1944, irrespective of the price charged by the assessee from the buyer, the maximum price fixed under any law for the time being in force would be the assessable value. This resulted in short levy of duty of Rs 3.38 crore during April 1996 to December 1997.

On being pointed out (January 1998), the department intimated (April 1998) that a show cause notice demanding duty of Rs 4.49 crore for the period from April 1996 onwards had been issued in February 1998.

Reply of the Ministry of Finance had not been received (November 1998).

5.2 Additional considerations not included in the assessable value

(i) Distribution charges

The Supreme Court, in the case of Bombay Tyre International, held in October 1983 that the expenses incurred on account of the several factors which have contributed to the value of the product upto the date of sale are to be included in the assessable value. This was reinforced by the judgement of the Supreme Court in the case of Madras Rubber Factory Limited {1995 (77) ELT 433} upholding the view that the expenses incurred in maintaining and running the sale depots (distribution expenses) cannot be deducted from the assessable value.

An assessee, in Raipur Commissionerate of Central Excise, engaged in the manufacture of various iron and steel products, undertook sale of their excisable goods through depots. It was noticed (November 1995) that the assessee had collected distribution charges from the buyers relating to expenses incurred towards running and maintenance of stock yards/depots, which were not included in the assessable value, resulting in short levy of duty of Rs 13.86 crore during March 1993 to January 1995.

In subsequent audit, it was noticed (February 1997) that a show cause cum demand notice for Rs 18.67 crore covering the period from March 1992 to January 1995 was issued by the Commissioner of Central Excise in November 1996 which was pending adjudication. Further progress was awaited (June 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Interest on deposits

The Ministry of Finance clarified on 13 June 1990 that interest accrued on advance deposits made by customers should be included in the assessable value since the manufacturer would have incurred liability to pay interest had he borrowed from banks and, therefore, it was not necessary to establish separately the nexus between the deposits and the price.

Five assessees, in Delhi II, Delhi III and Indore II Commissionerates of Central Excise, collected deposits/advances from the buyers and utilised the money as working capital. The element of interest on money advanced had a direct nexus with the price charged from the customers. Non inclusion of interest earned/accrued resulted in undervaluation of goods and consequent short levy of duty of Rs 5.43 crore during April 1994 and March 1997.

On being pointed out between February and December 1997, the department accepted the objection in the case of three assessees and intimated recovery/confirmation of demand of Rs 0.10 crore. In the case of fourth assessee, it stated that show cause notice issued was pending adjudication. In the case of the fifth assessee, the department stated (October 1997) that a stand was taken to include the value of notional interest on security deposit in the assessable value, and this was one of the grounds for provisional assessment.

Reply of the Ministry of Finance had not been received (November 1998).

(iii) Escalation charges

According to the circular of the Central Board of Excise and Customs dated 4 October 1980, in the case of running contracts, where there is a price variation clause, the goods should be provisionally assessed at the time of clearance and final assessment be made as soon as the assessee submits his bills for the escalated value, without waiting for their acceptance by the customers.

Twenty seven assessees, in Aurangabad, Chandigarh II, Delhi III, Jaipur II, Mumbai III, Pune I and II Commissionerates of Central Excise, either received the enhanced price or raised demands on the customers for escalation of prices but duty due was not paid. This resulted in short levy of duty of Rs 4.45 crore between April 1992 and April 1997.

On being pointed out between August 1995 and January 1998, the department stated (between July 1997 and April 1998), that while duty of Rs 0.64 crore had been recovered in seven cases, in fifteen cases recovery could not be effected as the relevant demands had become time barred. Reply in the remaining five cases had not been received (June 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(iv) Freight charges and surcharges

(a) Seven assessees, in Calcutta I, Chandigarh II, Cochin, Hyderabad I and Patna Commissionerates of Central Excise, engaged in the manufacture/procurement of various petroleum products, had incurred certain expenses such as transportation charges, state surcharges, retail pump outlet charges etc, between the place of procurement and the place of clearance of final product for sale. While clearing the goods for sale, the assessees recovered these expenses/charges from the purchaser but did not include them in the assessable value of the product. This resulted in undervaluation of the products and consequential short levy of duty of Rs 2.30 crore between March 1994 and November 1997.

On being pointed out between April 1997 and March 1998, the department admitted (between May 1997 and January 1998) the objection in six cases and raised demand of Rs 1.77 crore out of which demand of Rs 0.43 crore had been recovered.

The Ministry of Finance accepted the objection in one case (October 1998). Reply in the remaining cases had not been received (November 1998).

(b) An assessee, in Delhi III Commissionerate of Central Excise, engaged in the manufacture of 'Motor cars and other motor vehicles' collected freight charges from the customers in excess of the actual expenditure on freight. The excess collection being an additional consideration, was required to be included in the assessable value. Non inclusion in the assessable value of excess freight so collected, resulted in short levy of duty of Rs 1.65 crore during the period April 1994 to March 1995.

On being pointed out (August 1995), the department contended (April 1996) that the assessee had only gained a surplus amount on account of transportation charges. The reply of the department is not tenable as the surplus amount was an additional consideration flowing from the buyer to the assessee which was to be included in the assessable value in terms of rule 5 of the Central Excise Valuation Rules, 1975, which requires that the money value of any additional consideration, flowing directly or indirectly from the buyer, shall be included in the assessable value of goods, if price is not the sole consideration.

Reply of the Ministry of Finance had not been received (November 1998).

(v) Value of waste/scrap retained

An assessee, in Calcutta II Commissionerate of Central Excise, manufactured M.S. twisted rod (on fabrication contract basis) out of raw materials supplied free of cost by the customer. Waste and scrap generated during the process of manufacture of finished goods, was not returnable to the customer and was infact sold by the assessee in the market at Rs 7500 per tonne. However, while computing the assessable value of the finished goods, the sale value of such waste and scrap was not added. The benefit thus reaped by the assessee as a profit was in the nature of an additional consideration flowing indirectly from the customer and was accordingly liable to be included in the assessable value. As this was not done, there was a short levy of duty of Rs 56.97 lakh during April 1994 to July 1997.

On being pointed out (July 1995), the department contended (August 1996) that as per contract, the waste and scrap which arose during the manufacture of finished goods belonged to the processor company.

The department's contention is not acceptable since retention of waste and scrap valuing Rs 3.80 crore was an additional consideration which would have been taken into account while fixing the processing charges at a lower value.

Reply of the Ministry of Finance had not been received (November 1998).

5.3 Inadmissible deductions allowed from assessable value

(i) Duty element on inputs

The Supreme Court in the case of Kirloskar Brothers Limited {1992 (59) ELT 3 (SC)} held that while abatement of duty of excise is allowable for determining the assessable value of the goods being assessed, the excise duty paid on inputs/raw materials is not deductible from the assessable value. The Tribunal in the case of Incab Industries {1990 (45) ELT 342 (T)} has held that Modvat availed do not automatically reduce the assessable value under section 4 of the Central Excise Act, 1944.

(a) Three assessees, in Kanpur and Vadodara Commissionerates of Central Excise, manufactured pre-stressed/B.G. monoblock concrete sleeper and electrical conductor and supplied the product to Railways and various State Electricity Boards on contract price. These assessees cleared their product at the assessable value after deduction of Modvat credit availed. It was also noticed that the assessees were passing on the Modvat credit to the purchaser. The exclusion of Modvat credit from assessable value was incorrect and resulted in short levy of duty of Rs 5.07 crore between April 1992 and March 1996.

On being pointed out (April 1997), the department contended (between June 1996 and December 1997) that as the goods were cleared at a contract price, the judgement of Supreme Court was not applicable. The department however issued show cause cum demand notice for Rs 5.08 crore in two cases.

The departments contention is not acceptable in view of aforesaid decision of the Supreme Court and further section 4 does not permit abatement of duty paid on inputs.

Reply of the Ministry of Finance had not been received (November 1998).

(b) Five assessees, in Bangalore (1) and Chandigarh (4) Commissionerates of Central Excise, engaged in the manufacture of high density polyethylene woven sacks, viscose yarn and acrylic yarn, took Modvat credit of duty paid on inputs, which were used in the manufacture of intermediate excisable products. However, while determining the assessable value of intermediate excisable goods on cost basis, the assessees excluded the element of duty paid on the raw materials. The exclusion of the element of excise duty paid on the inputs in the cost data, led to undervaluation of the goods and consequential short levy of duty of Rs 1.16 crore during the period October 1994 to July 1995.

On being pointed out between September 1996 and April 1997, the Ministry of Finance confirmed (November 1998) the facts in one case. Reply in the remaining cases had not been received (November 1998).

(ii) Trade discount

As per section 4(4)(d)(ii), value in relation to any excisable goods does not include trade discount allowed in accordance with the normal practice of the wholesale trade.

An assessee, in Allahabad Commissionerate of Central Excise, engaged in the manufacture of polyester filament yarn had been claiming trade discount from the assessable value without actually passing it on to the buyers which was incorrect. As records relating to the details of the discount so claimed were not made available during audit (January 1996), short levy on this account could

not be quantified. While pointing out the omission, the department was asked (April 1996) to work out the short levy since August 1995 under intimation to Audit. Accordingly, show cause notices for Rs 3.07 crore for the period September 1995 to March 1996 were issued during April 1996 to August 1996 by the department, out of which demand of Rs 2.68 crore was subsequently (June and July 1997) confirmed.

The Ministry of Finance confirmed the facts in November 1998.

(iii) Dealers commission

As per decision of the Supreme Court in the case of Seshasayee Paper Mills {1990 (47) ELT 202 (SC)}, commission paid to selling agents is not deductible from the assessable value as a trade discount because such a commission is paid to an agent for the services rendered by him for procuring orders. In the case of Kirloskar Brothers {1992 (59) ELT 3 (SC)}, Supreme Court held that higher discounts given to some dealers in consideration of an obligation to undertake after sale services is not deductible while determining the assessable value.

Five assessees in Delhi I, Delhi II, Hyderabad II and Meerut I Commissionerates of Central Excise, engaged in the manufacture of various excisable goods, were selling their products through dealers/distributors, who were allowed commission/discount. Such commission/discount was deducted from assessable value of the products which was incorrect. This resulted in short levy of duty of Rs 2.29 crore during April 1992 to August 1997.

On being pointed out between August 1993 and August 1998, the department contended (May 1997) in one case that dealers margin was not includible as they were independent buyers and sales were at arm's length and the expenses incurred by them could not be said to have been incurred by the assessee. In the other case, it contended (October 1997) that the dealers were different class of buyers and the Supreme Court decision in the case of Kirloskar Brothers was not applicable.

The reply of the department is not tenable as the after sale services and advertisement charges had been paid as a part of dealer's commission as per sales agreement to promote the marketability of the article, and were thus includible in the assessable value.

Reply in the remaining three cases had not been received (November 1998).

5.4 Incorrect computation of assessable value

The Supreme Court in the case of Bombay Tyre International Limited had held that expenses incurred on account of several factors including after sale service which contribute to the enhanced value of the excisable goods are liable to be included in the assessable value.

(i) Value of tool kits not included

The Tribunal in the case of Bajaj Auto Limited {1996 (88) ELT 355 (T)} held that tool kits supplied alongwith the motor vehicles are input and Modvat credit is admissible. In view of this, the value of tool kits is includible in the assessable value of the final product, alongwith which it is cleared.

An assessee, in Delhi III Commissionerate of Central Excise, engaged in the manufacture of motor vehicles of heading 87.03 was clearing the tool kits and jack assemblies with every vehicle without including their cost in the assessable value, which was incorrect. This resulted in short levy of duty of Rs 4.31 crore during 1995-96 and 1996-97.

On being pointed out (January and December 1997), the department stated (March 1997), that value of tool kits and jack assemblies was not included as Modvat credit on these was not availed of by the assessee. The plea of the department is not acceptable as the cost of tool kits and jack assemblies was required to be added in the assessable value of the motor vehicles in view of the Supreme Court/Tribunals decision supra. Further, the material fact that Modvat credit on tool kits and jack assemblies was not availed by the assessee is not relevant for the purpose of determination of assessable value.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Value of raw materials/inputs

In the case of Burn Standard Company Limited {1992 (60) ELT 671}, it was held on 16 July 1991 by the Supreme Court that the value of free items supplied by Railways for the manufacture of wagons should be included in the assessable value of the wagons manufactured.

Nine assessees, in Delhi III, Guntur, Hyderabad I, II, III and Pune I Commissionerates of Central Excise, received certain raw materials/inputs free of cost from the buyers of the final products. The assessees cleared the final products to the suppliers of raw materials on payment of duty on contract prices excluding the value of input materials supplied free of cost. This resulted in undervaluation of excisable goods and consequent short levy of duty of Rs 3.49 crore between July 1992 and November 1997.

On being pointed out (between December 1994 and January 1998), the department intimated (between March 1996 and February 1998) recovery of Rs 64.78 lakh in three cases and issue of show cause notice in the fourth case.

In the two cases it contended that they were seized of the matter even before audit raised the issue in December 1994/November 1996 and in other two cases, demand was not raised because of Andhra Pradesh High Court decision of October 1984 in the case of Mysore Structurals Limited wherein it was held that the value of inserts supplied free of cost by railways was not to be included in the value of sleepers.

The reply of the department is not acceptable as out of the two cases in which the department contended that they were aware of the undervaluation, in one case, no show cause notice was issued and in the other case, the show cause notice was issued only in January 1995, after audit raised the point in December 1994. Further this case was adjudicated by the department in January 1997 holding that the decision of the Apex Court in Burn Standard case was binding on revenue. Action for demanding duty was also initiated by issuing show cause notices in two other cases on the basis of audit observations. This supports the audit's point of view that the cost of free supplied items was includible in the assessable value of the finished products.

Department's reply in the ninth case and Ministry's reply in all cases had not been received (November 1998).

(iii) Value of dies not included

Two assessees, in Mumbai VI and Pune I Commissionerates of Central Excise, manufactured parts of refrigerators and motor vehicles with the dies and tools supplied by the buyer free of cost. The cost of the dies and tools was not included in the assessable value of the final products. This resulted in short levy of duty of Rs 79.92 lakh during April 1994 to March 1997.

On being pointed out (October 1997 and May 1998), the department, in one case contended (October 1997) that the matter was already under investigation. Further progress had not been received (November 1998). Reply in the second case had not been received.

Reply of the Ministry of Finance had not been received (November 1998).

5.5 Incorrect valuation of goods manufactured at site

The Supreme Court in the case of Narne Tulaman Manufacturer (P) Limited {1988 (38) ELT 566} held that assembly of various duty paid components at site, bringing out a different product amounted to manufacture and the mere fact that the manufacturer bought out certain parts and manufactured certain parts and paid duty on manufactured parts would not change the position, because parts and products are separately dutiable.

(a) An assessee, in Ahmedabad II Commissionerate of Central Excise, entered into an agreement with Orissa Power Generation Corporation

Limited for supply of coal handling equipment. For the manufacture of complete machinery, the assessee manufactured some parts in the factory and the rest purchased/imported, which were supplied at site. The assessee did not include the value of purchased/imported parts in the assessable value of coal handling equipment. This resulted in short levy of duty amounting of Rs 3.34 crore during 1995-96.

On being pointed out (June 1996), the department stated (February 1998) that while the demand of Rs 6.81 crore (including penalty) from November 1992 to April 1994 had been confirmed in December 1997, show cause notice for duty of Rs 3.34 crore for the year 1995-96 was under consideration.

(b) An assessee, in Meerut Commissionerate of Central Excise, entered into contract with the customers for manufacture and supply of heavy electrical equipments like Turbo Generator Sets (chapter 85) at the customer's site. The parts and components required for the manufacture of the complete machinery were partly manufactured by the assessee in his factory and partly bought out from the market but value of the bought out items, testing and other service charges recovered from customers was also not included in the assessable value. This resulted in short levy of Rs 84.87 lakh during 1993-94 and 1994-95.

On being pointed out (August 1995), the department contended (August 1996) that in view of Tribunal's decision in case of Diamond Clock Manufacturing Company Limited {1988 (34) ELT 662 (T)}, value of bought out items were not includible in the assessable value. However, it was subsequently stated (February 1998) that protective demands were under issue.

Reply is not tenable in view of Supreme Court's decision mentioned above as the expenditure on bought out items, testing and other services were incurred prior to sale of the goods and those expenses enriched the value of goods and were essential for the marketability of the goods.

Reply of the Ministry of Finance had not been received (November 1998).

5.6 Incorrect adoption of assessable value of goods manufactured on behalf of others

An assessee, in Hyderabad Commissionerate of Central Excise, entered into an agreement with another manufacturer who was the owner of brand name 'Robin Blue'. In terms of agreement, brand name owner supplied the manufactured product Robin Blue in bulk, cartons, labels to the assessee and the assessee after repacking in small packs of marketable standard sizes of 100 gms, 200 gms handed them over to the sales depot of the brand name owner in Hyderabad. The factory gate of the assessee was treated as place of removal and duty was paid on the assessable value of the goods which was determined on the cost of production plus job charges. The goods were however sold at a much higher price from the sales depot. The variation in the sale price from depots of brand name owners and the value at the time of clearance ranged from Rs 31 to 93 per kilogram. Incorrect adoption of lower assessable value resulted in short levy of duty of Rs 3.73 crore during April 1995 to June 1997.

On being pointed out (July 1997), the department contended (March 1998) that the assessee was an independent job worker and hence the valuation of goods manufactured on job work basis were to be done under rule 6(b) of the Central Excise Valuation Rules, 1975, as per the Central Board of Excise and Customs circular of 14 October 1996.

The reply of the department is not tenable as in terms of section 4(1)(a), the principal manufacturer (viz. brand name owner) was the assessee in view of the fact that (i) he manufactured goods in bulk; (ii) retained the ownership of goods right from bulk packs till clearance in small packs; (iii) sold in the wholesale market through his depots and (iv) wholesale price for the goods was available. Further the valuation of goods on cost of production plus job charges under rule 6(b) was not correct as this rule was operative only if the normal price of the goods under section 4(1)(a) and rule 4 and 5 of Central Excise Valuation Rules, 1975 was not ascertainable. The value under section 4(1)(a) and rule 4 of Central Excise Valuation Rules, 1975 in this case was clearly available, being the sale price from depots.

While the reply of the Ministry of Finance had not been received (November 1998), audit recommends that this consumer product be brought under 'MRP based assessment' under section 4A of the Central Excise Act, 1944.

5.7 Incorrect computation of assessable value of goods captively consumed

Where excisable goods are wholly consumed within the factory of production or in any other factory of the same manufacturer, the assessable value is to be determined under section 4(1)(b) read with rule 6 (b) of the Central Excise Valuation Rules, 1975, on the basis of value of comparable goods or cost of

production if the value of comparable goods is not ascertainable. The Central Board of Excise and Customs also issued instructions in October 1975 that the data for determining the value on cost basis should be based on cost data relating to the period of manufacture and if such data is not available at the time of assessment, duty should be levied provisionally and finalised when data for the relevant period becomes available.

(a) An assessee, in Chennai Commissionerate of Central Excise, cleared 'Auto engine assembly' to their branch factories for captive consumption on payment of duty on the value adopted on cost construction method. The assessee was also clearing the same 'Auto engine assembly' to the dealers at a much higher price. Both the products were same except that the former was cleared without two elements namely 'Air filter' and 'Fan assembly'. Therefore, comparable price should have been adopted by reducing the value of two elements contained in the later product cleared to the dealer.

On being pointed out (August/November 1996), the Ministry of Finance admitted (March 1998) the objection and intimated that a demand of Rs 2.82 crore for the period February 1996 to August 1997 had been confirmed and a penalty of Rs 40 lakh also imposed.

(b) Three assessees, in Aurangabad and Calcutta I Commissionerates of Central Excise, engaged in manufacture of various excisable goods, were allowed to clear their final products to their sister units for captive consumption on payment of duty on the basis of cost of production.

Test check showed that while arriving at the assessable value, cost data for the relevant period was not adopted in one case, whereas in the second case profit margin and overhead expenses were not included in the assessable value and in the third case, profit margin was added to the assessable value at a lower rate. This resulted in short levy of duty of Rs 2.59 crore during the period April 1995 to October 1997.

On being pointed out between April 1997 and June 1998, the department recovered duty of Rs 1.21 crore in two cases but in one of these two cases it contended that the facts were already in their knowledge. Reply in the third case had not been received.

The department's reply is not tenable as no show cause notice was issued to safeguard the Government revenue till this was pointed out in audit.

Reply of the Ministry of Finance had not been received (November 1998).

5.8 Incorrect adoption of assessable value of goods sold to related person

As per section 4 of the Central Excise Act, 1944, where sales are routed through related person, the price at which such goods are sold by the related person, shall be the assessable value for the purpose of payment of duty.

An assessee, in Aurangabad Commissionerate of Central Excise, manufactured 'Air coolers' with the brand name of other company and sold the entire production to that company who undertook marketing and incurred all sale promotion expenses. Duty was, however, being paid on lower agreed price. The assessee and the brand name owner company were related persons in as much as one of the directors was common for both the companies. The sale, therefore, could not be treated as sale to a buyer in the course of wholesale trade where price was the sole consideration.

On being pointed out (August 1996), the department stated (February 1998) that show cause notice demanding duty of Rs 81.54 lakh for the period August 1993 to March 1997 had since been issued.

Reply of the Ministry of Finance had not been received (November 1998).

5.9 Other cases

In fifty other cases, the Ministry of Finance/department while accepting short levy of duty of Rs 3.06 crore reported recovery of Rs 1.93 crore in forty two cases till November 1998.

CHAPTER 6 : NON LEVY OF DUTY

Under rule 53 of the Central Excise Rules, 1944, every manufacturer is required to maintain daily stock account in a prescribed form (RG-1) indicating inter-alia, the description of goods, quantity manufactured and quantity removed from factory for various purposes. Rules 9 and 49 read with rule 173G ibid, further prescribe that excisable goods shall not be removed from the place of manufacture or storage unless the excise duty leviable thereon has been paid. If any manufacturer, producer or licencee of a warehouse, removes excisable goods in contravention of these rules or does not account for them, besides such goods becoming liable to confiscation, a penalty not exceeding three times the value of goods or five thousand rupees, whichever is greater, is also leviable under rule 173Q.

Some illustrative cases of non/short accountal of goods or removal of goods without payment of duty are given in the following paragraphs:

6.1 Duty not levied on goods captively consumed

Captive consumption of most of the items is exempt from duty provided the final product is not exempt or chargeable to 'nil' rate of duty.

(i) Steam

Ten assessees and a thermal power station in Bangalore II, Belgaum, Bhubaneswar II, Chandigarh I and II, Cochin I, Delhi IV and Tiruchirapalli Commissionerates of Central Excise, manufactured steam and consumed it captively without payment of duty for the manufacture of fertilisers and electricity during 1 March 1997 to 2 May 1997. As fertilisers and electricity were not chargeable to duty, steam produced and consumed was liable to duty. In addition, one of the assessees had also cleared steam without payment of duty during March 1997 to March 1998 which was incorrect. Duty payable on such captive consumption/clearance of steam worked out to Rs 54.93 crore. This was not demanded by the department.

On being pointed out in May and July 1998, the department contended (July 1998) in case of two assessees, that exemption was available under notification dated 16 March 1995. In the case of thermal power station, it stated (July 1998) that the demand could not be raised as it was not an excise licensee. Reply in the remaining eight cases had not been received (August 1998).

The reply of the department is not tenable as notification dated 16 March 1995 was not applicable to goods used in the manufacture of exempted or non dutiable finished goods.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Tobacco essence

Three assessees, in Chandigarh Commissionerate of Central Excise, engaged in the manufacture of Zarda and Chewing tobacco (sub-heading 2404.41 and 2404.49) also manufactured various types of tobacco essences for captive use in the manufacture of the aforesaid items. No duty was paid on tobacco essences, notwithstanding the fact that no notification providing exemption from duty was available. This resulted in avoidance of duty of Rs 4.08 crore during 1995-96.

This was pointed out in October 1996; reply of the Ministry of Finance/department had not been received (November 1998).

(iii) Jute yarn

Two assessees, in Visakhapatnam Commissionerate of Central Excise, manufactured jute yarn and consumed the same in the factory (during the period November 1994 to March 1996 in case of one assessee and March 1995 to March 1996 in the case of the second assessee) for manufacture of 'Straight reel hanks' without payment of duty, despite the fact that this final product was exempt from duty. Duty was also not demanded by the department.

On the omission being pointed out (February 1997), the department stated (October 1997), that two show cause notices for an amount of Rs 39.50 lakh were issued in April 1997. Further developments had not been intimated (January 1998).

Reply of the Ministry of Finance had not been received (November 1998).

6.2 Non levy of duty on goods not exported

Under rule 13 and notifications issued thereunder, goods can be cleared for export without payment of duty but under bond. The rules and notifications further require that the goods in question should be exported within six months from the date of clearance from the factory or warehouse and proof of export furnished. Rule 14 A provides for issue of a demand by the proper officer for duty leviable on the goods, if proof of export is not produced by the manufacturer within the prescribed period of six months. However, Commissioner of Central Excise may extend period of six months in a particular case.

Ten assessees, in Hyderabad I, III and Visakhapatnam Commissionerates of Central Excise, cleared goods for export without payment of duty between August 1990 and March 1997 but did not furnish the proof of export. The

department also failed to demand duty on these goods which worked out to Rs 26.25 crore.

On being pointed out between January 1992 and December 1997, the department in one case reported (October 1997) issue of show cause notice of Rs 4.55 lakh but in another case, it contended (December 1997) that the exports were made through a merchant exporter in Bombay and that the Maritime Commissioner of Central Excise had been addressed in January 1996, for furnishing proof of exports. Subsequent verification showed that the clearances in respect of which proof was not received from Maritime Commissionerate of Central Excise involved duty of Rs 79.67 lakh only for the period from August 1990 to February 1994.

Reply in the remaining eight cases had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

6.3 Evasion of duty by suppression of production

(a) In para 6.4 (ii) of Audit Report for the year ended 31 March 1997, a case of evasion of duty of Rs 28.73 lakh, by a public sector plant, in Bhubaneswar II Commissionerate of Central Excise, by short accounting of 2817 tonne of iron and steel slabs during the year 1995-96, had been featured.

Subsequent verification of annual statistical reports and daily stock account for the year 1996-97 of the same assessee revealed that 13,590 tonne of slabs and 19,156 tonne of cold rolled coils were neither accounted for in stock account (RG 1) nor physically available in the stock. This resulted in evasion of duty amounting to Rs 6.52 crore.

On being pointed out (October 1997), department stated that (October 1997) the action would be taken after reconciling the differences. Further progress had not been received (November 1998).

Reply of the Ministry of Finance to the earlier para as well as to this para had not been received (November 1998).

(b) Scrutiny of the annual operation report of an assessee, in Calcutta II Commissionerate of Central Excise, disclosed that a quantity of 1997 tonne of 'Transformer oil feed stock (TOFS)' and 271 tonne of 'CLY oil' was found short during the period from 1995-96 to 1996-97. The department did not conduct any physical verification to ascertain the short accountal of such excisable goods or raise any demand. This resulted in evasion of duty of Rs 29.92 lakh during the period 1995-96 and 1996-97.

On being pointed out (November 1997), the department stated (February 1998) that a show cause cum demand notice was being issued. Further progress had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

6.4 Duty not levied on shortfall in export quota of sugar

As per section 7 of the Sugar Export Promotion Act, 1958, where sugar delivered by any owner falls short of the export quota fixed for it by any quantity, then there shall be levied and collected on so much of the sugar despatched from the factory for consumption in India as is equal to the said quantity (i.e., quantity to the extent of shortfall in the export quota) a duty of excise at the rate of forty five rupees and fifty five paise per quintal.

Three assessees, in Aurangabad and seven assessees in Pune II Commissionerates of Central Excise, engaged in the manufacture of sugar did not fulfil the export quota of sugar fixed for them, between the years 1993-94 and 1996-97. However, duty of Rs 2.29 crore leviable on shortfall in export quota was neither paid by the assessees nor demanded by the department.

On being pointed out between September 1996 and March 1998, the department stated (August 1997 and June 1998) that show cause notices were being issued in the case of five assessees and in other four cases, the matter was under correspondence with the Ministry of Finance. Reply in one case had not been received (June 1998).

Reply of the Ministry of Finance had not been received (November 1998).

6.5 Duty not levied on goods cleared

(i) An assessee, in Mumbai III Commissionerate of Central Excise, engaged in the manufacture of chemical products had cleared 'Waste filter cake' without payment of duty and observing the procedure prescribed under the Central Excise Rules, 1944 for production and removal of excisable goods, treating the product as a non-excisable commodity. The assessee at the instance of department submitted under protest, classification list in January 1993, classifying the product, under heading 38.23 which was approved by the department in July 1993. The department also got the product tested by the Chemical Examiner in January 1995 which disclosed that the goods in question were correctly classifiable under heading 38.23 only. The department had also directed the assessee on 13 March 1995 to follow the procedure and clear the product on payment of duty. The assessee

however did not follow the prescribed procedure nor did he pay the duty due. Despite being aware of the incorrect practice the department did not issue any show cause notice which resulted in non levy of duty of Rs 1.16 crore during April 1992 to December 1996 and provided financial assistance of Rs 83.75 lakh to the assessee by way of interest not realised upto March 1998.

On being pointed out (February 1997), the department contended (September 1997) that the matter was in their knowledge and show cause notice would be issued after completion of investigation.

Reply of the department is not acceptable as the classification of the product was already decided in February 1993 and the product was also tested in March 1995.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Under a notification dated 28 February 1993, rates of duty on yarns falling under heading 55.05 and 55.06 were fixed ranging from 70 paise to Rs 14 per kilogram depending upon the counts and contents in the yarn and nil rate on double or multifold yarn of the same heading if the same were produced out of duty paid yarn.

Supreme Court in the case of Banswara Syntex Limited {1997 (13) CXLT (SC) CE-381} held that liability to pay duty arises at the time of manufacture of single yarn itself. It was immaterial whether the said yarn was captively consumed or subjected to any other process in view of rules 9 and 49 of the Central Excise Rules, 1944.

Five assessees, in Chandigarh I Commissionerate of Central Excise, manufactured 'Single cellulosic spun yarn (heading 55.05 and 55.06)' and consumed the same without payment of duty in the manufacture of double or multifold yarn. Duty was paid only on the quantity of multiple yarn cleared from the factory. Non payment of duty at single yarn stage, resulted in avoidance of duty of Rs 53.15 lakh on 284 tonne of single yarn wasted in the process of doubling or multiplying, which was subsequently cleared as waste at nil rate of duty, during April 1993 to February 1995.

On being pointed out (October 1996 and April 1997), the department contended (June 1997) that as yarn was cleared in the double or multiple form, no duty was leviable on the single yarn. It was further added that even otherwise, the single yarn captively used in the manufacture of double/multiple yarn was exempt under a notification dated 16 March 1995.

The contention of the department is not tenable as (i) it was contrary to the Supreme Court judgement cited above, (ii) in the case of General

Industrial Society Limited {1983 ELT 2497}, the Tribunal had also held that the process of doubling or twisting of yarn was a process of manufacture, (iii) notification dated 16 March 1995 is not relevant as the period of objection was prior to its issue and no notification exempting duty on single yarn existed during relevant period. Further, the notification dated 16 March 1995 is not applicable when waste was cleared at 'nil' rate of duty.

6.6 Duty not levied on shortages

(i) An assessee, in Bhubaneswar I Commissionerate of Central Excise, engaged in the manufacture of calcined-alumina, as one of its products, was removing it under bond for export. The physical verification of storage facility of the assessee at the port of shipping showed a shortage of 6859 tonne as on 31 March 1997 which was also reflected in the annual accounts for the year 1996-97. Duty of Rs 1.14 crore leviable thereon was not demanded by the department.

This was pointed out in April 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(ii) Scrutiny of the annual stock taking report as on 31 March 1996 of a public sector undertaking, in Bhubaneswar II Commissionerate of Central Excise, manufacturing steel and chemicals products falling under chapters 27, 28, 29 and 31 revealed that there were shortages of different finished products to the extent of 3,082 tonne and 375 kilolitres. Those shortages were deducted from the balances in RG 1 (on 16 July 1996) without assigning any reasons and without payment of duty. Duty was also not demanded by the department.

On being pointed out (February 1997), the department intimated (May 1998) that the demand of Rs 41.55 lakh had been confirmed. Report on recovery had not been received (November 1998).

6.7 Duty not levied on goods manufactured at site

The Supreme Court in the case of Narne Tulaman Manufacturers (P) Limited {1988 (38) ELT 566} held that assembly of various components/parts at site, bringing out a different product amounts to manufacture.

An assessee, in Hyderabad III Commissionerate of Central Excise, assembled at site 'Control systems' against contracts which included design engineering, manufacture and supply of hardware, software, assembling, erections, testing and commissioning of the entire system. However, duty was paid only on the value of goods manufactured and cleared from the factory and not on the value

of the entire system, though such systems were deemed to be manufactured in terms of the Supreme Court judgment cited above and was dutiable under heading 84.71. The total contracted value of the three systems was Rs 7.13 crore on which duty payable at the rate of 15 *per cent* ad valorem worked out to Rs 1.07 crore.

This was pointed out in April 1997; reply of the Ministry of Finance/department had not been received (November 1998).

6.8 Additional duty not levied on textiles and textile articles

As per section 3 of the Additional Duties of Excise (Textiles and Textile Articles) Act, 1978, additional excise duty is leviable at 15 *per cent* of the amount of basic excise duty chargeable. For the purpose of determining additional excise duty, the basic excise duty chargeable is to be calculated after excluding any exemption for giving credit or for reduction of duty already paid on raw material used in the production or manufacture of such goods.

An assessee, in Surat I Commissionerate of Central Excise, manufactured blended tops, woollen tops, woollen yarn and consumed the same captively without payment of basic excise duty, availing exemption under notifications dated 11 August 1994 and 16 March 1995 as amended. He also did not pay additional duty which was leviable by working out correctly the quantum of basic excise duty chargeable after excluding the benefit availed through the above exemption notifications. This resulted in non levy of additional duty of Rs 68.08 lakh between April 1995 and November 1996.

On being pointed out (September 1997), the department contended that the additional excise duty was leviable at the rate of 15 *per cent* of basic excise duty and since the basic excise duty was exempt, the exemption from payment of additional excise duty appeared to be correct.

Reply is not tenable since basic excise duty leviable was to be worked out notionally after excluding exemption claimed under said notification as they fall under excluded category in terms of section 3 of the Central Excise Act, 1944, ibid.

Reply of the Ministry of Finance had not been received (November 1998).

6.9 Non levy of interest

(i) Interest under Excise Act

The Central Board of Excise and Customs in its circular dated 1 October 1985 clarified that interest would be charged at 12 *per cent* per annum till 20 April 1985 and thereafter at 17.5 *per cent* in all cases of deferment of duty. As per section 11 AA of the Central Excise Act, 1944, as introduced from 29 May 1995 if duty determined is not paid by the assessee within three months from the date of such determination, he shall, in addition to duty, pay interest at the rate of 20 *per cent* per annum on such duty from the date immediately after the expiry of said period of three months till the date of payment of duty.

(a) An assessee, in Mumbai III Commissionerate of Central Excise, had not revised the prices of the product 'Cocoa butter (non deodorised)' and 'Cocoa butter (deodorised)' cleared for captive consumption to its other manufacturing units during November 1989 to March 1995. The department asked the assessee (April 1995) to revise the price and pay the differential duty. The assessee paid the differential amount of Rs 89.57 lakh and Rs 39.84 lakh in the month of July and August 1996 respectively for the period relating to November 1989 to March 1995. However, no interest on the duty short levied all these years was demanded. This resulted in financial accommodation by way of interest of Rs 52.65 lakh upto May 1995 and thereafter, non recovery of interest of Rs 25.83 lakh under section 11 AA till payment of duty in July/August 1996.

On being pointed out (April 1997), the department stated (April 1998) that a show cause notice for recovery of interest of Rs 25.83 lakh had been issued in July 1997 and contended that there was no financial accommodation as the goods were cleared to their own units who would have taken the credit of the duty paid.

Reply of the department is not tenable as the assessable value of the finished product would have increased had the value of inputs been adopted correctly and the duty paid thereon. Reply is also not relevant in view of existing provisions of the Central Excise Act/Rules.

Reply of the Ministry of Finance had not been received (November 1998).

(b) Commissioner of Central Excise, Chennai III, in his order-in-original dated 9 September 1993, determined and demanded duty of Rs 1.54 crore against a manufacturer of 'Furfural'. Aggrieved with the order, the assessee appealed before the Tribunal and on direction by them, deposited duty of Rs 40 lakh. Later on, Tribunal upheld (May 1996) the order of the Commissioner of Central Excise dated 9 September 1993. The assessee paid the balance duty of Rs 1.14 crore on 23 July

1996. However, department did not raise any demand for interest of Rs 20.88 lakh which was recoverable for delayed payment of duty.

On being pointed out (April 1997), the department replied (September 1997) that the assessee was served with a show cause notice in May 1997. Further progress had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(c) A manufacturer of 'Aluminium ingots', in Bhubaneswar II Commissionerate of Central Excise, was served with show cause cum demand notices, disallowing Modvat credit of Rs 1.17 crore taken during June 1994 to July 1995. The demands were also confirmed by the Assistant Commissioner of Central Excise on 8 August 1995 and 2 February 1996. The assessee reversed the credits in September 1996. As the assessee failed to reverse the credit within three months from the date of confirmation of demand, he was liable to pay interest of Rs 18.16 lakh in terms of sub-rule (3) of rule 57 I read with section 11 AA of the Central Excise Act, 1944.

On being pointed out (February 1997), the department issued show cause cum demand notice for recovery of interest in February 1997. Further progress had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Interest under value based advance licensing scheme

The Central Board of Excise and Customs vide Circular dated 10 January 1997 clarified that in cases where Modvat credit on input/raw materials was availed by the exporters in contravention of the conditions of the Value Based Advance License scheme, the assessees had to reverse the amount of credit so availed and pay interest at 20 *per cent* on the amount of Modvat credit retained by such exporters for the period between the date of exports and the date of reversal and deposit the amount before 31 January 1997.

An assessee, in Ahmedabad Commissionerate of Central Excise, had reversed the amount of Rs 69.18 lakh on the Modvat credit taken under Value Based Advance License scheme. However, out of total interest payable amounting to Rs 31.52 lakh the assessee paid only Rs 2.32 lakh till 15 March 1997 and the balance amount of Rs 29.20 lakh had not been paid. Non payment of interest by 31 January 1997, resulted in non recovery of total interest of Rs 32.20 lakh (Rs 29.20 plus Rs 3 lakh for the period February 1997 to July 1997).

On being pointed out (November 1997), the department accepted (February 1998) the facts and further contended that the matter was already on the records of the department and the show cause notice was required to be issued

by customs authorities. Department added that the assessee had paid an amount of Rs 9.96 lakh upto December 1997.

The contention of the department is not acceptable as even though the matter was within the knowledge of the department, the department had not taken any action for recovery nor had they intimated the customs authorities for issue of show cause notice.

Reply of the Ministry of Finance had not been received (November 1998).

6.10 Other cases

In eighty other cases of non levy of duty, the Ministry of Finance/department while accepting the objections involving duty of Rs 1.41 crore, reported recovery of Rs 28 lakh in sixty four cases till November 1998.

CHAPTER 7 : CLASSIFICATION OF EXCISABLE GOODS

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

7.1 Bodies, parts and accessories of motor vehicles

(i) Motor vehicle bodies

Heading 87.07 of the Central Excise Tariff specifically covers 'bodies' for the motor vehicles. The Punjab and Haryana High Court in the case of Darshan Singh Pavitar Singh {1988 (34) ELT 631} held that 'Motor vehicle bodies' built by independent body builders on the duty paid chassis supplied by customers are to be classified under heading 87.07, even though the goods emerging from body builder's premises is a complete motor vehicle falling under heading 87.01 to 87.05. The High Court of Madhya Pradesh in the case of Rajasthan Coach Builders concurred with this decision {1992 (58) ELT 471}. The Supreme Court has also agreed with the above judgement of the High Court {1997 (94) ELT 442}.

A case of incorrect classification of motor vehicle bodies under heading 87.02 or 87.04 as motor vehicles instead of under heading 87.07 as motor vehicle bodies leading to short levy of duty of Rs 89.06 lakh during April 1991 to December 1996 had been highlighted in para 10.5 of Audit Report for the year ended 31 March 1997. The reply of the Ministry of Finance had not been received. Further test check of the assessment records of fifty eight assessees, in nineteen commissionerates, disclosed that the classification of 'Motor vehicle bodies' under heading 87.02 to 87.05 instead of correctly under heading 87.07 was allowed by the department. This resulted in avoidance of duty of Rs 78.70 crore between April 1989 and June 1998 on the value of the bodies built on duty paid motor vehicle chassis.

On being pointed out between March 1990 and August 1998, the department in eight cases stated (January 1995) that the products emerged into a complete motor vehicle and hence classification under heading 87.02 or 87.04 was correct. Reply in the remaining cases had not been received.

The reply of the department is not tenable in view of various courts judgement and Supreme Courts decision quoted supra.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Dash board

Where a machine (including a combination of machines) consists of individual components (whether separate or interconnected by piping, by transmission devices, by electric cables or by other devices) intended to contribute together to a clearly defined function covered by one of the headings in chapter 84 or chapter 85, then the whole falls to be classified in the heading appropriate to that function. Dash boards for motor vehicles are specifically covered under heading 87.08 as motor vehicle parts as per explanatory note (B) under heading 87.08 in the HSN[5].

An assessee, in Delhi III Commissionerate of Central Excise, manufactured (i) clusters for car, van and gypsy which comprised of speedometer, thermometer, oil gauge, ammeter, wire harness and warning light and (ii) speedometers panel for motor cycles which were made with the combination of speed showing instrument, warning light, side indicator and neutral indicator. He classified these products under heading 90.31 and 90.29 respectively, treating these as measuring or checking instruments. As the instruments were not cleared individually but were cleared in combination with various instruments in a panel, these were dash boards/speedometer panels to be used in motor vehicles and motor cycles respectively. Therefore, these were correctly classifiable under heading 87.08 and 87.14 as parts of motor vehicles and motor cycles respectively. Incorrect classification of goods resulted in short levy of duty of Rs 4.30 crore from April 1989 to October 1997.

On being pointed out (October 1997), the department stated that the demand of Rs 15.65 lakh for the period from April 1997 to October 1997 had been confirmed and the duty for earlier period could not be demanded as it was time barred.

Reply of the Ministry of Finance had not been received (November 1998).

(iii) Transmission/crank shafts

The Central Board of Excise and Customs in its circular dated 9 July 1990 clarified that transmission elements like gears, gear boxes etc. are not classifiable under heading 84.83 when they have been specifically designed for use with motor vehicles but would be covered as parts of motor vehicles under heading 87.08.

An assessee, in Pune I Commissionerate of Central Excise, manufactured 'Transmission shafts including cam-shafts and crankshafts' and cleared them after classifying them under sub-heading 8483.90. Records of the assessee revealed that these goods were specifically designed for use solely or principally with the motor vehicles and were cleared to 'transport vehicle manufacturing companies' against their specific requirement with customers name. Thus, these were correctly classifiable as parts of motor vehicles under

[5] Harmonized Commodity Description and Coding System Explanatory Notes.

heading 87.08. The incorrect classification resulted in short levy of duty to the extent of Rs 1.03 crore during March to July 1997.

On being pointed out (September 1997), the department contended (January 1998) that the specific entry in the Central Excise Tariff would prevail over the general entry for classification of the product.

The reply is not tenable as it is not in consonance with the Central Board of Excise and Custom's clarification of 9 July 1990. Further, these goods have specifically been included under heading 87.08 as parts of motor vehicles in the HSN.

Reply of the Ministry of Finance had not been received (November 1998).

7.2 Products of chemical, beverages or allied industries

(i) Hair oil

Hair oil is liable to duty under sub-heading 3305.90/3305.99. The Central Board of Excise and Customs through its circular dated 31 August 1995 clarified that coconut oil meant for application on hair is classifiable as hair oil under chapter 33 of the Central Excise Tariff.

An assessee, in Meerut Commissionerate of Central Excise, engaged in the manufacture of Dabur brand 'Anmol coconut oil' cleared the oil in the pouch of 6 ml and in containers of 100/200 ml without payment of duty treating the product as non-excisable edible oil.

The manufacturing process of 'Anmol coconut oil' declared by the assessee and his records revealed that the product cleared in 6 ml pouches and 100/200 ml containers was containing Tertiary Butyl Hydro Quinol (TBHQ) and was meant for application on hair as hair oil. Therefore, the product was not an edible oil but was hair oil to be classifiable under chapter 33 in terms of the Central Board of Excise and Customs circular dated 31 August 1995. Incorrect classification of the product resulted in short levy of duty of Rs 5.38 crore during April 1992 to March 1998.

On being pointed out (July 1998), the department contended (July 1998) that the chemical test report disclosed that the product was coconut oil.

The reply of the department is not tenable because the manufacturing process declared by the assessee himself disclosed the mixing of TBHQ to the coconut oil.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Technical grade insecticides/pesticides

Heading 38.08 of the Central Excise Tariff covers insecticides, rodenticides, fungicides and similar products put up in forms or packings for retail sale only. However, separate chemically defined elements have been excluded from chapter 38 vide notes 1(a) and (2) of chapter 38 and are classifiable under chapter 28 or chapter 29. Further, the Central Board of Excise and Customs clarified in October 1997, that technical grades of insecticides, pesticides and other similar products contain active ingredient in a highly concentrated and toxic form are separate chemically defined compounds and are therefore, correctly classifiable under chapter 28 or 29, as per their composition.

Three assessees, in Coimbatore and Jaipur I Commissionerates of Central Excise, engaged in the manufacture of technical grade insecticides/pesticide cleared them on payment of lower duty under sub-heading 3808.10. Since the manufactured goods were technical grade insecticide/pesticide, they were classifiable either under chapter 28 or under chapter 29 according to their chemical nature. Incorrect classification of the goods had resulted in short collection of duty of Rs 1.36 crore between 23 July 1996 and 31 March 1998.

The mistakes were pointed out in June 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(iii) Livfit, ayucal dimbpro etc.

Medicaments including veterinary medicaments are dutiable under heading 30.03. Supreme Court in the case of Shree Baidyanath Ayurved Bhawan Limited {1996 (83) ELT 492 (SC)} held that 'medicine' is ordinarily prescribed by the medical practitioner and it is used for a limited time and not every day unless it is so prescribed to deal with a specific disease.

An assessee, in Jaipur Commissionerate of Central Excise, engaged in the manufacture of Ayurvedic and Allopathic medicaments was also manufacturing products like Livfit, Ayucal Dimbpro and Caldhan, which were classified as animal food supplements under heading 23.02. Audit scrutiny revealed that all the four products claimed to be animal food supplements were administered as per doses prescribed for a limited period by the Veterinarians for specific treatments. These products were, therefore, correctly classifiable under sub-heading 3003.39 as 'Ayurvedic medicaments'. The incorrect classification of the goods, resulted in short levy of duty of Rs 71.12 lakh during December 1994 to March 1998.

The omission was pointed out in May 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(iv) Essence for aerated water

Preparation for lemonades or other beverages intended for use in the manufacture of aerated water are classifiable under sub-heading 2108.10. According to explanatory note 12 at page 161 of HSN, 'preparations' intended to be consumed as beverages are classifiable under sub-heading 2108.10 (previously 2107.99) which is also in conformity with the Central Board of Excise and Customs clarification dated 20 December 1993.

Two assessees, in Bangalore I Commissionerate of Central Excise, manufactured essences and emulsions and classified them under sub-heading 3302.10 as mixture of odoriferous substances to be used in the beverage industry. The essences were cleared in two portions i.e., liquid portion and powder portion. These two portions were to be mixed together after dilution with water for making aerated water. The emulsions manufactured was directly used in the manufacture of aerated water. The products were, therefore, rightly classifiable under heading 2108.10. Incorrect classification of the product resulted in short levy of duty of Rs 40.15 lakh during March 1994 to March 1998.

On being pointed out (July 1995), the department in the case of one assessee stated (March 1997) that essence was only a flavouring agent and the chemical examiner's report disclosed that the main ingredient was odoriferous matter. However, show cause notices demanding duty of Rs 25.93 lakh have been issued between July 1995 and July 1997.

The reply of the department is not tenable as the essences cleared were used by the customers as beverage after simple dilution with water. Reply of the department has not been received in the case of the other assessee involving duty of Rs 30.41 lakh.

Reply of the Ministry of Finance had not been received (November 1998).

7.3 Base metals and articles of base metal

(i) Zinc waste

Waste and scrap of zinc metal are classifiable under heading 79.02.

A manufacturer, in Indore Commissionerate of Central Excise, obtained zinc waste in the process of galvanisation of zinc ingots and cleared them without payment of duty classifying under heading 26.20 as 'Slag and ash'. As the waste was obtained in processing of zinc ingots and the contents of zinc were between 74.5 to 90 *per cent* (as per chemical examiners report), such waste was rightly classifiable under heading 79.02 as zinc waste. Incorrect classification of the goods resulted in short levy of duty of Rs 1.54 crore during April 1989 to March 1997.

On being pointed out (March 1993 and January 1998), the department contended (March 1994) that the waste had not resulted from the mechanical working of metal and hence it was correctly classifiable as slag and ash.

The contention of the department is not tenable as (i) the waste was obtained from galvanisation process of zinc ingots and not from processing of zinc ore and (ii) the Tribunal in the case of Khalidas Sheet Metal Industry (P) Limited {1997 (94) ELT 165)} has decided that the zinc dross obtained in the process of electroplating would not be classifiable as slag and ash under heading 26.20 but would fall under chapter 79.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Lock assembly

Padlocks and locks (key, combination or electrically operated) of base metal; clasps and frames with clasps, incorporating locks, of base metal; keys for any of the foregoing articles, of base metal are classifiable under heading 83.01 of the Central Excise Tariff.

An assessee, in Delhi-II Commissionerate of Central Excise, manufactured lock assembly and classified the same under heading 87.08 as parts of motor vehicles. As the product was specifically included under heading 83.01, its classification as parts of motor vehicles was incorrect. Incorrect classification of the product resulted in short payment of duty of Rs 44.08 lakh during 1995-96.

On the omission being pointed out (August 1996), the department issued show cause notices for the period March 1996 to December 1996. Action taken for recovery of duty for the period prior to March 1996 had not been intimated. Subsequent verification revealed that the assessee had filed revised classification list of lock assembly under correct heading 83.01 from January 1997.

Reply of the Ministry of Finance had not been received (November 1998).

7.4 Other cases

In seventy one other cases of incorrect classification, the Ministry of Finance/department had accepted the objection involving duty of Rs 2.01 crore and reported recovery of Rs 0.50 crore in sixty one cases till November 1998.

CHAPTER 8 : GRANT OF EXEMPTIONS

As per section 5A(1) of the Central Excise Act, 1944, Government is empowered to exempt excisable goods from the whole or any part of the duty leviable thereon either absolutely or subject to such conditions as may be specified in the notification granting the exemption.

Some of the illustrative cases of incorrect grant of exemption noticed in test check are given in the following paragraphs:

8.1 Incorrect grant of exemption of additional duty of excise

(i) Processed fabrics

As per notification dated 11 August 1994 as amended, 'input fabrics' were exempt from whole of the duty of excise and additional duty of excise provided final products were not exempt from payment of whole of the duty or were leviable to 'nil' rate of duty.

Three assessees, in Ahmedabad II, Surat I and Surat II Commissionerates of Central Excise, produced 'input fabrics' and consumed them captively for further manufacture of 'processed fabrics' without payment of additional excise duty leviable under the Additional Duties of Excise (Goods of Special Importance) Act, 1957. As final products (viz., processed fabrics) were exempt from basic excise duty, the above notification granting the exemption was not applicable and therefore, they were liable to pay additional excise duty on 'input fabrics'. Incorrect availment of exemption resulted in non-levy of additional excise duty of Rs 20.36 crore during April 1994 to September 1996.

On being pointed out (March, October and December 1997), the department contended (July/December 1997 and February 1998) that the notification dated 11 August 1994 was issued exercising powers under both the Acts, therefore, the expression 'duty of excise' appearing in the notification would be duty leviable under both the Acts.

Reply of the department is not relevant as final product (viz., processed fabrics) being exempt from duty, the exemption notification was not applicable.

Incorrect grant of exemption, with duty effect of Rs 28.93 crore in 12 similar cases had also been pointed out through para 6.3 of Audit Report 1995-96 and in para 7.1 of Audit Report 1996-97. Reply of the Ministry of Finance had not been received (November 1998) in any of these cases.

(ii) Rubberised tyre cord fabrics

As per notification dated 16 March 1995, specified excisable goods, manufactured in a factory and used as inputs in a factory in or in relation to the manufacture of final products, were exempt from payment of whole of duty of excise leviable thereon.

The Supreme Court in the case of Modi Rubber Limited {1986 (25) ELT 849} held that an exemption notification issued under rule 8(1) of the Central Excise Rules, 1944, (now section 5A of the Central Excise Act, 1944), does not mean an exemption from special excise duty and additional excise duty unless such exemption notification also refers to the statutory provisions relating to special excise duty and additional duty.

An assessee, in Madurai Commissionerate of Central Excise, manufactured 'Rubberised tyre cord fabrics' falling under sub-heading 5902.10 and consumed it captively in the manufacture of 'tyres, tubes etc.' without payment of duty of excise and the additional duty of excise, claiming exemption under the notification, ibid. As additional duty of excise leviable under Additional Duties of Excise (Goods of Special Importance) Act, 1957, was not exempt, this resulted in short levy of additional duty of excise of Rs 1.63 crore during September 1996 to November 1997.

On being pointed out (May 1997 and February 1998), the department replied (March 1998) that though three show cause cum demand notices were issued to protect the revenue, the additional duty of excise was not leviable as the goods were captively consumed and no sale was involved.

The reply of the department is not tenable in the absence of any notification providing exemption from additional duty on captive consumption.

Reply of the Ministry of Finance had not been received (November 1998).

8.2 Incorrect grant of exemption on inputs used captively

As per notification dated 2 April 1986 and dated 16 March 1995, specified inputs manufactured in a factory and used within the factory of production in or in relation to the manufacture of specified final products were exempt from duty provided that the final product was not exempt from whole of duty or chargeable to nil rate of duty.

(i) Inputs not used in the manufacture of specified final products

(a) An oil refinery, in Cochin I Commissionerate of Central Excise, cleared raw naphtha for flushing of pipeline without payment of duty claiming exemption under the notification, ibid. As clearance of goods for flushing pipelines did not amount to clearance for captive

consumption in or in relation to the manufacture of specified final products, availment of exemption of Rs 10.43 crore during April 1994 to March 1998 was not in order.

On being pointed out (May 1995), the department contended (November 1995 and April 1998) that the process beginning from receipt of raw material to the final clearance of finished products, through a pipeline, was a continuous one and should be treated as process in or in relation to the manufacture of final products.

The department's contention is not acceptable as flushing of pipe line is only a cleaning process after which the flushed oil is received back in the crude tank for further processing in the production of final products. Therefore, at the point of clearance for flushing, it is not for production in or in relation to the manufacture of the final product. Reply of the department is also contradictory to the Ministry of Finance's instructions of September 1987 which clarified that chemicals used to flush and clear the system before introduction of different batch of manufacture, do not form part of the manufacturing process.

Subsequent verification showed that the department issued sixteen show cause notices demanding duty of Rs 10.07 crore, out of which demands in respect of seven show cause notices covering duty of Rs 36.22 lakh had also been confirmed.

Reply of the Ministry of Finance had not been received (November 1998).

(b) A public sector undertaking, in Visakhapatnam Commissionerate of Central Excise, manufactured iron and steel products like blooms, billets, wire rods, barmill products etc. and used them for construction and/for use in the auxiliary shops and other internal sections of the factory for purposes other than manufacture of dutiable final products. The assessee claimed exemption under the notification, ibid and was also incorrectly granted the same by the department.

On being pointed out (August 1996), the department reported (April 1998) issue of show cause notice for Rs 2.45 crore for the period April 1994 to August 1997.

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Inputs not used within the factory of production

An assessee, in Guntur Commissionerate of Central Excise, engaged in the manufacture of 'Clinker and cement' cleared 440189 tonne of clinker involving central excise duty of Rs 8.80 crore to his sister factory between

April 1995 and March 1997 without payment of duty, which was incorrect, since the exemption was not available in respect of clearances made from one factory to another factory.

On the omission being pointed out (September 1997), the Jurisdictional Assistant Commissioner of Central Excise contended (February 1998) that the presence of both units in the same premises with separate registrations may be treated as procedural lapse and the benefit of notification dated 16 March 1995 could be extended in view of the fact that only one set of invoices were being issued from 1 August 1997 and two units were merged with effect from 27 January 1998.

The reply of the department is not tenable since the status of the units as separate legal entities existed during relevant period and the notification allowed exemption only for captive consumption within a factory.

Reply of the Ministry of Finance had not been received (November 1998).

(iii) Inputs used in exempted finished products

(a) An assessee in Mumbai II Commissionerate of Central Excise, manufactured chassis, engine and other parts and used them in the manufacture of jeep which were cleared without payment of duty to the United Nations Organisation. Since the final products viz., jeep was exempt from duty, the inputs manufactured in the factory, were not eligible for exemption. In the absence of availability of details of the actual quantity and value of goods captively consumed, incorrect exemption availed was estimated at Rs 5.60 crore between November 1995 to August 1996.

On being pointed out (October 1996), the Ministry of Finance admitted (May 1998) the objection.

(b) An assessee, in Mumbai II Commissionerate of Central Excise, produced long residue (sub-heading 2713.30) and refinery gases (sub-heading 2711.19) and consumed them captively without payment of duty claiming exemption under notification dated 2 April 1986 and dated 16 March 1995. The grant of exemption was not correct as the final product (low sulphur heavy stock) in which long residue and refinery gases were used, were fully exempt from duty.

On being pointed out (June and December 1996), department admitted (October 1997) the objection and intimated that the show cause notice for Rs 3.98 crore for the period April 1994 to August 1996 was under issue. Further progress had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(c) An assessee, in Trichy Commissionerate of Central Excise, manufactured low sulphur heavy stock (LSHS) and other petroleum products and used them as fuel in the manufacture of other final products which were ultimately cleared without payment of duty under bond for export. No duty having been paid on the final products, grant of exemption on LSHS used captively was incorrect.

On being pointed out (February 1998), the department admitted (May 1998) the objection, issued show cause notice demanding duty of Rs 3.01 crore for the period from March 1994 to March 1998 and imposed a penalty of Rs 3.01 crore.

Reply of the Ministry of Finance had not been received (November 1998).

(d) An assessee, in Mumbai III Commissionerate of Central Excise, manufactured fuel gas falling under chapter 27 and used it for production of steam claiming the exemption under the notification, ibid. As steam was also consumed captively, on which no duty was payable, the exemption availed on fuel gas amounting to Rs 3.14 crore during March 1994 to May 1995 was incorrect.

The mistake was pointed out in February 1996; reply of the Ministry of Finance/department had not been received (November 1998).

8.3 Incorrect grant of exemption on finished goods

(i) Paper and paper board

As per notification dated 1 March 1986 and notification dated 1 March 1994 as amended, concessional rate of duty for paper and paper boards was available provided that the said goods were manufactured, right from the stage of pulp, in the said factory and such pulp contained not less than 50 *per cent* (75 *per cent* during the years 1995-96 and 1997-98) by weight of pulp made from materials, other than bamboo, hard wood, soft wood, reeds (other than sarkanda) or rags.

(a) Three assessees, in three commissionerates in Andhra Pradesh, produced paper and paper board using raw materials like paper cuttings, broken paper, board cuttings and corrugated kraft paper cuttings. The concessions under the said notifications were allowed on the ground that the pulp was made from materials other than bamboo, hardwood. In these cases since the raw materials for pulp was recycled waste paper cuttings etc., unless the raw material itself was made out of materials other than bamboo, hard wood, it was not correct to conclude by visual examination that the pulp contained specified percentages of pulp made from materials other than bamboo hard

wood. Since the percentage of required materials was not established, the concession granted was not in order and resulted in short levy of Rs 3.29 crore during April 1995 to July 1997.

On being pointed out (between October 1993 and September 1997), in one case the department replied (February 1998) that usage of waste paper, corrugated kraft paper cuttings etc. to generate pulp for producing the said goods, did not act as a bar for availing the concession. In the second case it was stated (March 1998) that the samples of pulp were drawn and sent for chemical examination and action would be initiated if the results did not match the declaration made by the assessee. Reply in the third case had not been received (May 1998).

The reply of the department is not tenable as the notification speaks of the composition of the pulp not containing more than a specified percentage of raw materials which obviously could not have been decided by visual examination as samples were not sent for chemical examination immediately after the concession was claimed by the assessee.

Reply of the Ministry of Finance had not been received (November 1998).

(b) An assessee, in Chandigarh Commissionerate of Central Excise, manufactured 2416.041 tonne of paper using 29,51,110 kilogram of conventional raw materials and 29,37,104 kilogram unconventional raw materials like wheat straw, bagassee, jute and rice straw and availed concessional rate of duty during July to September 1993. As the percentage of raw materials consumed other than bamboo, hard woods, soft woods, reeds or rags was less than 50 *per cent* (49.88 *per cent*) of the total raw material used, the exemption availed was irregular and resulted in short levy of duty of Rs 69.36 lakh.

On being pointed out (October 1993), the department accepted the objection and stated (February 1994) that show cause cum demand notice for Rs 1.14 crore had been issued in February 1994. However, the Ministry of Finance contended that quantity of wheat straw used was 15,95,807 kilogram and thus unconventional raw materials used was 29,77,107 kilogram which worked out to 50.22 *per cent* of the total raw materials and as such the unit was eligible for concessional rate of duty.

The case was re-examined by co-relating the purchase and consumption vouchers of raw materials and it was noticed (May 1998) that there was interpolation of 40,000 kilogram on receipt as well as on issue side on 5 August 1993 in form IV register of wheat straw account, to enhance the percentage of unconventional raw material to

50.22 *per cent*, whereas, it worked out as 49.88 *per cent* on the basis of actual figures.

The fresh findings were intimated in June 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(ii) Plastic articles

(a) As per notification dated 1 March 1988, as amended, 'Plastic films' were chargeable to concessional rate of duty if produced out of goods falling under headings 39.01 to 39.15.

An assessee, in Meerut Commissionerate of Central Excise, manufactured 'Metalised and laminated plastic films' from 'Plain plastic films' falling under sub-headings 3920.11 and 3920.12, obtained from outside and cleared the finished goods at the concessional rates under the notification, ibid. As the finished goods were not produced out of the goods falling under heading 39.01 to 39.15, availment of concession was incorrect and resulted in short levy of duty of Rs 2.06 crore during April 1990 to July 1993.

On being pointed out (October 1993/February 1995), the department contended (April 1995) that the payment of duty at the concessional rates was in order in view of the Central Board of Excise and Customs circular of 22 August 1990.

The reply of the department is not relevant as the Central Board of Excise and Customs circular dated 22 August 1990 contends that articles of plastic made out of intermediate goods not falling under headings 39.01 to 39.15 would be entitled to the exemption so long as it is proved that those intermediate goods had been produced out of duty paid material of heading 39.01 to 39.15. In the instant case, however, goods were manufactured out of material of sub-heading 3920.11 and 3920.12.

Reply of the Ministry of Finance had not been received (November 1998).

(b) As per notification dated 1 March 1994 as amended and notification dated 1 March 1997, certain plastic articles falling under heading 39.23, 39.24 and 39.26 were exempt from duty, if no credit of duty paid on the inputs used in the manufacture of goods had been availed by the manufacturer under rule 57A.

An assessee, in Chandigarh I Commissionerate of Central Excise, manufacturing articles of plastics (sub-heading 3923.19) was allowed to clear one particular category of final product, partially on payment of excise duty claiming Modvat credit and partially without payment of duty claiming exemption under the aforesaid notification by just

reversing the element of credit of duty on inputs under rule 57C and 57CC. Since simultaneous availment of Modvat credit under rule 57A as well as exemption under notification dated 1 March 1997 was not permissible under the Central Excise Rules, 1944, the procedure adopted by the assessee under permission by the department led to misuse of exemption resulting in short collection of duty of Rs 1.16 crore during April 1995 to 8 January 1998. Taking into account the value of goods cleared as exempted, the total clearance of all excisable goods during the years 1994-95 and 1995-96 exceeded Rs 3 crore. Thus the assessee was also not entitled for benefits of small scale exemption during the years 1995-96 and 1996-97. As a result of the incorrect SSI exemption availed by the assessee, there was thus a further short levy of duty of Rs 12.50 lakh for the years 1995-96 and 1996-97.

On being pointed out (September 1997), the department contended (October 1997) that proportionate credit on inputs availed was reversed and goods were correctly cleared without payment of duty, relying on Supreme Court judgement dated 12 December 1995 in the case of Chandrapur Magnet Wires (P) Limited {1996 (81) ELT 3 (SC)} in which it was decided that the exemption on the disputed goods was not deniable if the assessee had reversed the credit of duty paid on the inputs used in these exempted goods.

The contention of the department is not tenable as the assessee availing Modvat credit on inputs had to pay duty on the final products and notification did not contemplate the reversal of Modvat credit later. Further, the Central Board of Excise and Customs has clarified on 3 December 1997 that simultaneous availment of full exemption as well as Modvat credit would not be admissible.

Subsequent verification revealed that the assessee had since stopped availing exemption with effect from 9 January 1998 in consonance with the provisions of the notification.

Reply of the Ministry of Finance had not been received (November 1998).

(c) Two assessees, in Meerut I Commissionerate of Central Excise, engaged in the manufacture of 'Plastic containers (sub-heading 3923.90)' manufactured and cleared both kinds of containers, viz., chargeable to duty after availing Modvat credit of duty paid on inputs and chargeable to 'nil' rate of duty under notification dated 1 March 1997. In the case of goods, chargeable to nil rate of duty, the assessees were required to maintain separate accounts in accordance with sub-rule 9 of rule 57CC. But, the assessees did not maintain the proper and adequate accounts. Neither the use of inputs was co-related with the finished goods manufactured therefrom, nor was there any proof of payment of duty on inputs based on which exemption from payment of duty was admissible. The assessees were therefore, not eligible for exemption and were liable to pay duty. This resulted in non-payment

of duty of Rs 72.52 lakh on clearances during October 1997 to May 1998.

This was pointed out in July 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(d) An assessee, in Bangalore III Commissionerate of Central Excise, manufactured 'Overhead transparency film' and polyester film, from the inputs viz., 'Dimethyl Terepthalate' and 'Mono Ethyl Glycol' on which Modvat credit of duty paid was availed. He also cleared overhead transparency film without payment of duty availing exemption under notification dated 16 March 1995. Since the assessee had taken credit of the duty paid on inputs, the exemption availed was incorrect and resulted in short levy of duty of Rs 70.24 lakh for the period October 1995 to December 1997.

This was pointed out in January 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(e) An assessee, in Aurangabad Commissionerate of Central Excise, manufactured and cleared 'Plastic crates, Water bottles, Baskets, etc'., falling under heading 39.24, without payment of duty claiming exemption under the above notification, though these goods were manufactured out of 'Plastic scraps' generated while manufacturing 'Plastic chairs, Woven sacks etc'. which were manufactured from 'Plastic granules', on which Modvat credit had already been availed. The grant of exemption was, therefore, incorrect and resulted in short levy of Rs 57.93 lakh during the month of March 1997 alone. Department was asked to work out total short levy of duty before and after March 1997.

The department while accepting the objection stated (June 1998) that show cause notice was under process. Further progress had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(iii) Control panel/relay

As per notification dated 28 August 1995, goods supplied to the United Nations or an International Organisation for their official use or supplied to the projects financed by the United Nations or an International Organisation, were exempt provided the manufacturer, produces before the clearance of goods, a relevant certificate from the United Nation or the International Organisation.

An assessee, in Calcutta I Commissionerate of Central Excise, was allowed to clear 'Control panel, simplex relay etc'. availing exemption from duty under the said notification on the strength of certificate issued by Power Grid Corporation of India Limited. Since the certificate was not obtained from the

prescribed authority, the grant of exemption was incorrect. This resulted in short levy of duty of Rs 65.42 lakh during May 1997 to August 1997.

On being pointed out (November 1997), the department while accepting the objection stated (June 1998) that a show cause cum demand notice had been issued.

Reply of the Ministry of Finance had not been received (November 1998).

8.4 Other cases

In six other cases of incorrect grant of exemption, the Ministry of Finance/department had accepted the objections involving duty of Rs 25 lakh.

CHAPTER 9 : MODVAT SCHEME ON INPUTS

Under Modvat scheme, credit is allowed for duty paid on specified inputs for use in manufacture of finished products. This credit can be utilised towards payment of duty on finished product, subject to fulfilment of certain conditions.

Some cases where credit availed was incorrect are mentioned below:

9.1 Duty not paid on finished products

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

(a) An assessee, in Calcutta II Commissionerate of Central Excise, manufacturing 'Petroleum products' had availed Modvat credit on various inputs like ammonia, anti-oxidant, caustic soda, etc., and used these in the manufacture of a final product (slacked raw naphtha) which was cleared without payment of duty as it was exempt from duty. The assessee did not maintain any separate account of inputs used in the exempted products and utilised the credit towards the payment of duty on other final products. Duty equivalent to eight *per cent* of the value of final products was required to be paid but it was neither paid by the assessee nor was it demanded by the department.

On being pointed out (November 1996), the department issued show cause cum demand notices for recovery of duty of Rs 23.89 crore for the period from September 1996 to March 1998.

Reply of the Ministry of Finance had not been received (November 1998).

(b) An assessee, in Mumbai VI Commissionerate of Central Excise, manufactured both exempted and non-exempted pharmaceutical and other products, out of common inputs on which Modvat credit was availed. The assessee did not maintain separate inventory and accounts of the receipt and use of inputs for both category of goods. The assessee instead of paying duty equivalent to eight *per cent* of the

value of the exempted goods, reversed the Modvat credit availed proportionally on the inputs used in the exempted product which was not correct. This resulted in under payment of duty of Rs 1.33 crore during November 1996 to May 1997.

This was pointed out in May 1998; reply of the Ministry of Finance/department had not been received (November 1998).

(c) An assessee, in Madurai Commissionerate of Central Excise, engaged in the manufacture of certain inorganic chemicals (chapter 28) took credit on carbon dioxide (CO_2) which was used as input both in the manufacture of dutiable final product 'soda ash' and exempted final product 'ammonium chloride' in the same plant. However, the assessee did not pay an amount of Rs 1.03 crore equivalent to eight *per cent* of the value of the exempted products cleared during September 1996 to December 1996, which was in contravention of rule 57CC.

On being pointed out (March 1997), the department initially (May 1997) did not accept the objection but later on stated (August and October 1997) that the demand of Rs 1.84 crore for August 1996 to July 1997 had been confirmed (September 1997) and another show cause notice for Rs 56.50 lakh for the period from August to November 1997 was yet to be adjudicated.

Reply of the Ministry of Finance had not been received (November 1998).

(d) Nine assessees, in Calcutta I, II and III, Cochin I and Jaipur II Commissionerates of Central Excise, manufacturing both dutiable and exempted products, availed of Modvat credit on inputs and utilised the same towards payment of duty on dutiable final products. The assessees did not maintain any separate account of inputs for manufacture of exempted products. Accordingly, the assessees were liable to pay an amount equivalent to eight *per cent* of the value of such exempted products as per rule 57CC of the Central Excise Rules, 1944. No payment was made by the assessees on this account. This resulted in non payment of duty of Rs 1.19 crore during September 1996 to March 1998.

On being pointed out (between December 1996 and April 1998), the department, in four cases, admitted the objection and intimated (between June 1997 and June 1998) recovery of duty of Rs 8.32 lakh from two assessees and issue of show cause cum demand notices for Rs 10.59 lakh to another two assessees. In the fifth case it stated (January 1998) that the show cause cum demand notice for Rs 17.62 lakh was under issue. In the sixth case the department contended (June 1998) that the exemption availed was an adhoc exemption, therefore, the provision of rule 57CC were not contravened. In other two cases it stated (May 1998) that the point was already taken up by the internal

audit. The reply of the department in the remaining one case had not been received (June 1998).

The department's contention in the sixth case is not tenable as the provisions of rule 57CC are specific and do not differentiate between exemption on adhoc basis or otherwise. The reply of the department in the other two cases is not based on facts as in both these cases, the statutory audit party had issued audit notes to the department prior to visit of internal audit party.

The reply of the Ministry of Finance had not been received (November 1998).

9.2 Incorrect availment of credit on unspecified inputs

(i) Lubricating oils

As per rule 57B(2)(v) as introduced on 1 March 1997, the manufacturer of final products shall not be allowed to take credit of the duty paid on lubricating oils, greases, cutting oils and coolants used as inputs in the manufacture of final products. From 1 September 1997, the Modvat credit was allowed on these inputs by issue of another notification. It, therefore, follows that from 1 March 1997 to 31 August 1997 no credit on duty paid on lubricating oils etc., was to be allowed even if it was used as inputs in the manufacture of final products.

An assessee, in Calcutta I Commissionerate of Central Excise, manufacturing 'Blended lubricating oils and greases' falling under chapter 27, received lubricating base oil known as HVI and LVI, from a refinery and used it as inputs in the manufacture of final product 'Blended lubricating oils. He also availed Modvat credit and utilised it towards the payment of final products. The lubricating base oils so received were nothing but lubricating oils and did not qualify for availment of Modvat credit. This resulted in incorrect availment of credit of Rs 8.06 crore during March to August 1997.

This was pointed out in March 1998; reply of the Ministry of Finance/ department had not been received (November 1998).

(ii) Parts and components of machinery

As per explanation (i) below rule 57A as introduced on 23 July 1996, inputs do not include machine, machinery, plant, equipment, apparatus, tools and appliances or capital goods as defined in rule 57Q used for producing or processing of any goods or for bringing about any change in any substance in or in relation to the manufacture of the final products. However, Modvat credit on such items was again allowed under rule 57A from 31 August 1996.

Fourteen assessees, in Calcutta I and II Commissionerates of Central Excise, manufacturing machines and electrical equipments availed Modvat credit under rule 57A on those parts and components which were correctly classifiable as 'capital goods' as defined in rule 57Q. Since Modvat credit on capital goods used as inputs was not admissible due to exclusion clause under rule 57A this resulted in incorrect availment of Modvat credit of Rs 1.57 crore during the period 23 July 1996 to 30 August 1996.

On being pointed out (June-September 1997), the department admitted the objection in two cases and reported (September 1997 and March 1998) that two show cause cum demand notices for Rs 44.63 lakh was under issue. In the remaining cases the department contended that Modvat credit on those items was available since the notification dated 31 August 1996 was clarificatory in nature which would have a retrospective effect.

The department's contention is not acceptable since notification can not have retrospective effect as held (October 1969) by the Supreme Court in the case of Cannanore Spinning and Weaving Mills Limited {ECR 334 (S.C)}.

(iii) Packaging material

As per explanation below rule 57A, input does not include packaging material the cost of which is not included or had not been included during the preceding financial year in the assessable value of the final product. Crates and glass bottles used for aerated water are also excluded from the definition of inputs under the said explanation.

An assessee, in Bangalore I Commissionerate of Central Excise, engaged in the manufacture of aerated water was clearing the final product after filling the bottles and sealing it with cork. The assessee had availed and utilised Modvat credit on cork. Since the glass bottles were themselves not eligible for Modvat credit, and corks which forms a part of this packaging material, could not also be treated as an input.

On being pointed out (July 1997), the department stated (April 1998) that a show cause notice for Rs 48.52 lakh covering the period from November 1995 to October 1997 had been issued.

Reply of the Ministry of Finance had not been received (November 1998).

9.3 Incorrect availment of credit of inputs not in stock

As per rule 57H of the Central Excise Rules, 1944, the Assistant Commissioner of Central Excise may allow credit of duty paid on inputs provided such inputs are lying in stock and duty on inputs has been paid on or after 1 February 1986.

An assessee, in Nagpur Commissionerate of Central Excise, manufacturing HDPE bags had availed Modvat credit of Rs 2.97 crore on input, like HDPE, LDPE granules on 11 September 1996 under rule 57H though the inputs on which Modvat credit was availed, were not in stock as it had already been used in the manufacture of finished goods during the years 1989-90 and 1990-91. Further, out of the credit so taken, Rs 2.20 crore was utilised on the same day on 11 September 1996 for discharging past duty liabilities on account of clandestine removal of goods and differential duty. The availment of credit and its utilisation for discharging past duty liabilities was not in order.

On being pointed out (February 1997), the department stated (January 1998) that a show cause notice for Rs 2.97 crore had been issued in March 1997 which was pending adjudication.

Reply of the Ministry of Finance had not been received (November 1998).

9.4 Non reversal of excess credit

(i) Motor vehicles

As per sub rule 4A inserted under rule 57F on 16 March 1995, any credit of specified duty lying unutilised on 16 March 1995 with the manufacturers of tractors falling under heading 87.01 or motor vehicles falling under heading 87.02 and 87.04 or the chassis of such tractors or such motor vehicles falling under heading 87.06, shall lapse and shall not be allowed to be utilised for payment of duty on any excisable goods whether cleared for home consumption or for export, except credit of duty relating to inputs lying in stock or contained in the finished products lying in stock on 16 March 1995.

An assessee, in Jaipur I Commissionerate of Central Excise, manufacturing chassis for motor vehicles (heading 87.06) had an excess credit balance of Rs 2.36 crore as on 16 March 1995, in respect of which inputs were not lying in stock or were not contained in finished goods lying in stock. Neither did the assessee reverse the credit nor was any action taken by the department.

On being pointed out (September 1997 and January 1998), the department stated that the amount of Rs 2.36 crore had since been reversed.

(ii) Bulk drugs

According to sub rule 17 as inserted under rule 57F on 1 March 1997, any credit of specified duty lying unutilised on the first day of March 1997 with the manufacturer of bulk drugs, shall lapse and shall not be allowed to be utilised for payment of duty on any excisable goods cleared for home consumption or for export, except in the case of credit of duty of inputs or

inputs contained in finished products lying in stock on the first day of March 1997.

Three assessees, one each in Mumbai VI, Guntur and Hyderabad Commissionerates of Central Excise, engaged in the manufacture of bulk drugs continued to utilise the excess credit of Rs 1.96 crore as on 1 March 1997, for payment of duty after 1 March 1997 which was incorrect.

On being pointed out (May and September 1997), the department accepted the objection and intimated recovery of duty of Rs 1.80 crore and issue of show cause notice for Rs 16.10 lakh.

9.5 Incorrect grant of credit on goods not used as inputs

In the case of Kanoria Sugar and General Manufacturing Company Limited {1986 (87) ELT 522 (T)}, the Tribunal held that lubricants and grease used for better operation of the machinery were ineligible for Modvat credit under Rule 57A. These items, however, became eligible for credit as capital goods under rule 57Q only with effect from 1 March 1997. Prior to this date the items were not eligible for credit either under rule 57A as inputs or under rule 57Q as capital goods.

Two assessees, in Hyderabad and Visakhapatnam Commissionerates of Central Excise, availed Modvat credit on industrial lubricants, spin finish oil and coning oil etc. These goods were used as cleaning and lubricating agents for better operation of the machinery. As the goods were not used as inputs in the manufacture of finished goods, availment of Modvat credit of Rs 1.55 crore during April 1995 to February 1997 was incorrect.

On being pointed out (September 1996), the department, while admitting the facts in one case contended (March 1997) that the use of these inputs in relation to the manufacture of finished goods was indirect. Reply in the second case had not been received (November 1998).

The reply of the department is not tenable in view of the decision of Tribunal cited supra. The Ministry of Finance in para 3.4 (iv) of Audit Report for the year ended 31 March 1992 had admitted a similar objection.

9.6 Non payment of duty on waste and scrap

According to rule 57F (4) renumbered as rule 57F (5), waste and scrap arising from processing of inputs can be cleared only on payment of duty. According to the clarification of the Ministry of Finance dated 12 January 1993, the removal of waste and scrap of any kind outside the factory should be allowed only on payment of duty under rule cited above, as if such waste has been

manufactured in the factory. The Tribunal in the case of Nucon Industries Limited {1992 (59) ELT 122 (Tribunal)} held that waste and scrap arising from processing of inputs cannot be cleared under rule 57F (3) for conversion into casting, rods, etc., but can be cleared under rule 57F (4) on payment of duty.

Two assessees, in Chennai I Commissionerate of Central Excise, cleared waste arising from the manufacture of the excisable goods, without payment of duty for conversion into nylon chips, polyester fibre, steam compact materials etc., by a job worker between April 1995 and May 1996. Clearance of waste and scrap without payment of duty was in contravention of the provisions of rule 57F and resulted in non collection of duty of Rs 1.25 crore.

On being pointed out (March 1997), the department stated (September 1997) that as per the Tribunal decision in the case of Chloride Industries {1993 (63) ELT 663} waste and scrap could be cleared without payment of duty.

The reply of the department is not acceptable since (i) the Tribunal in the case of Shriram Refrigeration Industries {1996 (63) ECR 505 (T)} had decided that such scrap had to be dealt with in terms of erstwhile rule 57F(4). This decision had been based on the case law of Nucon Industries cited in para 1 supra, (ii) statutory provision under rule 57F(5) permits removal of waste and scrap generated from the process of manufacture of final products only on payment of duty and (iii) no further amendments had been issued by the Ministry of Finance to their earlier instructions issued on 12 January 1993.

Reply of the Ministry of Finance had not been received (November 1998).

9.7 Grant of credit on raw materials not used

Under rule 57A, a manufacturer can avail credit of duty on specified inputs used in or in relation to the manufacture of specified final products.

(a) Four assessees, in Bangalore I and II and Cochin Commissionerates of Central Excise, engaged in the manufacture of electronic products availed Modvat credit on various inputs for the manufacture of final products. It was noticed that the inputs valuing Rs 7.04 crore were written off due to obsolescence. But, corresponding credit was not expunged from Modvat account and the same was being utilised towards payment of duty on other final products where such inputs were not used. This resulted in incorrect availment of Modvat credit of Rs 1.64 crore between April 1991 and March 1997.

On being pointed (between August 1995 and June 1998), the department accepted objection in three cases and issued show cause notices for Rs 1.36 crore. In one case it contended (May 1997) that the

reversal of Modvat credit would be done only at the time of removal of input from the factory.

Reply of the department is not tenable as the inputs written off were not used and hence credit utilised was incorrect.

Reply of the Ministry of Finance had not been received (November 1998).

(b) Three assessees, in Calcutta I Commissionerate of Central Excise, manufacturing blended lubricating oil received lube base oil without payment of duty under bond. These assessees paid duty at the time of clearances of the product for manufacture of final product and took credit of duty paid and utilised it for payment of duty on final products. Scrutiny of the records relating to tank discharge reading and actual quantity used in the production revealed that lube base oil (input) ranging between 14 to 16 *per cent* was lost. Since Modvat credit on the quantity lost was not available, credit on this account ought to have been reversed. This was neither done by the assessees nor was the duty demanded by the department. This resulted in incorrect grant of credit of Rs 1.09 crore during the period from April 1995 to March 1996.

This was pointed out (January 1997); reply of the Ministry of Finance/department had not been received (November 1998).

9.8 Availment of credit without valid duty paying documents

As per proviso below rule 57G(2) of the Central Excise Rules, 1944, no credit of duty paid shall be taken unless the inputs are received in the factory under documents like an invoice issued by a manufacturer of inputs under rule 52A, an AR-1, application for removal of excisable goods or triplicate copy of bill of entry etc., evidencing the payment of duty on such inputs.

Ten assessees, in eight Commissionerates of Central Excise, manufacturing various excisable goods availed/utilised Modvat credit of duty paid on various inputs on the basis of original copy of invoice without obtaining permission of Assistant Commissioner of Central Excise, customers copy, xerox copy of bill of entry, copy of bill of entry other than triplicate copy, extra copy of invoices, uncertified copy of dealers invoices, etc. As these documents were not valid duty paying documents, grant of credit of Rs one crore between September 1996 and March 1997 was incorrect.

On being pointed out (between November 1995 and February 1998), the department intimated (between October 1997 and February 1998) recovery of duty of Rs 5.38 lakh from three assessees, issue of show cause notices for Rs 44.04 lakh to three assessees and acceptance of objection for Rs 17.86 lakh

in one case. Reply in the remaining three cases had not been received (June 1998).

Reply of the Ministry of Finance had not been received (November 1998).

9.9 Grant of credit after six months

According to second proviso to rule 57G(2) as inserted on 29 June 1995, credit of duty paid on inputs shall not be admissible after six months of the date of issue of specified duty paying documents.

Thirteen assessees, in seven Commissionerates of Central Excise, engaged in the manufacture of various excisable goods were allowed to take credit of Rs 1.06 crore between November 1995 and December 1996 on the inputs after a lapse of six months from the date of issue of specified duty paying documents. The credit so availed was also utilised by the manufacturers for the payment of duty on final products. The grant of Modvat credit beyond six months from the issue of duty paying documents was in contravention of the provisions of rule 57G.

On being pointed out (between January 1997 and June 1997), the Ministry of Finance admitted objection in four cases. Reply in the remaining cases had not been received (November 1998).

9.10 Availment of Modvat credit on inputs used in the manufacture of exempted goods

An assessee, in Mumbai II Commissionerate of Central Excise, engaged in the manufacture of goods falling under chapters 28, 29, and 31 had availed the Modvat credit on inputs viz., Caustic soda, Potassium Carbonide, IOW exchanger etc., which were used in the manufacture of ammonia. The ammonia was captively consumed for the manufacture of fertiliser. As both ammonia and fertiliser were exempt from duty, availment of Modvat credit of Rs 44.37 lakh during September 1996 to May 1997 was incorrect.

On being pointed out (June 1997), the department intimated (February 1998) recovery of Rs 44.37 lakh.

9.11 Other Cases

In three hundred and sixty four other cases of incorrect availment of Modvat credit, the Ministry of Finance/department while accepting the objections involving Rs 6.82 crore reported recovery of Rs 3.44 crore in three hundred and forty eight cases till November 1998.

CHAPTER 10 : MODVAT CREDIT ON CAPITAL GOODS

Modvat scheme was extended to capital goods with effect from 1 March 1994. Under the scheme, credit is allowed for specified capital goods to be used for producing or processing of goods. This credit can be utilised towards payment of duty on excisable goods, subject to the fulfilment of certain conditions.

Some of the cases of incorrect availment of credit noticed in test audit are mentioned below:-

10.1 Modvat credit on capital goods before being installed or put to use

The Central Board of Excise and Customs, in its circular dated 26 December 1994, clarified that credits of duty paid on capital goods should be taken only when such capital goods are actually deployed in the production process and not merely when the goods are received. Sub rule (2) (ii) had also been inserted under rule 57Q on 1 January 1996, to make it statutorily clear that no credit on capital goods should be taken before their installation or use.

(a) An assessee, in Meerut Commissionerate of Central Excise, engaged in manufacture of plastic articles, availed credit of duty paid on capital goods amounting to Rs 1.98 crore between June 1994 and November 1994 even before the capital goods being put to use for manufacture in March 1995. Availment of credit was in clear contravention to the aforesaid clarification.

The matter was reported in March 1997; reply of the Ministry of Finance/department had not been received (November 1998).

(b) Four assessees in Aurangabad, Pune I and Surat II Commissionerates of Central Excise, engaged in the manufacture of various excisable goods had availed Modvat credit of Rs 1.17 crore between April 1996 and March 1997 on capital goods prior to their installation in the factory.

On being pointed out in May and June 1997, the Ministry of Finance/department admitted objection and intimated recovery of Rs 1.17 crore.

10.2 Incorrect availment of Modvat credit on project imports

Goods falling under heading 98.01 of the Customs Tariff were outside the definition of 'capital goods' under rule 57Q prior to 1 March 1997, as the

heading 98.01 was not included in the Central Excise Tariff Act. Subsequently, through a notification dated 1 March 1997 issued under rule 57Q, manufacturers of specified final products were allowed Modvat credit of additional duty leviable under section 3 of the Customs Tariff Act, on Project imports falling under heading 98.01 of the Customs Tariff, only to the extent of 75 *per cent* of the additional duty paid.

(a) Four assessees in Calcutta I, Calcutta II and Patna Commissionerates of Central Excise were allowed to take and utilise Modvat credit of countervailing duty paid on 'Project imports' items falling under heading 98.01 of the Customs Tariff between March 1995 to February 1997. Since project items falling under heading 98.01 were not covered under rule 57Q till 1 March 1997, the Modvat credit of Rs 1.56 crore so availed was not in order.

On being pointed out (between April 1997 and November 1997), the Ministry of Finance admitted the objection in one case and intimated (October 1998) issue of demand notice for Rs 2.43 crore. Reply in the remaining three cases involving duty of Rs 1.33 crore had not been received (November 1998).

(b) Three assessees, one each in Calcutta II, Chennai III and Vadodara Commissionerates of Central Excise, were allowed to avail Modvat credit in March, June and August 1997 of the entire countervailing duty paid on 'Project imports' between December 1995 and June 1997. Since Modvat credit was permissible only to the extent of 75 *per cent* of additional duty (countervailing duty), this resulted in excess grant of credit of Rs 30.72 lakh.

On being pointed out (October 1997), the department admitted (December 1997 and May 1998) the objection in two cases. Reply in the third case had not been received (June 1998).

Reply of the Ministry of Finance had not been received (November 1998).

10.3 Removal of capital goods without payment of duty

According to rule 57S (6), a manufacturer may, with the permission of the Commissioner of Central Excise and subject to such terms and conditions as he may impose, remove 'Mould and dies' to a job worker, without payment of duty, for the purpose of production of goods on his behalf provided that the 'Moulds and dies' are returned to the manufacturer within a period of three months or within the extended period as may be permitted by the Commissioner of Central Excise.

An assessee, manufacturing 'Washing machines', in Nagpur Commissionerate of Central Excise, availed Modvat credit of Rs 87.89 lakh on 'Moulds and dies' between April 1995 and June 1996. He was allowed till 3 May 1998 to remove these without payment of duty, to another manufacturer who manufactured parts of 'Washing machine' and supplied them to the assessee after charging proportionate duty on cost of 'Moulds and dies' required for production of the goods. This manufacturer did not recover any job charges from the assessee. This indicated that the removal of the 'Moulds and dies' was infact not to a 'Job worker' but to another manufacturer. Removal of goods without payment of duty was not in order and duty was required to be paid by the assessee under rule 57S(1)(ii). Adoption of incorrect procedure, thus, resulted in non payment of duty of Rs 87.89 lakh.

On being pointed out (December 1997 and March 1998), the department contended (May 1998) that since there was no clear definition of job worker in the Central Excise Rules, 1944, the assessee had been permitted to bring back the capital goods by 3 May 1998 and the procedure followed by the assessee was appropriate.

Reply of the department was not tenable as the word 'Job work' and 'Job worker' had been defined in notification dated 17 June 1992 and 11 April 1994 as to mean 'Processing or working upon of raw material or semi finished goods, supplied to the job worker so as to complete a part or whole of the process resulting in the manufacture or finishing of an article'. Under job work system, job worker only recovers his job charges. In the instant case, the producer was not the 'Job worker' as he had declared himself as manufacturer of spare parts in the classification list filed with the department and had recovered cost of the goods and duty by issuing his own invoices.

Reply of the Ministry of Finance had not been received (November 1998).

10.4 Availment of credit on capital goods used in the manufacture of exempted goods

According to the provisions of rule 57R(1), credit of specified duty paid on capital goods was not allowable if such capital goods were used exclusively for the manufacture of exempted final products.

An assessee, in Bangalore II Commissionerate of Central Excise, imported in May 1997, a cell manufacturing line equipment and took credit of countervailing duty of Rs 69.36 lakh paid on such capital goods in July 1997. As the equipment was used exclusively for the manufacture of 'Solar photo voltaic cells' which were exempt from duty, the credit of Rs 69.36 lakh taken was incorrect.

On being pointed out (November 1997), the department accepted the objection and intimated (March 1998) recovery of Rs 69.36 lakh.

10.5 Simultaneous availment of credit under Modvat scheme and depreciation under Income Tax Act

As per sub-rule (5) of rule 57R of the Central Excise Rules, 1944, credit of duty paid on capital goods would not be allowed if the manufacturer claimed depreciation under section 32 of the Income Tax Act, 1961, on that part of the value of the goods which represented duty of excise. Provisions of rule 57T(1) also require that a manufacturer availing credit of specified duty shall file a declaration with the department to the effect that he would not claim depreciation under section 32 of the Income Tax Act, 1961.

Eight assessees, {Bangalore III (1), Mumbai III (4), Mumbai IV (2) and Surat II (1) Commissionerates of Central Excise}, had availed Modvat credit on capital goods amounting to Rs 53.80 lakh between 1994-95 and 1996-97 and claimed simultaneously depreciation on the same capital goods under section 32 of the Income Tax Act, 1961. Availment of Modvat credit was therefore incorrect.

On being pointed out (between February 1996 and October 1997), the department accepted the objection in seven cases (September 1997 and February 1998) and reported recovery of Rs 17.51 lakh. In one case it stated (April 1997) that while claiming depreciation, Modvat credit had been deducted.

Reply of the department was not tenable as a subsequent verification (June 1998) of the income tax assessments revealed that the amount of credit was not deducted from the value of asset claimed for depreciation.

Reply of the Ministry of Finance had not been received (November 1998).

10.6 Availment of Modvat credit without duty paying documents

As per rule 57R(3) of the Central Excise Rules, 1944, as amended on 17 June 1994, a manufacturer availing credit of duty paid on capital goods and who has entered into the agreement with a financial institution to finance the cost of capital goods including the specified duty, shall produce a certificate from the financing company to the effect that the duty on capital goods had been paid prior to the first lease rental installment alongwith copy of the agreement.

An assessee, in Surat II Commissionerate of Central Excise, manufacturing 'Organic chemicals' falling under chapter 29 entered into lease agreements with various financial institutions failed to produce the certificate of payment of duty as per the rule, ibid and availed credit of Rs 23.60 lakh incorrectly during July 1995 to September 1996.

On being pointed out (February 1997), the department admitted the objection (September 1997). Report on recovery of duty had not been received (October 1998).

10.7 Other cases

In four other cases, the Ministry of Finance/department while accepting incorrect availment of credit of Rs 55 lakh, reported recovery of Rs 55 lakh in all the cases.

CHAPTER 11 : OTHER TOPICS OF INTEREST

11.1 Retention of central excise duty collected by assessees - unjust enrichment

As per section 11 D (1) of the Central Excise Act, 1944, every person who has collected any amount from the buyer of any goods in any manner as representing duty of excise, shall forthwith, pay the amount so collected, to the credit of Central Government. In para 4.2 of the Audit Report for the year ending 31 March 1996 and para 4.1 of the Audit Report for year ending 31 March 1997, cases of irregular retention of Rs 1493 crore of central excise duties collected but not paid to the Government account were highlighted. While none of these two paras have been replied to by the Ministry of Finance, similar cases have again been noticed in audit suggesting the need for immediate action by the department/Ministry to plug this leakage of revenue. The cases noticed were as under:

(i) Duty collected by petroleum companies

Four public sector oil companies, in three commissionerates, obtained high speed diesel oil, superior kerosene oil and furnace oil, on which countervailing duty was paid and sold them together with their indigenous products at the administered prices fixed by the Ministry of Petroleum and Natural Gas. In addition to the administered prices, the assessees charged central excise duty at the rate of 10 *per cent* ad valorem from their customers. The central excise duty amounting to Rs 55.36 crore so collected from the customers, during the period March 1994 to June 1998 on imported products, was not remitted to the Government.

On being pointed out (between March 1997 and January 1998), the department in one case confirmed a demand of Rs 26.72 crore (including penalty of Rs 13.26 crore) and in two other cases issued show cause notices for Rs 28.34 crore besides another show cause notice for levy and recovery of interest of Rs 6.22 crore in the third case. Reply in the fourth case had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

(ii) Duty collected by footwear company

A multinational footwear manufacturing company, in Patna Commissionerate of Central Excise, cleared some of the articles of footwears without payment of duty by claiming exemption under a notification dated 10 February 1986 which exempted footwears of value not exceeding Rs 125 per pair. The break up of the price (MRP) charged by the assessee disclosed that the assessee had actually collected excise duty at appropriate rate from the customers but did not pay the duty so collected to the Government. The element of duty so collected but not paid to the Government would form part of the assessable

value of the footwears, resulting in value of footwear, infact exceeding the limit of Rs 125 per pair, and hence, exemption claimed was also not admissible.

On being pointed out (May 1993), the department stated (December 1997) that the demand of duty for Rs 7.05 crore for the years 1988-89 to 1992-93 had been confirmed.

11.2 Fictitious revenue collection

Under rule 9 of the Central Excise Rules, 1944, the manufactured goods can be removed from the factory of manufacture only on payment of appropriate duty. The duty may be paid either through a personal ledger account (PLA) as laid down in rule 173 G or through adjustment in Modvat account as prescribed in rule 57G of the Central Excise Rules, 1944. However, for purpose of accounting of revenue realisation during a financial year, the duty paid through PLA alone is taken as revenue realised for the year. As the correct revenue realisation particulars are required for the preparation of Union Budget, any irregular accounting in PLA would lead to incorrect revenue estimates.

Revenue collection records relating to seventeen assessees, in four Commissionerates of Central Excise, revealed that the assessees, debited their PLA on 31 March even without clearance of any excisable goods resulting in creation of fictitious revenue of Rs 11.77 crore for achieving the revenue collection (budget) targets. The amount so debited was either refunded to the assessees or recredited/adjusted by the assessees themselves on the first day of the next financial year or allowed to be re-credited on the same day even without waiting for the receipt of RT 12 returns from the assessees. The unjust collection of revenue was contrary to all the accounting principles since revenue collected on the last working day of the financial year was refunded immediately.

On the irregularities being pointed out (April 1996 to July 1998), the Divisional Officer in Chennai I and Tiruchirapalli Commissionerates of Central Excise stated (September 1996 and November 1997) that the procedure was adopted to achieve the revenue targets. Commissioner of Central Excise, Tiruchirapalli stated (February 1998) that the refund of duty was made because the assessee had paid the duty in excess by oversight on 31 March 1997. Reply of the Mumbai I and Chandigarh II Commissionerates of Central Excise had not been received (November 1998).

Reply of the Ministry of Finance had not been received (November 1998).

11.3 Inconsistent approach of the Ministry of Finance in classifying certain cosmetics

Pharmaceutical products are classifiable under chapter 30, whereas cosmetics

and preparations for the care of skin are classifiable under chapter 33 of the Central Excise Tariff.

The Supreme Court in the case of Shree Baidyanath Ayurved Bhavan Limited {1996 (83) ELT 492 (SC)} had laid down principles for classification of the products as medicaments or cosmetics. Notwithstanding the provisions of the Central Excise Tariff for classification of the products as cosmetics and the decisions of the courts, the Central Board of Excise and Customs had been taking an inconsistent approach by issuing varying instructions from time to time (1989 to 1997) for classification of goods either as 'cosmetic' (chapter 33) or as medicine (chapter 30).

The Public Accounts Committee during oral evidence on Para 4.3 of Audit Report for the year ended 31 March 1996 (No.11 of 1997), directed the Ministry of Finance to review all cases of classification claimed as medicaments.

Test check of the records of nineteen assessees, in eighteen commissionerates, revealed revenue loss of Rs 51.15 crore for the period 1991-92 to 1997-98 due to mis-classification of the cosmetic products like prickly heat powder, herbal products, vicco vajardanti, dant manjan, santosh hair tone, hair and body oil, herbal face cream, hair tonic, dant shakti yog and brahmi oil etc., as medicaments.

The Ministry of Finance confirmed revenue loss of Rs 37.73 crore (Prickly heat powder Rs 8.65 crore, Vicco vajardanti Rs 21.83 crore, Dant manjan lal 2.57 crore and Herbal products Rs 4.68 crore) on clearances between August 1989 and November 1997.

11.4 Allowance of higher abatement under MRP system of valuation

In terms of section 4A of the Central Excise Act, 1944, inserted vide clause 80 of the Finance Bill, 1997, the Central Government may, specify goods which would be charged to duty on a value equal to the 'MRP' of the product less abatement allowed by the Government. In pursuance of the aforesaid provisions, Government issued notifications covering certain items like, Cosmetics (headings 33.03, 33.05 to 33.07), Paints & Varnish (headings 32.08 to 32.10), Footwear (heading 64.01), Aerated water (headings 22.01, 22.02), Colour television (heading 85.28) and Tooth powder and tooth paste (sub-heading 3306.10) etc.

It was noticed that rate of abatement from the MRP of certain products as allowed by the Government was higher than the abatements the manufacturers were themselves availing prior to the introduction of the MRP system, resulting in lower duty realisation. The rationale behind fixation of higher abatements could not be checked in audit as the Government files leading to issue of the concerned notifications were not made available to Audit despite repeated requisitions. Some of the illustrative cases are given below:

(i) Footwear

(a) Footwear falling under chapter 64, was charged to duty with reference to the assessable value determined under section 4 of the Central Excise Act, 1944. As per notification dated 27 August 1997 effective from 1 September 1997, duty on footwear was to be charged on the basis of maximum retail price of the product after allowing abatement to the extent of 50 *per cent* from the MRP.

Eleven assessees, in six commissionerates, manufacturing branded footwear (heading 64.01), were clearing goods on payment of duty on the assessable value ranging between 53 and 55 *per cent* of MRP (determined under section 4 of the Central Excise Act, 1944). From 1 September 1997 onwards the duty was being paid on 50 *per cent* of the MRP, as allowed under the notification, ibid. This resulted in fixation of the assessable value lower than that prevailing prior to 1 September 1997 despite the fact that the MRPs of the products had not changed. Duty of Rs 1.92 crore had to be foregone in eleven cases alone during the periods September 1997 to May 1998 due to the higher abatement allowed. Subsequently, with effect from 2 June 1998, Government reduced the abatement from 50 *per cent* to 40 *per cent* which established the audit point that the initial rate of abatement fixed was on the higher side.

(b) Sub-heading 6401.12 provides 'Nil' rate of duty on 'Footwear' of value not exceeding Rs 75 per pair. The value referred to against this sub-heading refers to the normal price in the course of wholesale trade in terms of section 4 of the Central Excise Act, 1944.

A multinational footwear company operating in three commissionerates, was clearing certain varieties of footwears (with MRP upto Rs 150 per pair) on payment of duty on the assessable value arrived at under section 4 of the Central Excise Act, 1944 prior to 1 September 1997. After introduction of the system of MRP on footwears with effect from 1 September 1997, which allowed abatement of 50 *per cent* from the MRP for determining assessable value under the new section 4A of the Central Excise Act, 1944, these goods at the same MRP were shown at an assessable value of less than Rs 75, thereby paying no duty by availing the exemption under the notification cited above. This was made possible because of the higher rate of abatement allowed by the Government. The revenue foregone/short levied on this account was Rs 45.93 lakh during September 1997 to March 1998 in the aforesaid cases.

The Government has since plugged the loophole from 2 June 1998 by exempting footwear with reference to MRP not exceeding Rs 125 per pair.

(ii) Colour television

As per notification dated 10 September 1997 effective from 16 September 1997 excise duty, on 'Colour television' was to be paid on the value equal to MRP after allowing abatement of 30 *per cent* of the maximum retail price.

Three units, in two commissionerates, engaged in the manufacture of colour televisions cleared the products after paying duty on 70 *per cent* of the MRP with effect from 16 September 1997. It was observed that the assessable value under the new system had shown a substantial reduction. The shortfall in the assessable value ranged between 9 and 28 *per cent* during the period 16 September 1997 to 31 March 1998 when compared to the assessable value prevailing prior to 16 September 1997 determined under section 4 of the Central Excise Act, 1944. This resulted in duty of Rs 1.14 crore having been foregone during the period from 16 September 1997 to 31 March 1998. Reply of the department had not been received (November 1998).

(iii) Perfumed hair oil

As per notification dated 19 June 1997 effective from 1 July 1997, 'Perfumed hair oil' (sub-heading 3305.10) was chargeable to excise duty on assessable value equal to the MRP after allowing 50 *per cent* abatement therefrom.

In the case of an assessee, in Allahabad Commissionerate of Central Excise, engaged in the manufacture of perfumed hair oil under the brand name of 'Keo Karpin' (sub-heading 3305.10) it was observed that the assessable value after abatement of 50 *per cent* of MRP was short by 21.6 *per cent* as compared to the assessable value prevailing prior to 1 July 1997 though there was no change in the market conditions, decrease in the prices of inputs and wages of labourers etc. The reduction in the assessable value resulted in duty of Rs 51.23 lakh having been foregone for the period July 1997 to May 1998.

This was pointed out in November 1998; reply of the Ministry of Finance/ department had not been received (November 1998).

11.5 Non fixation of norms of production

As per rule 173E of the Central Excise Rules, 1944, an officer duly empowered by the Commissioner of Central Excise in this behalf, may fix quantum and period of time when the production in the assessee's factory was considered normal by such officer having regard to the installed capacity of the factory, raw material utilisation, labour employed, power consumed and such other relevant factors as he may deem appropriate. The normal quantum of production during a given time so determined by such officer shall form the norm. The assessee shall, if so required by the said officer, be called upon to explain any shortfall in production during any time, as compared to the norm. If the shortfall is not accounted for to the satisfaction of the said officer, he

may assess the duty due thereon to the best of his judgment, after giving the assessee a reasonable opportunity of being heard.

Test check of records revealed that in none of the cases test checked in audit, norms of production as required under rule 173E of the Central Excise Rules, 1944, ibid, were fixed by the department. In the absence of such norms, no independent method to verify the correctness of production accounted for by the assessee, was available. Since the provision of rule 55, regarding maintenance of accounts for basic raw material and submission of quarterly return (RT 5) was deleted from the Central Excise Rules, since June 1998, absence of norms of production could adversely effect duty realisation. Accordingly, there is a need for a mandatory provision prescribing norms of production under rule 173E.

This was pointed out between March and June 1998; reply of the Ministry of Finance/department had not been received (November 1998).

11.6 Miscellaneous

In 529 other cases, the Ministry of Finance/department while accepting the objections involving duty of Rs 4.48 crore reported recovery of Rs 3.54 crore till November 1998.

New Delhi 30 MAR 1999 **(S.K. BAHRI)**

Dated: **Principal Director (Indirect Taxes)**

Countersigned

New Delhi **(V.K.SHUNGLU)**

Dated: 31 MAR 1999 **Comptroller and Auditor General of India**