Report of the
Comptroller and Auditor General of India

for the year ended March 2010

Union Government
(Indirect Taxes – Service Tax and Customs)
(Performance Audit)
No. 15 of 2011-12

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

23 अगस्त AUG 2011

TABLE OF CONTENTS

PREFACE

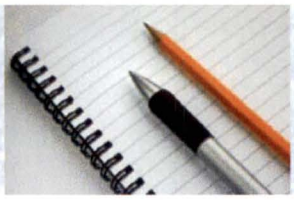
This Report for the year ended March 2010 has been prepared for submission to the President of India under Article 151(1) of the Constitution of India.

Audit of Revenue Receipts – Indirect Taxes of the Union Government is conducted under the Section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The Report presents the results of audit reviews and appraisals of receipts under indirect taxes (Service Tax and Customs Duties).

The Report is arranged in two sections. Section 1 of the Report contains a performance audit relating to service tax receipts and Section 2 contains a performance audit relating to customs receipts, under the following chapters:-

Section 1	**Service Tax**
Chapter 1.1 to 1.6:	Service Tax on Banking and other Financial Services
Section 2	**Customs**
Chapter 2.1 to 2.4:	Duty Drawback Scheme

The observations included in this Report have been selected from the findings of performance audits carried out during the year 2009-10. The results of our audit alongwith recommendations are contained in this Report.



EXECUTIVE SUMMARY

SECTION 1 - SERVICE TAX

This section contains a performance audit of Service Tax on 'Banking and other Financial Services'.

We conducted a performance audit to evaluate the adequacy of provisions of the Finance Act, 1994, Service Tax Rules and related instructions in ensuring proper levy, assessment and collection of service tax on Banking and other Financial Services.

We found procedural deficiencies in registration of assessees, receipt of returns, scrutiny of returns, ambiguities/inadequacy in rule provisions and non-compliance. While the total financial implication of this audit intervention was ₹ 1923.30 crore, the direct additional revenue which could come to the Government was ₹ 264.50 crore. Observations with money value of ₹ 90.55 crore had been accepted by the department and ₹ 21.52 crore recovered.

The key findings and related recommendations were: -

- We identified 1142 service providers who had provided Banking and other financial services and were liable to pay service tax but were not on the departmental registration lists. We found that 65 of these potential assessees were liable to pay service tax of ₹ 92.12 crore.
- We recommended that the department may liaise with statutory authorities such as the RBI to obtain information regarding non banking financial companies to bring them under the service tax net.

(Paragraph 1.2.1)

- The information furnished by the department showed that 6 per cent of service tax returns were received late and 14 per cent of the returns were not received at all. We found, through cross verification of service tax returns with income tax returns and other records, instances of evasion of service tax totalling ₹ 28.93 crore. We recommended that the monitoring mechanism for receipt and scrutiny of returns may be streamlined.

(Paragraphs 1.2.2.1, 1.2.3.2, 1.2.3.3 and 1.2.4)

- We found that the relevant exemption notification did not indicate the treatment of interest charged for late realisation on discounted bills and recommended that the issue may be clarified.

(Paragraph 1.2.5)

- We found that the provisions for service tax on foreign exchange broking services provided two very unequal options and recommended that the government may consider prescribing a fixed percentage of the gain from currency exchange as representing the service charges on foreign exchange

transactions on which service tax would be payable. The Board intimated that the relevant rules have been amended in the Budget 2011.

(Paragraph 1.2.6)

- We found that different institutions were following different practices for availing cenvat credit on interest income earned by the banks resulting in excess availing of cenvat credit and recommended that suitable clarifications may be issued to remove any anomalies. The Board intimated that an amendment has been made in the rules in Budget 2011 which takes care of the issue.

(Paragraph 1.2.7)

- We found instances of non compliance to rules and provisions on incorrect valuation, incorrect/excess availing and utilisation of cenvat credit, non-remittance of service tax, etc. resulting in revenue impact of ₹ 251.38 crore.

(Chapters 1.3 to 1.6)

SECTION 2 - CUSTOMS

This section contains a performance audit of 'Duty Drawback Scheme'.

We conducted a performance audit of the Duty Drawback Scheme to evaluate the adequacy of provisions of the relevant Acts, Rules and instructions in ensuring proper assessment and disbursement of drawback. We found instances of procedural deficiencies and absence of clear provisions. The total financial implication of this audit intervention was ₹ 120.25 crore.

- We observed that no supplementary rules have been framed under Section 74(3) of the Customs Act, 1962 laying down the parameters for identification of goods in case of re-exports.

(Paragraph 2.2.2)

- We observed that the board has not issued instructions specifying how to determine whether goods were "used" or not and recommended that such instructions should be issued.

(Paragraph 2.2.3)

- We observed delays in claim processing and absence of floor value in the Customs Valuation rules for freight charges on exported goods.

(Paragraph 2.3.3)

- We observed that market verification of the declared price had not been initiated in cases where there was material difference between the declared price and declared market value.

(Paragraph 2.3.5)

- Fixation of All Industries Rate of drawback had not been fully documented.

(Paragraph 2.3.6)

- We found instances of non compliance to rules and provisions on processing of time barred claims, delay in fixation of brand rates, sanction

of drawback on products not specified in brand rate letters and excess payment of drawback due to mis-classification.

(Paragraphs 2.3.7.1, 2.3.13 and 2.3.14)

Section 1 - Service Tax

CHAPTER 1.1
INTRODUCTION

1.1.1 Banking and other Financial Services- a brief description

Financial services refer to services provided by the finance industry. The finance industry encompasses a broad range of organisations that deal with management of money. Among these organisations are banks, credit card companies, insurance companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

A bank is a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly or through capital markets. A bank connects customers with capital deficits to customers with capital surpluses.

Service tax on Banking and other Financial Service (BFN) was levied with effect from 1 July 2001. The scope of this service has been expanded from time to time through changes/amendments in the Finance Acts.

Section 65(12) of the Finance Act, 1994 defines BFN as 'any service' in relation to: -

(a) Banking companies and financial institutions including non banking financial companies (NBFC) with effect from 16 July 2001.

(b) 'Other body corporate' not covered in (a) with effect from 16 August 2002. Body corporate will include all types of organisations, which are incorporated under any statute. All the services provided by body corporate will be liable to service tax. The body corporate need not be a banking company or financial institution including NBFC.

(c) Foreign exchange broker not covered in (a) or (b) with effect from 1 July 2003. Foreign exchange broker includes any authorised dealer of foreign exchange. Being an inclusive definition, it covers any person engaged in foreign exchange broking and mainly intended to rope in other entities (like individuals, HUFs, firms) who are engaged in foreign exchange broking.

(d) Other commercial concerns not falling under (a) to (c) with effect from 10 September 2004. Cooperative banks which are not covered under the definition of 'banking company,' fall under the category of 'any other commercial concern' and become taxable under this category of service with effect from 10 September 2004.

(e) Other persons (including commercial concerns) not falling under (a) to (d) with effect from 1 May 2006.

The following two services were further included in the definition of banking and other financial services:

- Banker to an issue services; and
- cheque, transfer of money including telegraphic transfer, mail transfer and electronic transfer services.

Credit card services have been removed from 'Banking and other Financial services' with effect from 1 May 2006 and are being taxed separately.

1.1.2 Why we chose this topic

The banking business is no longer the monopoly of Government of India. Many new entrants from private sector have made their presence felt in banking business and have given a completely new dimension to the banking business. The banking business had gone much beyond its primary activity of borrowing/lending of money.

The service tax on Banking and other financial service is also a major contributor in service tax revenue. Its contribution during the years 2007-08 and 2008-09 is 7.09 per cent (₹ 3634.94 crore out of ₹ 51,301.79 crore) and 6.15 per cent (₹ 3747.65 crore out of ₹ 60,940 crore) respectively. Thus, this service was considered topical for taking up the review.

1.1.3 Audit objectives

The comprehensive performance review was conducted in audit to: -

- seek assurance that the mechanism to identify and bring in potential assessees providing banking and other financial services in tax net for levy of service tax was effective;
- examine the rules, regulations and procedures to identify ambiguities and lacunae that were required to be addressed; and
- identify instances of non-compliance to rules leading to loss of revenue.

1.1.4 Organisational structure

The Central Board of Excise and Customs is the Chief Executive Authority administering Service Tax. It administers service tax through six exclusive service tax commissionerates and 68 other commissionerates which administer both central excise and service tax.

The Directorate General (Service Tax) is a body constituted by Government of India in 1997 to centralise the work of service tax which has been expanding speedily by coverage of more and more services under the service tax net. This body was constituted to ensure that proper establishment and infrastructure could be created under different central excise and service tax commissionerates to monitor the assessment and collection of service tax.

1.1.5 Scope of audit and methodology

We had an entry conference with the officers of Ministry of Finance and CBEC on 24 July 2009 where the audit objectives, scope and special areas of concern were presented and suggestions of the Ministry solicited.

We test checked the records relating to this service, in 60 out of total 74 commissionerates dealing with service tax. Our selection included all the six

exclusive service tax commissionerates and 54 commissionerates dealing with both service tax and central excise. Period covered under audit was from the year 2006-07 to 2008-09.

1.1.6 Response of the department

We acknowledge the cooperation extended by the Ministry of Finance and most of the field formations in providing the necessary information and records during the conduct of this audit. However, some of the commissionerates did not provide all items of information to us. Details of these commissionerates are given in paragraphs 1.2.1 (one commissionerate), 1.2.2.1 (10 commissionerates), 1.2.3 (six commissionerates and two divisions of one commissionerate) and 1.2.4 (six commissionerates). The reasons for not being able to furnish the information were also not communicated. These were noticeable aberrations as other commissionerates were able to provide the same information. The audit recommendations and some of the audit findings were discussed in an exit conference held on 14 June 2011 with the officers of the Ministry. The responses have been incorporated appropriately in the report.

CHAPTER 1.2
FINDINGS ON SYSTEMS, RULES, REGULATIONS AND INTERNAL CONTROLS

We have arranged the audit findings in this chapter under two parts. Part A contains findings on procedural deficiencies in registration of assessees, receipt of returns and scrutiny of returns. Part B covers ambiguities and inadequacy in rule provisions which result in foregoing of revenue. The relevant provision of Act/Rules is highlighted in a box in the beginning of the audit observation. The notional revenue implication of these findings was ₹ 1457.13 crore and the amount recoverable was ₹ 9.09 crore. Certain illustrative cases have been used to highlight these issues.

PART A: PROCEDURAL DEFICIENCIES

1.2.1 Registration

Every person liable to pay service tax has to apply for registration within a period of 30 days from the date of commencement of his business.

For registration of eligible service providers, the Government has relied largely on 'voluntary compliance'. Thus an entity, though liable to pay service tax, can evade tax by not applying for registration.

The Director General of Service Tax, Mumbai, the nodal agency to administer service tax, had issued a comprehensive action plan in May 2003 to monitor the administration of service tax. As per this instruction dated 26 May 2003, the department was required to collect the list of service tax providers from various service providers associations, yellow pages, other local association publications, advertisement appearing in newspapers, regional registration authorities, websites, etc. to identify the unregistered service providers and to get them registered.

It had identified field survey as one of the important mechanisms in the action plan to identify potential assessees and broaden the tax base. The circular had also suggested a performance monitoring system for surveys. Every range officer was to be entrusted with the job of doing surveys to identify potential service tax assessees in his jurisdiction and report the outcome every fortnight to their commissionerates through the divisional office.

In our earlier performance audit reports on Management Consultant's services, Scientific or Technical Consultancy services, Technical Testing and Analysis services and Technical Inspection and Certification Services (March 2006), Rent-a-cab scheme Operators' services, Photography services and Health Club and Fitness Centre services (March 2007), Business Auxiliary services (March 2008) and Construction Services (March 2009), we had commented on the inadequacy and ineffectiveness of surveys undertaken by the department. Our findings in this review are quite similar.

None of the 60 commissionerates test checked in audit had fixed any targets for survey during 2007-08 to 2008-09. No surveys were conducted in 27 out of 60 commissionerates, including all the six exclusive service tax commissionerates. Chennai III commissionerate did not provide the information on the number of surveys conducted. Out of 32 commissionerates where surveys were conducted, 9 commissionerates stated that 154 new service providers of BFN were registered through surveys resulting in additional revenue of ₹ 1.84 crore during the year 2007-08 to 2008-09. However, no new service providers could be registered through surveys for this service in remaining 23 commissionerates. Moreover, in the 32 commissionerates where surveys had taken place, the outcome was not monitored as prescribed in the DGST circular.

We attempted, on a limited scale, to identify unregistered service providers who were liable to pay tax. For this purpose, we identified entities, who had provided BFN services to various departments of State and Central Government. We also identified service providers by scrutinising returns in the Income Tax department and records of other secondary sources like Registrar of companies, Registrar of co-operative societies, Reserve Bank of India and National Bank for Agriculture and Rural Development (NABARD). Thereafter, we obtained a list of registered service providers from the jurisdictional excise commissionerates and verified whether the service providers identified by us were featuring in the list of registered providers provided by the department. We found that in 26 out of 60 commissionerates, there were 1142 service providers for this service, who, though liable to pay service tax, were not available on the departmental registration lists. The majority of them were in the commissionerates where surveys had not been conducted. However there were 92 such cases detected in 8 commissionerates[1] where surveys had been conducted. The majority were from Jamshedpur (34 cases) and Ranchi (48 cases) commissionerates.

We attempted to quantify the extent of evasion by these identified potential assessees. Out of the 1142 identified by us, we were able to obtain data relating to 65 such providers from various sources such as income tax returns (14 cases), Registrar of companies (30 cases), Annual Accounts (11) and other sources (10 cases). We found that, prima facie, these potential assessees had not paid service tax to the extent of ₹ 92.12 crore. This also implied additional penalty upto ₹ 92.12 crore with further interest liability of ₹ 21.35 crore. All these cases required further detailed verification by the department. The department had confirmed only two cases of non registration upto April 2011 which had a revenue implication of ₹ 9.94 crore besides interest and penalty.

Recommendation Nos. 1 and 2

- *The department needs to take up various measures prescribed by the DGST, including surveys to identify potential assessees for service tax and get them registered.*
- *The Board may liaison with statutory authorities such as the RBI to obtain information regarding non banking financial companies to bring them*

[1] Hyderabad II (1), Hyderabad III (2), Vadodara II (1), Chandigarh I (3), Jamshedpur (34), Ranchi (48), Nagpur (2) and Jaipur I (1)

under the service tax net. Further, the Board should widely publicise the requirement of registration in the electronic and print media.

Pursuant to the exit conference, the Board intimated about some general measures like field surveys, collection of information from other commissionerates/ departments, collection of data through websites/yellow pages etc. on a continuous basis by the field formations to identify unregistered service providers. However, it was silent about specific measures like liaisoning with statutory authorities such as RBI to obtain information regarding non banking financial companies as recommended by us.

1.2.2 Monitoring of receipt of service tax returns

Every person liable to pay service tax has to assess and pay his own tax. He has to furnish half yearly returns to the department. A person failing to furnish timely returns is liable to pay a penalty subject to a maximum of one thousand rupees.

The scrutiny of returns is one of the critical tools for effective administration of service tax and to guard against risk of evasion by registered service providers. It, therefore, follows that the regular receipt of returns from all service providers is to be monitored by the department.

1.2.2.1 Receipt of returns

We had called for the statistics on the returns submission from all 74 commissionerates. The information was furnished by 64 commissionerates and 10 commissionerates[2] did not furnish the requisite information. The information furnished by these 64 commissionerates showed that a large number of returns were either not received or received late but the department had not taken any corrective action. The position of receipt of returns during the period September 2004 to March 2009 by the department is shown in the following table: -

Table No. 1

Name of service	No. of returns due	No. of returns received	Returns received by due date	Returns received late	No. of returns not received	Penalty levied and waived for late submission	Penalty not levied @ ₹ 1000/- per return
						(Lakh of rupees)	
BFN	226490	194151	181474	12677	32339	14.77	435.39
Percentage of returns due		85.72	80.12	5.60	14.28		

- The table shows that six per cent of returns were received late and 14 per cent of the returns were not received at all. We found that the test checked commissionerates had not followed any monitoring mechanism to ascertain the reasons for non-submission of returns.
- The Government had exempted small service providers delivering taxable service upto ₹ 4 lakh from payment of service tax from 1 April 2005. This

[2] Hyderabad IV, Delhi ST, Panchkula, Rohtak, Ahmedabad ST, Bolpur, Kolkata ST, Pune I, Pune III and Chennai III.

limit was increased to ₹ 8 lakh from 1 April 2007 and ₹ 10 lakh from 1 April 2008. Amongst the returns not received, we found 301 service providers, whose annual receipts of BFN had exceeded ₹ four lakh during the year 2005-06, but they had not submitted the returns for the year 2006-07. Further, 440 service providers, whose annual receipts of BFN had exceeded ₹ eight lakh during the year 2006-07, but they had not submitted the returns for the year 2007-08. Similarly, 513 service providers whose annual receipt of BFN had exceeded ₹ ten lakh during the year 2007-08, had not submitted the returns for the year 2008-09. The department had not taken any action to ascertain whether the value of services provided had fallen below exemption limits for these assessees or they had stopped filing returns to evade payment of tax. Thus, it did not know why these service providers had abruptly stopped filing returns.

- The levy of penalty for delayed submission and non submission of returns serves as a deterrent but the department did not impose penalty of ₹ 4.35 crore on defaulting assessees. This amount was 97 per cent of the total amount leviable (₹ 4.50 crore).

1.2.2.2 Registered service providers who have stopped filing returns

We did an independent verification, on a limited scale, of income tax returns and other connected records of some of the registered service providers who had stopped filing returns for service tax. We found 7 assessees in Nagpur commissionerate, who had not filed their service tax returns but had continued to provide services during the period of non-filing. This resulted in non-payment of service tax of ₹ 20.33 lakh and interest of ₹ 4.97 lakh. Some illustrative cases are mentioned in the table below: -

Table No. 2

(Amount in lakh of rupees)

Sl. No.	Commissi-onerate	Name of Assessee	Revenue effect		Source of data
			Tax	Interest	
1.	Nagpur	M/s. Berar Finance	7.71	1.88	IT return
2.	Nagpur	M/s Leo Marketing and Auto Deal	3.00	0.77	IT return
3.	Nagpur	M/s Mendhekar Enterprises	2.94	0.57	IT return

1.2.3 Scrutiny of returns

The authority to conduct scrutiny of returns is provided in Rule 5A of the Service Tax Rules, 1994 which authorises the Commissioner to empower any officer to carry out 'Scrutiny, verification and checks, as may be necessary to safeguard the interest of revenue'. The Rule also allows such an officer to call for any record maintained by the assessee for scrutinising the return to determine the correctness of the assessments made. The Board has also issued guidelines vide letter F.No.137/27/2007 CX.4, dated 8 February 2007, which makes it mandatory to scrutinise returns on a regular basis. The guidelines clearly envisaged that returns' scrutiny would become the core function of the Service Tax Ranges.

1.2.3.1 The compiled departmental data for 67 out of 74 commissionerates

and two divisions of Delhi ST commissionerate for the year 2008-09 showed that 12.38 per cent of the returns received for this service (received: 52423 verified: 45935) were pending preliminary verification/scrutiny. Six commissionerates[3] and two divisions of Delhi ST commissionerate did not furnish the information.

1.2.3.2 We also found 99 cases in 22 commissionerates where the departmental officers had scrutinised the returns but failed to detect irregularities like payment of service tax at lower rate, non-levy of interest and penalty, short payment of interest, etc. which had led to short levy of service tax totalling ₹ 7.02 crore and interest of ₹ 1.56 crore. Of these, the department had accepted audit observations involving revenue of ₹ 2.15 crore and had recovered ₹ 1.21 crore and issued SCNs for ₹ 1.21 crore. An illustrative case is given below: -

We observed that M/s Citifinancial Consumer Finance India Ltd., in Delhi ST commissionerate continued to pay service tax at the lower rate during the period between April 2006 to March 2008 even after the rates has been enhanced from 10.2 per cent to 12.24 per cent with effect from 18 April 2006. This resulted in short payment of service tax of ₹ 77.33 lakh.

We pointed this out in September 2009. The reply of the department was awaited (April 2011).

1.2.3.3 No system exists in the department to co-relate the taxable income as shown in the income tax return with the ST-3 return to identify cases that indicated the need for further examination due to large gaps.

We did a cross verification of ST returns with income tax returns and other records maintained by assessees. We found that 116 assessees (in 29 commissionerates) had shown lower figures in ST returns which had service tax implication of ₹ 21.91 crore and interest of ₹ 2.94 crore during the period from September 2004 to March 2009. Two illustrative cases are given below: -

(a) M/s State Bank of India (Industrial Estate Branch), Balasore, in Bhubaneswar I commissionerate was engaged in providing BFN. A cross verification of income tax return with the ST-3 returns filed by the assessee revealed that the assessee had exhibited taxable value in income tax return and value of taxable services in ST-3 returns as ₹ 3.93 crore and ₹ 2.40 crore respectively. In the absence of process of cross verification, the difference had not been examined. This had service tax implication of ₹ 14.23 lakh.

(b) M/s. Cholamandalam DBS Finance Ltd, in Chennai ST commissionerate, was offering income received on processing/service charges, pre-closure charges, insurance/administration charges, documentation charges and PDC (Post Dated Cheque) Swap charges for service tax.

However, other incomes like reimbursement of expenses towards cheque bouncing charges, Electronic Clearing Scheme transfer, Outstation cheque collection, field collection and recovery, post seizure interest charges were not included for service tax purposes for the financial years from 2006-07 to 2008-

[3] Bangalore ST, Bolpur, Kolkata ST, Pune I, Pune III, Chennai III and Delhi ST (Division I and II)

09. These incomes have to be reckoned as consideration for the purpose of levy of service tax. Non-levy of service tax on this account worked out to ₹ 8.99 crore and interest of ₹ 2.18 crore.

When we pointed this out, the department partially accepted the audit observation involving service tax of ₹ 8.55 crore and intimated that SCN for ₹ 9.43 crore had been issued in July 2010. Further development was awaited (April 2011).

1.2.4 List of books of accounts not filed

Rule 5 (2) of Service Tax Rules, 1994, stipulates that every assessee shall furnish to the superintendent of central excise at the time of filing his return for the first time, a list of books of accounts maintained by the assessee in relation to service tax.

The shortfall in receipt of details of books of accounts for the period from April 2007 to March 2009 in 68 out of all the 74 commissionerates, is shown below:-

Table No. 3

Name of service	No. of returns received from service providers for the first time	No. of first returns where list of books of accounts not received	Percentage
BFN	9273	2438	26.29

We observed that 26 per cent of service providers had not given the list of books of accounts maintained by them. During the period from April 2007 to March 2009, in 10 commissionerates, not a single assessee had submitted the list of books of accounts at the time of filing of returns for the first time in respect of BFN. The Commissionerates had not pursued these cases to ascertain the reasons for non-submission of these details. Six commissionerates[4] did not provide the data relating to accounts details being filed with the first ST return despite repeated pursuance for over six months.

Recommendation No. 3

- *The mechanisms for monitoring the receipt of returns and scrutiny of returns is required to be streamlined so that timely action is taken to pursue and resolve exceptions and deviations.*

Pursuant to the exit conference, the Board stated that e-filing of ST-3 returns had been made mandatory vide notification dated 19 February 2010 for an assessee who had paid a total service tax of ₹ 10 lakh or more in the preceding financial year. It further stated that a service tax return scrutiny manual has been prepared and circulated to its field formations on 23 April 2009 which contains guidelines for checking/verifying ST-3 return submitted by the service providers. Further it informed that the system of Automation of Central Excise and Service Tax (ACES) had been introduced throughout the country which was able to check the correctness of the returns from the

[4] Delhi ST, Bolpur, Kolkata ST, Pune I, Pune III and Chennai III

prespective of arithmetical accuracy right away leaving the officers with greater time to perform a detailed scrutiny based on risk parameters. In addition, a revised Service Tax Audit Manual had been circulated to field formations for enhanced efficiency of internal audit which would act as a deterrent to deviations.

PART B: RULES, REGULATIONS AND SYSTEMS

1.2.5 Incorrect interpretation of exemption of interest charged on discounting of bills

As per Rule 6(2)(iv) of Service Tax (Determination of Value) Rules, 2006, interest on loans was excluded from the taxable value.
Again, notification No. 29/2004-S.T, dated 22 September 2004 exempts value of the taxable services provided to a customer, by a banking company, in relation to the interest on (a) overdraft facility, (b) cash credit facility. This notification also exempts the value of discount on bill discounting facility from the levy of service tax.

In 'bill discounting facility', a bank takes the bill drawn by borrower on his customer and pays the borrower after deducting some amount as discount. The bank presents the bill to the customer on the due date of the bill. The deduction on account of discounting is received by the bank as a consideration and has been exempted from payment of service tax by the aforementioned notification. However, if the payment by the customer is delayed, the borrower or his customer pays the bank pre-determined interest depending upon the terms of the transaction.

Therefore, the interest amount charged on bills on delayed payment by the customer is neither in the nature of 'interest on loan' nor covered under any exemption notification and thus, such interest should be chargeable to service tax.

We observed that M/s. UCO Bank, in Kolkata commissionerate, engaged in providing banking and other financial services, received ₹ 70.75 crore as interest from the 'customers' for bills on which discounting facility service was provided during the periods 2008-09. However, no service tax on such interest income was paid treating it as exempted. Had such interest been charged to tax, it would have resulted in realisation of ₹ 8.60 crore as service tax.

When we pointed this out (November 2009), the department replied (May 2010) that SCN for ₹ 10.93 crore had been issued in April 2010. Further development was awaited (April 2011).

Recommendation No. 4

- *Notification dated 22 September 2004 does not exempt interest amount charged for late realisation on discounted bills but the service providers were availing exemption under this notification. The government needs to clarify this issue.*

Pursuant to the exit conference, the Board stated that the matter would be examined and clarification issued.

1.2.6 Avoidance of tax on Foreign Exchange broking services

Foreign exchange broking service is leviable to service tax in the category of banking and other financial services. Notification No. 19/2008, provided that the brokers and foreign exchange dealers had the option to pay at 0.25 per cent of the gross amount of currency exchanged towards discharge of service tax liability or at the rate specified in Section 66 of Finance Act, 1994 on the consideration for this service, if the consideration had been shown separately.

We observed that prior to this notification, the service providers providing foreign exchange broking service were not indicating any consideration separately. However after the introduction of this notification, they introduced some very nominal charges as consideration on foreign exchange transactions. We did not find any uniformity in charging of this consideration.

These service providers purchased the foreign currency at the price quoted for the purchase of foreign currency and sold foreign currency at a price quoted for sale of foreign currency and the difference between the two represented the consideration for providing the service.

We found during test check that 32 assessees in 14 Commissionerates would have paid ₹ 1330.57 crore more as service tax had they paid at 0.25 per cent of transaction value instead of 12.36 per cent of the nominal values of service charge depicted by them. Some illustrative cases are narrated below: -

We observed that M/s Indian Overseas Bank, in Chennai LTU commissionerate, was exchanging foreign currencies. The bank was charging ₹ 100/- per transaction irrespective of amount of currency exchanged although the income of the assessee was directly proportionate to the amount of currency exchanged. It was also observed that the assessee exchanged currency of ₹ 302695.52 crore in 2008-09. The service tax payable at the rate of 0.25 per cent on this amount would have been ₹ 756.74 crore but the service tax paid by the assessee at the rate of 12.36 per cent of nominal processing fee was only ₹ 1.37 lakh.

Two other examples are tabulated below: -

Table No. 4

(Amount in crore of rupees)

Sl. No.	Name of assessee	Commiss-ionerate	Value of currency exchanged	Service tax @ 0.25% of transaction	Service tax paid on nominal consideration	Difference
1.	M/s SBI (Corporate Accounts Group) Branch	Delhi ST	85156.00	212.89	12.63	200.26
2.	M/s South Indian Bank Ltd., Thrissur	Calicut	30268.90	75.67	0.07	75.60

It was evident that the option of 0.25 per cent was totally non-operative as there was a huge gulf with the other option.

We feel that some fixed percentage of the total consideration could represent the service charge, increasing proportionately with increase in consideration.

Recommendation No. 5

- *The government may consider prescribing a fixed percentage of the gain from currency exchange as representing the service charges on foreign exchange transactions on which service tax would be payable.*

Pursuant to the exit conference, the Board stated that in the Budget 2011-12, the relevant rules have been amended[5]. Now the service tax is payable as a transaction graded percentage depending on the value of turnover of currency exchange. Alternatively, the value of service may be determined as the difference between the transaction value and the RBI reference rate.

1.2.7 Inconsistent treatment for availing Cenvat credit on interest income

The Cenvat Credit Rules, 2004, allows credit on input services used by a service provider for rendering of output service and utilise such credit towards payment of service tax on output service. Rule 6(3) of Cenvat Credit Rules, 2004 provides that the assessee may either claim Cenvat credit only on inputs used in providing of taxable service by keeping separate accounts of Cenvat credits of inputs, or reduce the Cenvat credit in proportion to the non-taxable service provided.

Rule 6(2)(iv) of Service Tax (Determination of Value) Rules, 2006 has excluded interest on loans in determination of taxable value of Banking and other Financial Services. Input services availed by the financial institutions are being used for providing taxable service as well as granting loans. Consideration is obtained in the form of service charges for the services provided and as interest on loans. Hence, cenvat credit availed by the financial institution for these input services should be reversed proportionate to the component of interest on loans.

We found that the income from interest received in the service of providing loans is a major portion (it ranges from 56.16 per cent to 98.72 per cent of total income of service providers). We also observed that State Bank of India branches in Delhi ST commissionerate were directed by their Headquarters to proportionately reduce cenvat credit treating interest income as exempted service. However, the other assessees were not following this practice. This resulted in accumulation of cenvat credit of input services linked to interest earned which was exempt from service tax.

Two instances where such proportionate reduction was not effected are tabulated below with revenue implication of ₹ 43.45 crore.

[5] Vide Notification No. 3/2011 - ST, dated 1 March 2011 and
Notifications No. 24/2011 - ST and 26/2011 - ST, both dated 31 March 2011.

Table No. 5

(Amount in crore of rupees)

Sl. No.	Name of Assessee, period	Commissionerate	Total income including interest on loan	Total taxable income	Total cenvat credit availed	Cenvat credit eligible	Excess cenvat credit availed
1.	M/s Cholamandalam DBS Finance Ltd., 2006-09	Chennai ST	2295.35	209.72 (9.14 per cent)	43.75	4.00 (9.14 per cent)	39.75 (90.86 per cent)
2.	M/s Sundaram Finance Ltd., Chennai, 2008-09	Chennai LTU	1107.19	48.49 (4.38 per cent)	3.87	0.17 (4.38 per cent)	3.70 (95.62 per cent)

It was evident that different financial institutions were following different practices resulting in lack of uniformity and excess availing of credit.

Recommendation No. 6

- *In view of this anomalous position, the government may clarify that Cenvat credit on input services should be reversed in the proportion of interest income from loans to the total income.*

Pursuant to the exit conference, the Board stated that in the Budget 2011-12 amendment had been made in the Cenvat Credit Rules, 2004[6] requiring a banking company and a financial institution including a non-banking financial company providing taxable service to pay, for every month, an amount equal to fifty per cent of the Cenvat credit availed on inputs and input services in that month. Thus effectively, only 50 per cent of the Cenvat credit availed is allowed to be utilised towards payment of tax or duty.

1.2.8 Incorrect suo-moto adjustment of excess service tax paid

As per Rule 6(4A) of the Service Tax Rules, 1994, where an assessee has paid to the credit of the central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, as the case may be, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter, as the case may be. Under sub-rule (4B), the adjustment of excess amount paid under sub-rule (4A), may be adjusted with a monetary limit of rupees fifty thousand (Rupees one lakh with effect from 1 March 2008) for a relevant month or quarter, as the case may be.

We found that a separate row was provided in the ST-3 return form to show amount adjusted under Rule 6(4A). However, the checklist prescribed in Annexe 2.1 of manual for Scrutiny of Service Tax Returns for preliminary scrutiny of ST-3 returns did not have an item to check the ceiling of ₹ 50000/one lakh. We found 12 instances where the assessees adjusted ₹ 2.07 crore in excess of the prescribed limits. A few examples are given below: -

[6] By introducing Rule 6(3B).

1.2.8.1 M/s State Bank of India, in Kolkata ST commissionerate, paid service tax on foreign exchange earned for the period from April 2008 to September 2008 which was not actually payable. We found, that the service provider adjusted this amount against service tax liability for the month of March 2009. This amount was required to be claimed as refund and no adjustment was permissible under the Rules cited supra. This had resulted in irregular adjustment of ₹ 29.05 lakh for March 2009 on which interest of ₹ 1.89 lakh was chargeable.

When we pointed this out to the Department in October 2009, the department accepted (March 2011) the audit observation.

In other cases presented in the table below, the assessees adjusted amount largely in excess of the limit of ₹ 1 lakh per month: -

Table No. 6

(Amount in lakh of Rupees)

Sl. No.	Name of the Assessee, Commissionerate	Period	Amount of excess ST paid and adjusted	Actual amount eligible for adjustment	Excess amount adjusted	Interest payable on excess amount adjusted	Total
1	M/s. Citifinancial Consumer Finance (India) Limited, Delhi ST	October 2006 to September 2007	97.27	3.00	94.27	13.99	108.26
2	M/s SBH (IFB) Hyderabad, Hyderabad II	Oct-07, Jun-08 and Sept-08	22.76	3.00	19.76	1.97	21.73
3	M/s SBI, Commercial Branch, Chennai, Chennai ST	March-07	14.83	1.00	13.83	3.60	17.43
4	M/s SBH Main Branch, Gunfoundry, Hyd., Hyderabad II	Jun-07 to Aug-07	16.42	3.00	13.42	1.16	14.58

In the case of M/s. SBI, Commercial Branch, Chennai, in Chennai ST commissionerate, the department had accepted the audit observation (January 2010) and issued SCN for ₹ 14.83 lakh in February 2010. Reply in other three cases was awaited (April 2011).

Recommendation No. 7

- *The Government should include an item in the ST-3 preliminary scrutiny checklist for checking the limit of adjustment permitted under Rule 6(4A) of Service Tax Rules. This check should also be incorporated in the ACES.*

Pursuant to the exit conference, the Board stated as ACES had been developed and monitored by Director General of Systems, the matter would be taken up with them.

1.2.9 Non-maintenance of documents for availing exemption on discount charges

CBEC Notification No. 29/2004 ST dated 22 September 2004 read with No. 30/2004 of the same date and Rule 4A of Service Tax rules provide that discounts charges on bills discounted are exempted from service tax provided that the discount charges are shown in a document containing other essential information specified in Rule 4A.

M/s Vijaya Bank in Bangalore LTU Commissionerate had collected discounted charges of ₹ 145.21 crore during 2004-05 to 2008-09 on account of bills discounted. The bank had not issued any separate invoice/bill or challan but had credited amounts net of discount directly to the customers' accounts. Consequently, the conditions specified in rule and notifications for claiming exemption had not been fulfilled. Similarly, SBI commercial branches, Jaipur and Bhilwara collected ₹ 4.58 crore as discounting charges and availed exemption without issuing any documents.

When we pointed this out (August 2009), the LTU Bangalore contended (November 2009) that under notification 30/2004 the customers were provided with the option of issuing **any document** viz. account statements/pass book, vouchers containing various details required as per service tax rules. It was also stated that this was the uniform practice followed across the Banking industry considering the magnitude of the transactions. The reply of the department did not specify the document(s) issued by banks that contained all the mandatory information namely name, address and the registration number of persons providing and receiving taxable service; description, classification, and value of taxable service and service tax payable thereon.

Recommendation No. 8

- *We recommend that the Board should make it binding on banks and similar financial institutions to disclose the documents issued to fulfil the mandatory information requirements for availing exemption on discount charges.*

Pursuant to the exit conference, the Board stated that Banking industry was issuing statement of accounts periodically wherein all the charges debited to parties accounts were reflected in which the details of discount, interest or other such charges were clearly mentioned. However, the Board informed that it would consider issuing a suitable clarification in this regard.

1.2.10 Discount received on Collateralized borrowing and Lending Obligations (CBLO)

The discount received from CBLO attracts Service Tax under 'Banking and other Financial Services' under Section 65 (12) (a) (vi) of chapter V of Finance Act, 1994 under other auxiliary financial services.

CBLO is a discounted instrument used in electronic book entry form with maturity period ranging from one day to one year. The borrowers can deposit securities (Central Government securities including Treasury bills with a residual maturity period of more than six months) with Clearing Corporation of India Ltd., (CCIL) which acts as a Central Counterpart (intermediary) for both borrowers and lenders. The CCIL issues bonds discounted on face value which are purchased by the lender at discounted value. On the date of maturity, borrower deposits the face value with CCIL and the lender gets the same amount. Thus, the lender receives the discount amount in the form of a consideration. We observed that various assessees had not paid service tax on the discount, as described below: -

- M/s. Federal Bank Ltd., Ernakulam, in Cochin commissionerate, received an amount of ₹ 7.86 crore as discount on CBLO during the period from April 2008 to March 2009 on which service tax of ₹ 97.13 lakh was payable.
- M/s. Vijaya Bank, in Bangalore (LTU) Commissionerate, received an income of ₹ 19.69 crore towards CBLO activities for the period from 2005-06 to 2008-09 on which service tax of ₹ 2.15 crore was payable.
- Similarly M/s. Dhanalakshmi Bank Ltd, Thrissur and M/s. South Indian Bank, Thrissur, both in Calicut commissionerate, had not paid service tax on ₹ 4.92 crore (₹ 3.55 crore and ₹ 1.37 crore respectively), of discount received on CBLO during the period April 2007 to March 2009. Service tax of ₹ 60.74 lakh (₹ 43.83 lakh and ₹ 16.91 lakh respectively) was recoverable.

On this being pointed out (September 2009), the respective commissionerates stated (November 2009) that the discount received by M/s. Vijaya Bank and M/s. Federal Bank Ltd. were the interest for the number of days the funds were borrowed/lent. Since interest on loans was exempted from service tax, the demand of service tax on discount received on CBLO was contrary to the provisions of Act, read with Service tax (Determination of Value) Rules, 2006.

The reply was not tenable. The lending and borrowing is done through CCIL which acts as an intermediary. The intermediary gets guarantee from the borrower through deposited securities and provides guarantee of payment to the lender. Therefore, this instrument is not a direct loan arrangement between two parties. The lender receives the discounted amount as an income. It is relevant to mention that the discount on account of discounting of bills is a similar kind of transaction and was specifically exempted vide notification No.29/2004 dated 22 September 2004. This indicated that the discount received on CBLO is liable to service tax until specifically exempted.

In the cases of M/s. South Indian Bank, Thrisssur, the department stated (January 2011) that SCN had been issued in October 2010.

No reply has been received in respect of M/s Dhanlakshmi Bank Ltd. (April 2011).

Recommendation No. 9

- *It is recommended that the Board may examine the issue and clarify the levy of service tax on discount earning from CBLO.*

Pursuant to the exit conference, the Board stated that the matter would be examined and clarified.

CHAPTER 1.3
VALUATION OF TAXABLE SERVICE

The value of taxable service is determined as per Rule 3 of Service Tax (Determination of Value) Rules, 2006. We found 64 instances of undervaluation which resulted in short payment of service tax of ₹ 53.80 crore that was recoverable with interest of ₹ 1.54 crore and penalty. A few cases are described below: -

1.3.1 Undervaluation due to wrong calculation

The branches of State Bank of India (SBI) were maintaining a separate account for the commission and exchange amount earned by them. The service tax was paid for the amount received in this account in month 1 by debiting the same account in month 2. The SBI Head office at Mumbai had instructed the branches to add back the service tax paid in month 2 to work out the total exchange/commission earned in month 2 on which tax would be paid in month 3.

We found that four commissionerates of Gujarat, involving six branches of SBI had not added back the service tax paid, as instructed. Consequently, the total income of exchange and commission was getting understated. During the period from 2004-05 to 2008-09, this resulted in short payment of service tax of ₹ 97.46 lakh including interest.

When we pointed this out (October 2009), the department reported (October 2009) that the entire amount of ₹ 97.46 lakh had been recovered immediately after the audit observations.

1.3.1.1 Similarly, State Bank of India, Industrial Finance, State Bank of India, Overseas branch and State Bank of India, Leather and International branch, all in Chennai (ST) commissionerate, had not added back the service tax payments of the earlier months.

The short payment of service tax for the years from 2006-07 to 2008-09 worked out to ₹ 2.57 crore which was recoverable with interest.

It was ascertained that the correct procedure had been adopted from May 2009.

When we pointed this out (January 2010), the department admitted the audit observations in all the three cases (August 2010) and intimated that SCN for ₹ 2.57 crore had been issued to these assessees in July 2010.

1.3.1.2 Three bank branches (two branches of State Bank of India and one branch of State Bank of Patiala), in Ludhiana commissionerate, had also not added back the previous month's service tax liability during 2004-05 to 2008-09 resulting in short levy of service tax of ₹ 26.18 lakh. This amount was required to be recovered along with interest of ₹ 8.14 lakh and penalty.

1.3.2 Non inclusion of foreclosure charges in the assessable value

Ministry of Finance letter F.No. 345/6/2008- TRU dated 11 June 2008 has clarified that any amount collected by a service provider on account of lending is either interest or service charges. Pre-closure / fore-closure charges are collected for early payment of loans. These charges not being 'interest' are required to be treated as consideration for the services provided and are accordingly leviable to service tax under Section 65(105)(zm).

M/s. Infrastructure Development Finance Corporation Ltd (IDFC), in Mumbai (ST) commissionerate, had collected ₹ 825.54 lakh on account of foreclosure charges of loans during the period April 2006 to September 2009, on which service tax amounting to ₹ 99.00 lakh was not paid. This was recoverable with interest.

When we pointed this out in December 2009, the Department accepted the audit observation and reported that show cause notice for ₹ 98.78 lakh had been issued in March 2010. Further progress was awaited (April 2011).

1.3.3 Incorrect interpretation of the nature of 'Commitment Charges' leading to its non inclusion in the assessable value

Commitment charges are made for keeping available the undisbursed balance of a loan commitment. Therefore, they are in the nature of charge for services provided and should be included in the assessable value for service tax under BFN services.

1.3.3.1 We found that M/s. Federal Bank Ltd., in Delhi ST Commissionerate, had received directions from its head office to treat commitment charges as taxable. However, M/s. State Bank of India (Corporate Accounts Group Branch) and M/s. State Bank of Patiala (Commercial branch), both in Delhi commissionerate, had received instructions to the contrary. They had not included ₹ 2.84 crore received on account of 'commitment charges' while computing assessable value. Service tax amounting to ₹ 34.98 lakh had not been paid on this amount and was recoverable with interest and penalty.

We pointed this out in October 2009. The reply of the department was awaited (April 2011).

1.3.3.2 During scrutiny of the records of M/s. Indorama Synthetics (India) Ltd., Butibori, in Nagpur commissionerate, registered under BFN service, we found that the assessee had raised loan from two German banks (IKB Deutsche Industriebank, Germany and DEG –Deutsche Institions-UND Entwicklungsgesellschaft-MBH). According to the loan agreements, the assessee had to pay commitment fee for any undrawn amount of loan. During the years 2005-06 to 2007-08, the assessee had paid ₹ 1.71 crore towards commitment fee to these banks on which service tax of ₹ 18.80 lakh was not paid. This was the liability of the assessee as the service providers (German banks) did not have any office in India. Thus, service tax of ₹ 18.80 lakh was recoverable with interest of ₹ 7.45 lakh and penalty.

This was pointed out in September 2009. The reply of the department was awaited (April 2011).

1.3.3.3 Similarly, M/s Infrastructure Development Finance Corporation Ltd., in Mumbai ST commissionerate had collected commitment fees of ₹ 97.35 lakh during the period April 2006 to March 2009 but had not included in assessable value. Service tax of ₹ 12.03 lakh was payable with interest.

When we pointed this out in December 2009, the department accepted the audit observation and reported (January 2011) issue of show cause notice for ₹ 19.05 lakh in March 2010. Further development was awaited (April 2011).

This issue was also discussed in the exit conference. The Board stated that this would be examined and clarification for achieving a uniform practice would be issued.

1.3.4 Undervaluation due to incorrect classification

Notification No. 29/2004, dated 22 September 2004 provided that discount earned from discounting of bills, bills of exchange or cheques would be exempted from service tax.

M/s. Canbank Factors Limited (a subsidiary of M/s. Canara Bank), in Chennai ST Commissionerate, was providing BFN and claiming exemption under Notification No. 29/2004, dated 22 September 2004 in respect of bank charges and discount charges and the same was allowed in the service tax assessments for the financial years 2006-07 to 2008-09.

As disclosed by the assessee company, the only activity of the assessee was the business of factoring. While, 'factoring' has similarities to 'bill discounting', the former involves outright sale and purchase of receivables whereas the latter is a borrowing where an invoice is used as a collateral. Therefore, two transactions are not identical and the provisions of the notification of September 2004 do not cover the discount income from factoring services. The incorrect exemption resulted in non-payment of service tax of ₹ 21.33 crore which was recoverable with interest.

When we pointed this out in November 2009, the department accepted (January 2010) the audit observation and issued SCN for ₹ 21.33 crore in July 2010. Further development was awaited (April 2011).

1.3.5 Miscellaneous charges and commissions

As per section 67(1) (i) of Finance Act, 2006, where service tax is chargeable on any taxable service with reference to its value, then such value shall in a case where provision of service is for a consideration in money, be gross amount charged by the service provider for such service provided or to be provided by him.
As per section 67(3) of Finance Act, 2004, inserted on 16 June 2005, the gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

1.3.5.1 M/s Karnataka State Financial Corporation, in Bangalore ST commissionerate, received an amount of ₹ 7.61 crore towards risk premium charges, monitoring agency commission and application fee during the period April 2005 to March 2009. However, Service Tax amounting to ₹ 92.79 lakh on the said charges had not been paid by the assessee and was recoverable with interest.

1.3.5.2 Similarly, in three other cases M/s. ING Vysya Financial Services, M/s. Cisco Systems Capital India Pvt Ltd. and M/s. Vulcan International Insurance, in Bangalore ST commissionerate, had also not added miscellaneous income, service charges, early termination fee and insurance charges to the gross amount of service. This resulted in undervaluation and consequential short payment of service tax amounting to ₹ 58.24 lakh which was recoverable with interest.

1.3.5.3 Cash Management Service (CMS) attracted service tax with effect from 1 June 2007 as exclusion of CMS from the scope of "BFN" was removed through budget changes in 2007 amending section 65.

Since Chit funds were in the nature of CMS, foreman commission on Chit funds attracted service tax with effect from 1 June 2007. According to Profit and Loss Account of M/s. Kerala State Financial Enterprises (KSFE), Thrissur, (Calicut Commissionerate) as on 31 March 2008, it had received an amount of ₹ 9614.96 lakh as foreman commission, finance charges, writing charges and scrutiny fee being the taxable value under BFN. As against the service tax liability of ₹ 11.88 crore, the assessee paid an amount of ₹ 42.85 lakh due to non-inclusion of foreman commission in assessable value. Thus, there was short payment of service tax of ₹ 11.46 crore which was recoverable with interest.

On this being pointed out (September 2009), the department stated (January 2011) that the registered M/s. KSFE Limited, Thrissur, is not providing service under BFN. The branches of the firm all over Kerala have taken independent registration and discharging service tax liability on foreman commission received on chit funds separately. Wherever instance of short payment were noticed, SCNs have been issued to safeguard revenue, by respective jurisdictional offices.

The reply of the department is not accepted in audit. All the receipts of the enterprises including the receipts of branch offices were shown in the centrally maintained profit and loss account. So all type of payments including taxes paid were also shown in this profit and loss account. Thus the total service tax payment shown in their profit and loss account represents the payment of service tax paid at branches as well. The amount of service tax payment was shown as ₹ 42.85 lakh only. Thus the amount of service tax paid was less than the tax payable by the assessee. Further, the department had not produced the details of service tax paid after pointing out by audit.

1.3.5.4 M/s. State Bank of India, Kerala Circle, in Trivandrum commissionerate, was engaged in providing BFN on commission basis. According to the P&L Account of the assessee, bank received commission/exchange on letter of credit, deferred payment/other guarantees, loan processing fee/up front fee, SD locker, postage, telegraph, etc amounting

to ₹ 262.08 crore on which service tax of ₹ 32.15 crore was payable. However, the assessee paid ₹ 23.49 crore, for the years 2006-07 to 2008-09. Thus, there was short payment of service tax to the extent of ₹ 8.66 crore which was recoverable with interest.

1.3.5.5 M/s Suresh Rathi Securities Pvt Limited, Jodhpur, in Jaipur II commissionerate while providing share broking services to its clients collected an amount of ₹ 86.15 lakh during 2007-08 to 2008-09 as late payment charges for making payment to stock exchanges on behalf of the clients. These charges were directly linked to the taxable service being provided to customers and were part of the assessable value. The assessee did not pay service tax of ₹ 10.65 lakh leviable thereon which was recoverable with interest.

1.3.6 Suppression of assessable value

We compared the financial records and ST-3 returns of M/s. IVF Advisors Ltd, an assessee in Mumbai ST commissionerate and found that the value of taxable service under the category of banking and financial services during the period August 2008 to March 2009 had been declared as ₹ 3006.95 lakh in the ST-3 return whereas ₹ 3299.17 lakh had actually been received by the assessee as per its accounts. Thus, the assessee had understated the assessable value by ₹ 292.22 lakh and evaded service tax of ₹ 36.12 lakh. This was recoverable with interest of ₹ 3.13 lakh and penalty.

CHAPTER 1.4
CENVAT CREDIT

In terms of rule 4 of the Cenvat Credit Rules, 2004, credit of excise duty or service tax paid on any input, capital goods or any input service is allowed to a provider of taxable service. Credit can be utilised towards payment of service tax on output service subject to the fulfilment of certain conditions.

We observed incorrect availing and utilisation of cenvat credit totalling ₹ 105.30 crore, by providers of banking and financial services in 75 cases. Interest of ₹ 6.26 crore was also leviable in these cases. The department had accepted audit observations involving revenue of ₹ 9.90 crore, recovered ₹ 3.07 crore and issued SCNs for ₹ 9.48 crore.

Some illustrative cases are mentioned in the following paragraphs: -

1.4.1 Separate account of dutiable and exempted goods not kept

Prior to 1 April 2008, if Cenvat credit had been availed on common inputs and input services which were used in providing taxable as well as exempted services and separate account of their use was not maintained, then the output service provider was allowed to utilise credit only upto 20 per cent of the amount of service tax payable on taxable output service.

1.4.1.1 We observed that M/s Infrastructure Development Finance Co Ltd, in Mumbai (ST) commissionerate, provided infrastructure advisory work to the International Finance Corporation for World Bank projects in India during the period 2006-07 and 2007-08 and recovered advisory fees. The assessee availed exemption from service tax under Notification No. 16/2002 dated 2 August 2002 for services provided to International Organisation. The assessee did not maintain separate accounts for receipt, consumption and inventory of input services use for taxable and exempted services.

As per the provisions mentioned above, the assessee was liable to restrict the utilisation of cenvat credit to 20 per cent of the service tax payable during the period 2006-07 and 2007-08. Out of the 24 months in 2006-07 and 2007-08, the assessee paid service tax of ₹ 1198.04 lakh in 12 months[7]. While the utilisation of cenvat credit to make these payments should have been restricted to ₹ 239.61 lakh (20 per cent), the actual utilisation was ₹ 626.65 lakh. This led to excess utilisation of credit of ₹ 387.04 lakh which was recoverable with interest of ₹ 95.84 lakh.

When we pointed this out (December 2009), the Department accepted (January 2011) the audit observation and reported that SCN for ₹ 387.04 lakh had been issued in March 2010.

[7] May 2006, September 2006, December 2006, January 2007, March 2007, April 2007, May 2007, July 2007, August 2007, September 2007, December 2007 and March 2008

1.4.1.2 M/s. Dena Bank, in Mumbai service tax commissionerate, had received an amount of ₹ 1165.41 lakh as agency commission from Reserve Bank of India for handling Government business (as exempted service) during the period 2006-07 to 2008-09. As the assessee was not maintaining separate accounts for input credit for use in taxable and exempted services, the assessee was liable to restrict utilisation of Cenvat credit to 20 per cent of the service tax payable for the period 2006-07 to 2007-08 and pay an amount equal to 8 per cent of the value of the exempted services during 2008-09. The assessee did not restrict the utilisation of cenvat credit to 20 per cent during the years 2006-07 to 2007-08. This resulted in excess utilisation of credit of ₹ 644.01 lakh during these two years. Thereafter, the assessee did not pay at the rate of 8 per cent of the value of exempted services of ₹ 403.63 lakh. This resulted in non-payment of service tax of ₹ 32.29 lakh during the year 2008-09. Thus, the assessee short paid service tax of ₹ 676.30 lakh which was recoverable with interest of ₹ 185.44 lakh.

When we pointed this out, department intimated that the assessee had segregated services in respect of which they were entitled to utilise 100 per cent cenvat credit during the period 2006-07 and 2007-08 as per Rule 6(5) of Cenvat Credit Rules, 2004. Department further intimated that for 2008-09 the assessee had paid service tax of ₹ 32.29 lakh at the rate of 8 per cent of the value of exempted services along with interest of ₹ 1.05 lakh through the cenvat account and that action was being taken for recovery of interest in cash.

Department's contention that the assessee had utilised 100 per cent credit only on the 16 services specified under Rule 6(5) of the cenvat credit was not correct. Test check of cenvat credit register (soft copy) of 2006-07 and 2007-08 in respect of Ahmedabad and Bhopal regions of Dena Bank revealed that the assessee had availed 100 per cent credit on general insurance (Oriental Insurance Co.), ATM maintenance (NCR Corporation), Sundry expenses, repairs of motor car services, authorised service station services, transport of goods by road, market research agency services, air travel agent services, advertising services, telephone services (BSNL) etc. These services were not specified services on which 100 per cent credit was available as mentioned under Rule 6(5) of the Cenvat Credit Rules, 2004.

1.4.1.3 M/s Gruh Finance Ltd. and M/s. State Bank of India (Specialized Commercial Branch), Ahmedabad, in Ahmedabad (S.T) commissionerate and M/s. The Surat People's Co-operative Bank, in Surat-I commissionerate, had received commission on taxable and non-taxable services rendered and had availed and utilised entire cenvat credit on all the common input services towards payment of service tax without restricting the utilisation to the extent of 20 per cent of service tax payable which resulted in excess utilisation of cenvat credit. The credit utilised for the year 2005-06 to 2007-08 was ₹ 138.37 lakh, whereas credit eligible to be utilised (20 per cent) was ₹ 80.24 lakh. This resulted in short payment of service tax to the extent of ₹ 58.13 lakh which was required to be paid in cash. The assessees were also liable to pay interest of ₹ 18.97 lakh.

With effect from 1 April 2008, an output service provider not maintaining separate accounts was permitted to choose one of the following options:

(i) Pay an amount of 8 per cent of the value of exempted services

(ii) Pay an amount equal to the Cenvat credit attributable to inputs and input services used for provision of exempted services provided by him subject to certain conditions.

1.4.1.4 M/s State Bank of India, Karnal, in Panchkula commissionerate, was rendering both taxable BFN (commission and exchange income) and exempted services (interest on cash credit, discounting of bills, overdraft, bill of exchanges etc). The assessee had availed of cenvat credit of service tax on common input services (telephone, courier, audit fee etc.) but had not maintained separate accounts for input services used in the taxable and exempted output services. The assessee provided exempted output services valued as ₹ 58.72 crore during the year 2008-09. It was liable to pay an amount equal to eight per cent of the exempted output service of ₹ 58.72 crore provided during 2008-09. The unpaid service tax of ₹ 4.70 crore was recoverable with interest of ₹ 45.80 lakh.

1.4.1.5 M/s Akola Janta Commercial Co-op Bank Ltd, in Nagpur Commissionerate, was engaged in providing various taxable banking and financial services like forex broking, lending, issue of letter of credit and bill of exchange, providing bank guarantee, over draft, bill discounting facility etc. It was also providing exempted services such as interest on loans / cash credit / overdraft, discount on bills / cheques purchased and commission received on Government transactions for which it had received ₹ 57.67 crore as per P&L account for the year ended 31 March 2009. It had availed and utilised cenvat credit of service tax paid on various input services during the year 2008-09 without maintaining separate accounts for input services used in providing exempted and taxable services. The assessee was required to pay eight per cent of ₹ 57.67 crore amounting to ₹ 4.61 crore and interest of ₹ 29.99 lakh.

Some other similar cases are tabulated below:

Table No. 7

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissi-onerate	Period	Value of Exempted service	8 per cent of exempted income
1	M/s Bank of India	Kolkata ST	2008-09	1314.91	105.19
2	M/s City Union Bank Ltd.	Trichy	2008-09	23131	1850.48
3	M/s Bank of India, Mumbai Corporate Branch	Mumbai ST	2008-09	3905.83	312.47
4	M/s ABN AMRO Bank	Mumbai	2008-09	296.34	23.71

For the case mentioned at sl. no. 1, when we pointed this out in October 2009, the department admitted the audit observation and intimated that SCN had been issued in January 2010.

1.4.2 Short-payment of amount under Rule 6(3) of Cenvat Credit Rules, 2004

Rule 6(3A)(a) read with Rule 6 (3)(ii) of the Cenvat Credit Rules, 2004 prescribe that the manufacturer of goods or the provider of output services can pay an amount equal to the credit availed that is attributable to exempted products or exempted services. The payment can be made on a provisional basis every month.

1.4.2.1 M/s Allahabad Bank in Kolkata ST commissionerate rendered various taxable financial services as well as exempted services. The assessee did not maintain separate accounts for common input services used for taxable and exempted output services. It determined the amount payable provisionally every month without considering the interest on cash credit and overdraft facility which were exempt from service tax. Failure to do so had resulted in short-payment of ₹ 515.56 lakh for the period from April 2008 to March 2009 which was recoverable with interest of ₹ 47.69 lakh.

The issue was pointed out by us to the Department in October 2009. Reply was awaited (April 2011).

We observed three other similar cases which are tabulated below: -

Table No. 8

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissionerate	Period	Income from exempted output services	Cenvat credit to be reversed	Cenvat credit actually reversed	Short reversal of cenvat credit
1	M/s Lakshmi Vilas Bank Ltd.	Trichy	2008-09	34318	164	Nil	164
2	M/s Tamilnadu Mercantile Bank Ltd.	Tirunelveli	2008-09	28266	117	5.37	111.63
3	M/s Global Trade Finance Ltd.	Mumbai ST	2008-09	42668	65.20	8.13	57.07

1.4.3 Improper distribution of cenvat credit by input service distributor

In terms of rule 7 of the Cenvat Credit Rules, 2004, an input service distributor (ISD) may distribute the cenvat credit in respect of the service tax paid on the input service to its manufacturing unit or units providing output service. The input service distributor is required to be registered for distribution of input service credit.

We found three assessees who had distributed cenvat credit although they were not registered. This resulted in incorrect distribution and availing of cenvat credit of service tax amounting to ₹ 1.55 crore which was recoverable with interest.

1.4.3.1 M/s. Bank of India, in Kolkata (ST) commissionerate, availed and utilised credit on input services distributed by their Head Office located at Mumbai during the period from June 2005 to October 2007. We ascertained that the head office of the service provider at Mumbai had taken registration as input service distributor with effect from 10 December 2008. Consequently, the distribution of credit by their Mumbai office before taking registration and its availing by the assessee were both irregular. This resulted in irregular availing of service tax credit amounting to ₹ 33.96 lakh (including interest) during the period from June 2005 to October 2007.

When we pointed this out, the department admitted the audit observation and intimated (February 2010) that a show cause notice had been issued for ₹ 26.95 lakh in January 2010. Further development was awaited (April 2011).

Two more instances of distributing cenvat credit without proper registration are given in the table below: -

Table No. 9

(Amount in lakh of rupees)

Sl. No.	Name of Assessee	Commissionerate	Period	Observation
1	M/s SBI, Commercial Branch, GPO, Indore	Indore	2008-09	Cenvat credit irregularly received and availed ₹ 82.51 lakh
2	M/s Bank of India	Goa	2006-09	Cenvat credit irregularly distributed ₹ 39.04 lakh

1.4.4 Overstatement of cenvat credit balance in ST-3 returns

We found that the ST-3 return of M/s. Citifinancial Consumer Finance India Limited in Delhi ST commissionerate for the period April 2006 to September 2006 had a closing balance of Cenvat credit of ₹ 9.47 crore whereas in the ST-3 return for the period October 2006 to March 2007, the opening balance of cenvat credit had been depicted as ₹ 11.47 crore. This resulted in excess availing of cenvat credit of ₹ two crore.

The assessee accepted the audit observation and stated (9 October 2009) that the account would be corrected and appropriately reflected in ST-3 return for period April 2009 to September 2009. Confirmation of the correction was awaited from the department (April 2011).

1.4.5 Incorrect availing of cenvat credit on exempted services

In terms of Rule 6(1) of Cenvat Credit Rules, 2004, an assessee is not entitled to avail cenvat credit on such portion of input services which is used for providing exempted output services.

The Food Corporation of India (FCI), in order to meet out its funding requirement for procurement and distribution of food grains, obtained funds from various banks in India routed through SBI. In order to carry out the

operation, a consortium had been formed for which SBI was the lead bank. The share of each bank was fixed by the RBI.

M/s. Indian Bank, in Chennai (ST) commissionerate, received interest on the advance funded to FCI. The transaction was routed through the lead bank SBI, which collected handling charges inclusive of service tax.

M/s. Indian Bank availed and utilised credit of the service tax paid on the handling charges during the financial years 2007-08 and 2008-09. The handling charges paid to SBI were in the nature of an input service used for providing the output service of giving advance. For the service of giving advance to FCI, the Indian Bank had received consideration in the form of interest which was exempt from payment of service tax. Since the output service was tax exempt, the assessee was not entitled to avail Cenvat credit of the Service tax paid on handling charges (corresponding input service) which amounted to ₹ 72.62 lakh. This amount was recoverable with interest.

When we pointed this out (November 2009), the department accepted (February 2010) the audit observation and intimated (May 2010) that SCN for ₹ 72.62 lakh had been issued in April 2010.

1.4.6 Availing of Cenvat credit without proper documents

According to Rule 9 of Cenvat Credit Rules, 2004, Cenvat credits shall be taken by the manufacturer or provider of out put service or input service distributor, as the case may be, on the basis of an invoice, a bill of entry, a challan, etc.

M/s SBI Dispur branch, in Guwahati Commissionerate, took credit of ₹ 30.40 lakh for the period from March 2006 to February 2009 but no supporting records/documents on the basis of which credit was taken, could be made available to audit.

When we pointed this out (December 2009), the department intimated (March 2010) that a SCN had been issued to the assessee. Further development was awaited (April 2011).

1.4.7 Irregular availing of Cenvat credit before paying service tax

As per rule 4(7) of the Cenvat Credit Rules, 2004, cenvat credit of input service can be availed a day after the date on which payment is made on the value of the input service.

M/s Dena Bank, in Mumbai ST commissionerate had availed cenvat credit of ₹ 305.50 lakh on Core Banking System (CBS) charges payable to M/s Wipro Ltd in March 2009. We found that the actual CBS charges paid up to 31 March 2009 involved service tax of only ₹ 265.32 lakh. This resulted in irregular availing of cenvat credit of ₹ 40.17 lakh in March 2009.

When we pointed this out, the department intimated (November 2009) that the assessee had been directed to reverse/make payment of the cenvat credit

wrongly availed by them along with interest. Thereafter, the department issued SCN for ₹ 40.17 lakh in March 2011.

1.4.8 Irregular availing of cenvat credit on 'input services'

The Cenvat Credit Rules, 2004, provide that cenvat credit can be taken for service tax paid on input services which are utilized for providing output services.

M/s. Canara Bank, in Bangalore LTU Commissionerate, availed cenvat credit on Service Tax paid on services such as Life Insurance service, Forward contract service, Authorized service station service, Stock broker service, TV or radio programme service, construction of residential complex service, Real Estate agent's service, Cable operator service, Program producer service etc during the years 2006-07 to 2008-09. As these services had no relation to providing the output service of 'Banking and other Financial Services', they could not be termed as input services and availing of cenvat credit of ₹ 195.43 lakh on such services was irregular and was required to be recovered with interest.

CHAPTER 1.5
NON-REMITTANCE OF SERVICE TAX

1.5 Service tax collected but not remitted to the Government

Section 73 A of the Finance Act, 1994 (as amended with effect from 18 April 2006), provides that any person who is liable to pay service tax and has collected any amount in excess of the service tax assessed shall forthwith pay the amount so collected to the credit of the Central Government.

We found 14 cases of retention of service tax collected amounting to ₹ 1.41 crore that was recoverable.

A few cases are described below: -

1.5.1 On scrutiny of records of M/s Central Bank of India, Civic Centre, Bhilai, in Raipur commissionerate, we observed that during 2006-07 to 2008-09 the assessee had collected service tax of ₹ 158.28 lakh from customers but deposited only ₹84.74 lakh through challan and retained an amount of ₹ 73.54 lakh. This resulted in irregular retention of service tax of ₹ 73.54 lakh, which was recoverable with interest and penalty.

We pointed this out to the department in September 2009. Reply was awaited (April 2011).

1.5.2 We observed that after reduction in rates of service tax from 12.36 per cent to 10.30 per cent with effect from 24 February 2009, 10 assessees (six branches of State Bank of India, four branches of State Bank of Patiala) in three commissionerates continued charging the higher rate from their customers and collected service tax of ₹ 135.30 lakh in the month of February and March 2009 but deposited service tax of ₹ 112.75 lakh at the lower rate. This resulted in undue retention of service tax of ₹ 22.55 lakh which was required to be recovered with interest and penalty.

We pointed this out to the department in September 2009 & December 2009. Reply was awaited (April 2011).

1.5.3 On reconciling the Ledger Accounts, which contains the details of the service tax collected by the assessees, with the ST-3 returns for the period 2006-07 to 2008-09, we observed that M/s. Bank of India in Delhi ST commissionerate collected service tax of ₹ 4.01 crore but paid only ₹ 3.59 crore. This resulted in short payment of service tax amounting to ₹ 41.29 lakh, which was required to be recovered with interest and penalty.

We pointed this out to the department in December 2009. Reply was awaited (April 2011).

CHAPTER 1.6
MISCELLANEOUS ISSUES

We found 33 instances of non compliance to different provisions of Acts and Rules leading to revenue loss of ₹ 52.27 crore that was required to be recovered. The cases are cited in the subsequent paragraphs.

1.6.1 Service tax on exchange (forex) broking services

Exchange (forex) broking services are liable for levy of service tax under section 65(12) (IV) of the Finance Act, 1994 read with section 65(105) of the Act ibid.

Scrutiny of trial balance/ledger account of two branches of State Bank of India, Ludhiana, in Ludhiana commissionerate, revealed that they had received exchange (forex) charges of ₹ 318.55 lakh during 2007-08 and 2008-09 but had not paid service tax of ₹ 39 lakh by treating the services as exempted. This was required to be recovered along with interest of ₹ 5.58 lakh.

When we pointed this out (November 2009), the department intimated (August 2010) that the assessee had paid service tax of ₹ 32.89 lakh including interest.

1.6.2 Service tax on lease rent of wagons

Financial leasing services including equipment leasing and hire purchase fall under "Banking & other financial services" and are liable to tax with effect from 16 July, 2001.

M/s Lafarge India & M/s Tata Steel Ltd, in Jamshedpur Commissionerate, purchased railway wagons which was used by the railways. The two assesses received lease rent amounting to ₹ 3.26 crore during the year 2006-07 to 2008-09 but did not pay applicable service tax of ₹ 39.88 lakh including education cess. This was recoverable with interest of ₹ 11.95 lakh and penalty.

The audit observation was pointed out in December 2009. The reply of the department was awaited (April 2011)

1.6.3 Irregular benefit under Export of Service Rules, 2005

Export of service is exempt from the levy of service tax under rule 3(2) of the Export of Service Rules, 2005. Export of service is defined as service provided from India and used outside India and payment must be received by the service provider in convertible foreign exchange.

We test checked the records of 12 assesses in Delhi (ST) commissionerate, relating to export of service viz. invoices, ST-3 returns, bank realisation

certificates etc. We found that M/s Indiabull Financial Services Limited had received consideration for service provided in Indian rupees instead of convertible foreign exchange. Thus, it was not eligible to avail any benefit under the rules ibid. This resulted in non-payment of service tax and cess aggregating to ₹ 122.42 lakh on value of service of ₹ 990.48 lakh that was claimed for exemption during July 2008.

This was pointed out in September 2009. The department replied that M/s. Indiabull Financial Services Limited had deposited ₹ 122.42 lakh from their available cenvat and interest amount of ₹ 17.75 lakh vide challan dated 14 December 2010.

1.6.4 Exemption availed before date of effect

As per provisions of notification No. 29/2004 ST dated 22 September 2004, interest collected in relation to overdraft, cash credit facility etc. were exempted from payment of service tax. However, income of interest was taxable during the period from 10 September 2004 to 21 September 2004.

1.6.4.1 We found that M/s. United Bank of India, Kolkata in Kolkata ST commissionerate did not pay service tax of ₹ 1.83 crore on the income of interest in relation to service provided on overdraft and cash credit facility during the period from 10 September 2004 to 21 September 2004 (12 days). The department failed to detect the omission which resulted in loss of revenue to the tune of ₹ 1.83 crore.

When we pointed this out in October 2009, the department accepted the audit observation (March 2011). Further development was awaited (April 2011).

1.6.4.2 Similarly, 12 more assessees, in three commissionerates, did not pay service tax of ₹ 3.97 crore on the interest income realised by them during the period between 10 September 2004 to 21 September 2004.

1.6.5 Non levy of service tax on service charges collected for maintenance of provident fund accounts

Under section 65(45) of the Finance Act, 1994, 'financial institution' has the meaning assigned to it in clause (c) of section 45-I of the R.B.I Act, 1934. Sub-clause (vi) of the said clause (c) defines 'financial institution' as any non-banking institution which carries on its business or part of its business in the activity of collecting, for any purpose or under any scheme or arrangement by whatever name called, money in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing money in any other way, to persons from whom money is collected or to any other person.

M/s Coal Mines Provident Fund Organisation (CMPFO), Dhanbad an autonomous body under Ministry of Coal, in Ranchi commissionerate, engaged in the services of collecting subscription in lumpsum from coal companies received ₹ 207.36 crore towards service charges at the rate of three

per cent on the gross amount of provident fund contributions collected during the period 2006-07 to 2008-09. The amount so collected was further invested in Banks (SBI/ICICI) and securities. These services were in the category of Banking & Other Financial Services as the CMPFO fulfilled the definition of a financial institution. As such M/s CMPFO was liable to pay service tax and education cess amounting to ₹ 25.42 crore, interest of ₹ 5.69 crore and penalty.

When we pointed this out in December 2009, the department accepted the audit observation (November 2010). Further reply was awaited (April 2011).

1.6.6 Non-payment of Service Tax under section 66 A

As per section 66 A of Finance Act, 1994, where any service specified in clause (105) of section 65 is provided by a person or a business from a country other than India, the recipient has to pay service tax on the service provided.

1.6.6.1 M/s. ICICI Venture Funds Management Co. Ltd, in Bangalore LTU Commissionerate, paid ₹ 103.84 crore during 2006-07 to 2008-09 in foreign currencies as professional fees to foreign consultants and advisors for various services that come under Banking and other Financial Services, Business support services, Business auxiliary services etc. The applicable service tax of ₹ 12.79 crore was recoverable with interest and penalty.

When we pointed this out (November 2009), the department stated (December 2009) that service tax of ₹ 5.96 crore along with interest of ₹ 2.46 crore had been recovered. Action taken to recover the balance was awaited (April 2011).

1.6.6.2 In two other cases of similar nature, M/s Federal Bank Ltd., Ernakulam, in Cochin commissionerate and M/s Dhanalakshmi Bank Ltd., Thrissur, in Calicut commissionerate, had not paid service tax on services received from outside the country. When we pointed this out, they deposited service tax and interest of ₹ 34.81 lakh.

We found three more assessees who had not paid service tax amounting to ₹ 24.39 lakh on services received from outside the country. The action taken by the department was awaited (April 2011).

1.6.7 Non payment of service tax by M/s National Security Depository Ltd. (NSDL)

According to the Board Circular No.96/7/2007-S.T dated 23 August 2007 as amended by Circular No.98/1/2008-S.T dated 2 January 2008, the depository service provided by Central Depository Services (India) Ltd. (CDSL) including electronic access to securities information for a fee are liable to Service tax under "Banking and other financial services."

M/s. National Security Depository Ltd. (NSDL), Mumbai had collected ₹ 7.39 crore from M/s. Geojith BNP Paribas, Ernakulam, in Cochin commissionerate, as settlement fee for inter settlement transfer, settlement fee for pool-pool transfer, miscellaneous fee settlement for debit to beneficiary

account, pledge fee, settlement fee on clearing member account etc. during the period 2005-06 to 2008-09. Since NSDL was also providing depository services, they were also liable to pay service tax. Therefore, the unpaid service tax of ₹ 87.47 lakh was recoverable with interest and penalty.

1.6.8 Service tax on postage and other charges

M/s. State Bank of India, Commercial Branch, Bhilwara and Jaipur, both in Jaipur I commissionerate, collected ₹ 54.49 lakh as postage and telegraph charges (Bhilwara - ₹ 44.17 lakh and Jaipur - ₹10.32 lakh) during 2006-07 to 2008-09 on bills purchased. This was required to be treated as consideration in terms of Rule 5(1) of Service Tax (Determination of Value) Rules, 2006, attracting liability of service tax of ₹ 6.08 lakh. This amount was recoverable with interest.

1.6.9 Non-levy of service tax on commission income earned through vostro/nostro accounts[8]

M/s. Indian Overseas Bank (IOB), in Chennai (ST) commissionerate, received income earned through Vostro/Nostro accounts for the financial years from 2005-06 to 2008-09. The assessee remitted service tax on the income earned from vostro/nostro accounts with effect from 1 April 2008. Service tax had not been paid for the financial years from 2005-06 to 2007-08.

Another assessee, M/s. Tamilnad Mercantile Bank Ltd., in the same commissionerate, also did not pay service tax on the income earned through these accounts for the financial years from 2006-07 to 2008-09.

The Service tax leviable worked out to ₹ 1.11 crore.

When we pointed this out in October 2009, in the case of M/s. Indian Overseas Bank (IOB), in Chennai (ST) commissionerate, the department intimated (March 2011) that SCN for ₹ 97 lakh had been issued for audit observation period 2005-06 to 2007-08 in August 2010.

In the case of M/s. Tamilnad Mercantile Bank Ltd., in Chennai (ST) commissionerate, when we pointed this out in December 2009, the department did not accept the audit observation (July 2010) and stated that the incentives received by the assessee were not taxable. The reply of the department is contradictory because similar commission income earned through vostro/nostro account by Indian Overseas Bank, Chennai has been treated as taxable service by the department.

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[8] **Nostro** and **vostro** (Italian, from Latin, *noster* and *voster*; English, 'ours' and 'yours') are accounting terms used to distinguish an account held **for** another entity from an account held **by** another entity. Speaking from the bank's point-of-view a *nostro* is our account of *our* money, held by you and a *vostro* is our account of *your* money, held by us.

1.6.10 Non-levy of service tax on upfront fee

M/s. State Bank of India, Corporate Accounts Group, in Chennai (ST) commissionerate, received upfront fee at 1 per cent of the term loan sanctioned. Service tax was paid on the above fees collected during the financial years from 2007-08 and 2008-09. Service tax was, however, not paid for the fees collected during the financial year 2006-07. The Service tax recoverable worked out to ₹ 31 lakh.

When we pointed this out (November 2009), the department accepted the audit observation (January 2010) and intimated that SCN for ₹ 31 lakh had been issued in March 2010.

1.6.11 Short payment of service tax

M/s Yes Bank Ltd, in Mumbai commissionerate, had made an adjustment of ₹ 30.25 lakh paid in excess as service tax in November 2008 under Investment Banking, while determining the service tax liability for the month of March 2009. This adjustment was not shown in the yearly ST-3 return of 2008-09 submitted to the department. This resulted in short payment of service tax amounting to ₹ 30.25 lakh in March 2009.

We pointed this out in October 2009. The reply of the department was awaited (April 2011).

Similarly, M/s. Mahindra and Mahindra Financial Services Ltd. and M/s Shriram Transport Finance Company Limited had short paid service tax of ₹ 8.01 lakh and ₹ 5.10 lakh during the period 2007-08 and 2006-07 respectively.

When we pointed this out (October and November 2009), the department intimated that M/s. Mahindra and Mahindra Financial Services Ltd. and M/s Shriram Transport Finance Company Limited had deposited service tax alongwith interest of ₹ 8.97 lakh and ₹ 7.19 lakh during October 2009 and December 2009 respectively.

1.6.12 Non levy of service tax on the gold consignment agents' income

As per section 65(12)(v)of Finance Act, 1994, custodial services attract service tax under the banking and other financial services.

M/s. Indian Overseas Bank, in Chennai LTU commissionerate, imports gold on consignment basis from M/s. Union Bank of Switzerland (UBS), ZURICH and MKS Finance, Geneva after paying customs duty, education cess etc. When customers place orders for gold, the bank fixes the price of gold in consultation with the foreign banks, collects the money from the customers, sends the money to the banks and delivers gold to the customers. As such, the assessee bank functions like a custodian of the gold. The income earned in the process is in the nature of custodial services which attracts service tax.

The service tax leviable on such custodial services worked out to ₹ 3.02 crore during the period from 2006-07 to 2008-09. This amount was recoverable with interest and penalty.

When we pointed this out (October 2009), the department partially accepted the audit observation (August 2010) and intimated that the issue of SCN was under process. Further development was awaited (April 2011).

Section 2 - Customs

CHAPTER 2.1 INTRODUCTION

2.1.1 Duty Drawback: A brief introduction

Duty Drawback is a duty neutralization scheme designed to promote exports. It seeks to compensate all duties/taxes embedded in the cost of manufacture of exported products. This ensures that exported products are revenue neutral. Section 74 and Section 75 of the Customs Act, 1962, Section 37 of the Central Excise Act, 1944 and the Finance Act, 1944 empowers the Central Government to grant duty drawback.

Section 74 of the Act authorizes the grant of drawback on re-export of duty paid imported goods. Whenever imported goods are identifiable as such at the time of re-export, drawback to the extent of 98 per cent of duty paid can be allowed. Claims for drawback on re-export are made and processed manually.

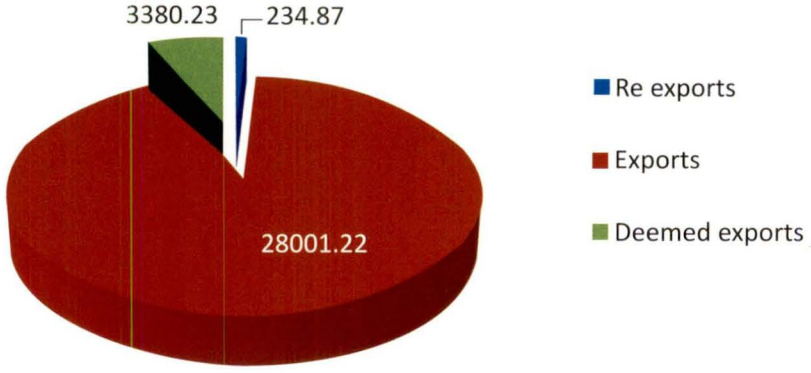
Under Section 75, drawback is payable on manufactured articles when exported. The exporters have the option to apply for drawback either as per the All Industry Rate (AIR) schedule notified by the Government of India or the Brand Rate (BR) fixed by the jurisdictional Excise Commissioner. All India Rates (AIR) of duty drawback are notified every year by the Directorate of Drawback at the Ministry of Finance, GoI after an assessment of average incidence of Customs and Central Excise duties suffered on inputs utilized in the manufacture of export products. These rates feature in the Drawback schedule where they are listed against the four, six or eight digit code describing the commodity. Whenever AIR rate for a particular commodity is not specified or the refund under the prescribed AIR rate covers less than 80 per cent of the cost incurred by the exporter on input duties, the exporter can opt for claiming fixation and payment under the Brand rate. For BR fixation, the exporter has to apply to the jurisdictional Excise Commissioner along with mandated documents. The rates are dependent on the specifics of actual duty incidence. Claims made under Section 75 are made by exporters online on the Indian Customs Electronic data interchange System (ICES).

Drawback is also available on 'Deemed Exports'[9] in which goods do not leave the country and payment for such supplies is received either in Indian Rupees, or in free foreign exchange. The AIR schedule is not applicable to deemed exports. The rate admitted for payment of deemed export duty drawback, is fixed by the jurisdictional Jt. DGFT.

[9] As per para 8.2 of FTP 2009-14, supply of goods by DTA supplier i) against Advance Authorisation/DFIA for intermediate supplies, ii) to units located in EOU, STP etc, iii) to EPCG licensee for capital goods supply on invalidation, iv) to projects/ turnkey contracts funded by multilateral agencies notified by the Department of Economic Affairs, against international competitive bidding, to power projects and refineries under international competitive bidding, to nuclear projects through competitive bidding, to projects funded by UN agencies

During the period between April 2006 and March 2010 the total payment of drawback was ₹ 36,000 crore. The commissionerates and RLAs test checked by us paid ₹ 31,616 crore were paid as drawback. The bulk of these payments were made on Section 75 cases. Details are shown in figure 1.1 below:

Fig 1.1 :Drawback payments 2006-2010 (₹ in crores)



2.1.2 Audit objectives

The audit review was conducted to

(i) examine the rules, regulations and procedure to identify ambiguities and lacunae that are required to be addressed

(ii) seek assurance that the fixation of All Industry Rates and Brand Rates are done in the prescribed manner

(iii) identify instances of non-compliance to provisions relating to drawback leading to loss of revenue.

2.1.3 Scope and methodology of Audit

The audit was carried out in 39 out of 93 Customs Commissionerates across 12 states[10] where the volume of drawback transactions was relatively higher. We got access to data relating to 34.58 lakh drawback cases out of 46 lakh cases (i.e. 75%) settled between April 2006 and September 2009. We executed queries on the data and scrutinised selected case files. We examined the fixation of the All Industry Rate in the Ministry of Finance, GoI and brand rates of drawback at 28 Central Excise Commissionerates. We also scrutinised the records of 19 Regional DGFTs/ Development Commissioners for deemed export drawback allowed under the FTP. The audit observations included in this report are based on the audited samples.

[10] Delhi, Maharashtra, Tamil Nadu, Kerala, Karnataka, Uttar Pradesh, West Bengal, Gujarat, Bihar, Punjab, Andhra Pradesh and Rajasthan

2.1.4 Acknowledgement

The Indian and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and the Ministry of Commerce and Industry along with their field formations in providing the necessary information and records during the conduct of this audit. The objectives, scope and audit methodology for the review was discussed in the entry conference held on 24 July 2009 with Ministry of Finance. The draft Report was issued to Ministry of finance and Ministry of Commerce and Industries on 27 April 2011. The recommendations and audit findings were discussed in an exit conference on 15 June 2011 with both the Ministries. Responses to the recommendations were received (June 2011) from Ministry of Finance and have been appropriately incorporated in this Report.

CHAPTER 2.2
DRAWBACK ON RE-EXPORTS: SECTION 74

2.2.1 Claims under Section 74

Drawback under Section 74 is paid as per sliding rates which take into account the duration of use, depreciation in value and other relevant circumstances. Unlike Section 75, where drawback is claimed at the time of filing shipping bill, under Section 74, drawback is to be claimed within a maximum period of six months from the date of export. The claim is preferred manually. Since these claims are for re-export of imported goods, the Customs Department examines each shipment to verify that they are the same goods that were imported. At the time of filing the claim the exporter has to submit the Shipping Bill bearing examination report recorded by the proper officer of the customs at the time of export. After scrutiny and passing of the drawback claim, payment is made to re-exporter through cheque.

2.2.2 Identification of goods

As per provisions of Section 74(2) of the Customs Act, 1962, when any goods capable of being easily identified have been imported into India are exported within two years from the date of import, payment of duty drawback at the rate prescribed is allowed. According to section 74(3)(b), the Central Government may make rules which, *inter alia*, would provide for the manner in which the identity of the imported goods may be established and may specify the goods which shall be deemed to be not capable of being easily identified. Further, the export goods are to be identified to the satisfaction of the Asst. Commissioner/Dy.Commissioner of Customs as the case may be.

We found that no supplementary rules have been framed under Section 74(3) ibid laying down the parameters for identification of goods in case of re-exports. In the absence of specific instructions the establishment of such identity remains with the discretion of the concerned Assistant Commissioner of Customs. The only item that had been declared not capable of being easily identified was Gum Arabic, Gum Benjamin and variants, which had been done in June 1881 under the provisions of Sea Customs Act 1878.

Test check of cases indicated that the markings on the export item were used as an important criterion for identification. However, we found instances of discrepancy in other parameters like dimension, gross weight, chemical properties etc. We feel that these discrepancies were adequate to merit a detailed examination. However, in the absence of specific parameters, all opinion becomes subjective. Therefore, there appears to be a clear requirement to specify some criteria. We found 12 such cases involving drawback payment of ₹ 1.42 crore and a few are narrated to illustrate the nature of the discrepancies.

M/s Tata Tele Services, Hyderabad imported one set of Wireless Soft Switch (WSS), Wireless Gateway (WGW) and test equipment weighing 740 Kg gross, on 12 July 2006 through Air Cargo Complex, Shamshabad under Hyderabad-II Commissionerate. The said goods, after being put to use, were re-exported on 10 January 2007 and drawback of ₹ 15.77 lakh was sanctioned with a gross weight of 1050 Kgs and net weight of 950 Kgs. The significant rise in gross/net weight was not explained.

In two export claims in Chennai Air commissionerate, drawback amounting to ₹ 22.41 lakh was paid. We observed similar variation in gross weight and number of units between import and re-export in both the cases.

Three exporters were paid drawback amounting to ₹ 62.34 lakh for re-export of chemicals. In two of these cases no markings were available for the items and identity was established in terms of documentary evidence. In the third case where enzymes were re-exported after fifteen months of import, we found that the examination report mentioned that the identity of the imported item was established only with reference to the markings in the drums and names of enzyme indicated in the Bill of entry. We feel that the scope for identification by markings was not fool proof in the case of chemicals and testing of samples was essential to avoid risk of erroneous identification.

We found 'Remelted Zinc Blocks' were re-exported and drawback permitted on the basis that the subject bulk goods were identifiable and identical to goods lying in the import area which were related to other consignment. This method was used because the Zinc blocks were of irregular dimensions, shapes & sizes and having no distinct markings, was inherently incapable of being easily identified.

Recommendation No. 1

- *The Department may issue necessary instructions/ frame rules under Section 74(3) indicating parameters for identification of re-exported goods with the originally imported items. Physical properties of goods placed for re-export, along with documentary declarations, should be cross verified with particulars of related imports on the basis of instructions issued.*

The Ministry stated (June 2011) that the recommendation would be examined in consultation with field formations and a final decision will be taken thereafter.

2.2.3 Determination of use

As per provisions of Section 74(1) of Customs Act, 1962, when any goods capable of being easily identified have been imported into India and duty has been paid on such import, duty drawback at the rate of 98 per cent of duty paid at the time of import is to be re-paid if the goods are re-exported without being put to use. In case of used goods drawback is to be sanctioned on depreciated value at the rate specified in the Notification No.19/1965 dated 6th February 1965, (as amended in March 2008).

In the revision petition against the order of Commissioner of Customs (Appeals) Chennai in the case of M/s Seljegat Printers v. U.O.I (2002(143) ELT 719), the Revisionary Authority, Department of Revenue, held that once a machine is operated, may be for a short time for demonstration or exhibition to show its performance etc, the machinery is to be treated as used. Thus the term 'use after import' need not be only commercial use. Usage for a short period for demonstration, exhibition or tests also amounts to use after import.

We observed that there were no instructions of the board specifying how to determine whether goods were "used" or not. Test check of cases in audit indicated that a large number of goods fulfilled the criteria for "used after import", but were treated as unused goods. We found 55 such cases involving drawback payment of ₹ 1.74 crore. Some illustrations are given by way of example:

2.2.3.1 M/s. Toyota Kirloscar Motor (P) Ltd, under Chennai Sea commissionerate, imported Toyota Prototype Vehicles manufactured by their parent company viz M/s. Toyota Motor Corporation, Japan for the purpose of 'testing and evaluation'. These vehicles were re-exported on 9 August 2008 with FOB value of ₹ 1.83 crore on which drawback claim for ₹ 2.12 crore was admitted. Audit scrutiny revealed that the vehicles were exported after 'testing and evaluation' and hence amounted to 'use'. Therefore, the exported item was not eligible for sanction of drawback as 'unused' good under section 74 of Customs Act, 1962.

2.2.3.2 M/s Ajanta Manufacturing Ltd, under Kandla Commissionerate, re-exported 52,500 pieces of high pressure lamps in October 2006 claiming duty drawback of ₹ 19.63 lakh under section 74 of the Customs Act. The claim was sanctioned to the party in May 2007. Audit scrutiny revealed that Asst. Commissioner (Docks) remarked in his examination report that "the goods were found to bear the marking 'mfd. by Ajanta Mfg Ltd, Orpat House, Kutch' and hence the identity of goods imported was not established under section 74 of the CA 1962". In spite of the adverse examination report, the claim was sanctioned by the Deputy Commissioner without recording any reasons. The payment of drawback amounting to ₹ 19.63 lakh allowed was therefore irregular.

On this being pointed out, the Dy. Commissioner of Customs (Exports) Customs House, Kandla stated (March 2010) that a demand-cum-show notice for ₹ 19.63 lakh had been issued to the exporter for recovery of the drawback erroneously granted. The reply did not indicate what action was taken against the official who passed the claim despite the adverse examination report.

2.2.3.3 In terms of section 2(f)(iii) of the Central Excise Act, 1944, "manufacture" includes any process, which, in relation to the goods specified in the Third Schedule, involves packing or repacking of such goods in a unit container or labeling or re-labeling of containers etc,.

M/s TTK LIG Ltd. (Chennai Sea and Air Commissionerates) imported 'Vibrator ring' in December 2005 and re-exported the same in January 2006 citing the transaction as 'Outright sale'. The transactions of import and re-

export involved no foreign exchange remittance since the goods were imported on Free of Cost basis. However, value was assessed and duty collected on the goods. The exporter received foreign exchange by way of packing charges on the goods re-exported. The exporter was granted drawback at 98 per cent of the import duty paid treating the goods as unused. We found that the imported goods were not in their original packing but were repacked for which the exporter also collected packing charges. Therefore, the goods imported underwent the process of repacking, which amounted to manufacture. Hence the claim having financial implication of ₹ 36.12 lakh did not merit sanction under Section 74.

We communicated the observation (January '2010) to the Department. The department, in reply, cited the judgment in the case of M/s Torrent Pharmaceuticals V. UOI (2001 (138) ELT 949) and stated that drawback under section 74 was admissible when the goods were repacked, relabeled and re-exported and the description of the goods on import documents and on the re-export documents tallied.

The reply of the department was not acceptable because Section 2f (iii) ibid was introduced in March 2003, i.e. after the case law cited by the department.

Recommendation No. 2

- *The Department may issue suitable instructions to clarify the typical conditions under which goods are to be treated as "used after import".*

The Ministry stated (June 2011) that the recommendation would be examined in consultation with field formations and a final decision will be taken thereafter.

2.2.4 Irregular payments

2.2.4.1 Time barred claims and delayed replies to deficiency memo

As per Rule 5 of Re-export of Imported Goods Rules, 1995, a claim for drawback shall be filed with relevant documents within three months from the date on which LEO is granted. If the Assistant Commissioner of Customs is satisfied that the exporter was prevented by sufficient cause to file his claim within the aforesaid period of three months, he can allow the exporter to file his claim within a further period of three months. Sub rule 5(3) states that the date of filing of the claim shall be the date of affixing the dated receipt stamp on the claim which is complete in all respects and for which an acknowledgement is issued. Further, as per sub-rule 4(a) of Rule 5, any claim which is incomplete in any material particulars or is without the documents shall not be accepted and returned to the claimant with deficiency memo within 15 days of submission and shall be deemed not to have been filed. Where exporter complies with the requirement specified in deficiency memo within 30 days from the date of receipt of deficiency memo, the same will be treated as a claim filed under Sub-Rule (1) of Rule 5.

(i) We found 54 cases in Bengaluru, Chennai, Delhi, Hyderabad II and Kandla, where time barred claims were admitted and drawback payment of ₹ 1.19 crore was made.

We also found that 171 claims were filed in ACC Shamsabad under Hyderabad II during the review period. The Department had neither affixed receipt stamp nor issued acknowledgment in any of these cases. Even though internal audit of these payments were carried out in the Commissionerates at Hyderabad, no observations in this regard were made in any of the commissionerates. Two illustrations on admission of time barred claims are given below:

- M/s Salora International Limited, New Delhi re-exported Storage Unit MP3 Players in December 2005 and filed a drawback claim of ₹ 20.14 lakh at maximum admissible rate (98%) in March 2006. The claim was allowed in July 2007. We observed that after the claim was submitted in March 2006, the department issued a deficiency memo in June 2006 directing the exporter to submit BRC, import packing list and bill of lading. The Department issued a reminder in September 2006. The claimant complied with these requirements in March 2007, i.e after nine months against the maximum permissible period of 30 days. However, despite the claim being time barred, the Department passed the claim and paid the inadmissible drawback which was recoverable.

- M/s Bharti Airtel Ltd under Chennai Air Commissionerate re-exported 'Test equipment', on 16 July 2007. The department granted drawback of ₹ 10.43 lakh @ 95 per cent since the goods were cleared as 'used'. Audit scrutiny revealed that the claim was filed on 20 December 2008 i.e after a delay of seventeen months and four days from the date of Let Export. Thus, the drawback allowed was inadmissible in terms of provision ibid.

(ii) Audit scrutiny at Bengaluru, Chennai and Hyderabad revealed 16 cases where drawback under section 74 amounting to ₹ 1.53 crore was paid to exporters although replies to deficiency memos issued were not submitted within the stipulated timeframe of 30 days. In four out of these 16 cases, the claims were admitted even without the receipt of any reply from the exporters. An illustration is given below:

M/s BEL, Bengaluru, under Bengaluru Commissionerate, was issued a deficiency memo in February, 2008, against claim filed under Section 74. It was found that although the claimant did not respond to the memo issued, the Department sanctioned drawback amounting to ₹ 21.07 lakh after five months (in July 2008).

On this being pointed out, the Department issued SCN to the exporter. However, the department did not intimate action taken against the officials responsible for authorising the amount and causing loss to Government.

2.2.4.2 Reversal of Cenvat Credit

Rule 3(5) of Cenvat Credit Rules 2004 stipulates when inputs on which cenvat credit was taken, are removed as such, the manufacturer of the final products shall pay an amount equal to the credit availed in respect of such inputs. The provision indicates that when imported inputs are re-exported, any cenvat credit availed for the CVD paid on the import, needs to be reversed for admissibility of drawback under Section 74.

We observed two cases at Chennai and Vishakhapatnam Commissionerates where the exporters were granted drawback of ₹ 72.46 lakh although they did not reverse the cenvat credit availed on imports. One case is illustrated below:

M/s Ford Chennai India (P) Ltd. under Chennai Sea Commissionerate was awarded drawback of ₹ 61.92 lakh for the re-export of 'steering columns'. We found that the exporter had availed Cenvat credit but not reversed the same at the time of preferring the drawback claim. The omission to reverse the Cenvat credit had resulted in incorrect grant of drawback to the extent of ₹ 44.41 lakh which was recoverable with interest.

The observation was communicated to the department (January 2010) and their reply was awaited.

CHAPTER 2.3 DRAWBACK ON EXPORTS: SECTION 75

2.3.1 Claims under Section 75

Drawback claims under Section 75 are filed and processed through the EDI system. The EDI system automatically processes a shipping bill for drawback under the AIR rate unless the exporter specifically prefers his drawback claim under brand rate or opts for another export incentive scheme.

Wherever exporters opt for brand rate, the Customs department sanctions the drawback after the Excise Commissionerate concerned fixes and communicates the brand rate.

After the Customs Department grants the 'Let Export' order against a particular shipping bill, the carrier submits the details of the Export General Manifest online. The claim is transmitted to the drawback queue for processing by the Drawback branch. After the drawback is sanctioned online, the amount payable to the exporter is electronically credited to the bank account of the exporter.

2.3.2 Delays in claims processing

Section 75A of the Customs Act 1962 provides that where any drawback payable to claimant is not paid within one month from the date of filing of the claim, interest at six per cent *per annum* is to be paid to the claimant thereafter. In 2002, the Board directed that drawback claims should be cleared within 3/5 working days from the date of shipment and electronic filing of EGM where processing is done online/manually. As per Drawback Rules, if a drawback claim is incomplete, deficiency memo is to be issued to the exporter within 10 days.

We queried the drawback transactions data made available to us pertaining to Andhra Pradesh and Gujarat and found significant delays in processing of drawback claims in the Commissionerates situated in these locations. In Andhra Pradesh, we noted delays in processing in 10,177 cases – more than half of which were processed after more than three months. In 20 per cent of these claims, settlement was delayed beyond a year.

In Gujarat, out of 88,000 claims analysed/queried, delays occurred in 20,856 (23.7 percent) cases. Delayed settlement of cases held up the payment of drawback and in 4048 cases of delayed processing at Kandla and Ahmedabad, we found deficiency memos were raised much later (ranging from 31 days to more than 2 years) after filing of claim. The Kandla Commissionerate stated that delays in processing occurred as the claimants were not submitting the requisite documents in response to the deficiency memos issued by the Department. The reply was not tenable as we found that queries were raised much beyond the stipulated time of 10 days. Moreover, numerous queries were incomplete with comments like 'please produce documents' without

clearly specifying the deficiencies. That led to further clarificatory communications and compounded the delays. Such large delays went against the basic tenor of directions of the Board in 2002, which provided for quick processing and disposal of claims to facilitate early payment of drawback to the taxpayers.

Similarly, 2,276 claims settled at Bihar, Mumbai, Rajasthan and UP, we noted delay between 13 days to four year in processing the claims.

Recommendation No. 3

- *The Department needs to streamline the verification procedures to enable faster processing of claims. Further, whenever the documents filed are found to be deficient, these should be communicated to the applicant in clear, unambiguous terms within the stipulated time frame of 10 days.*

The Ministry while accepting the recommendation stated (June 2011) that the field formations would be sensitised once again on this issue.

2.3.3 Declaration of freight

For claims U/Sec 75 drawback is allowed on ad valorem basis on the FOB value. Wherever transaction value is inclusive of freight cost, the freight component is reduced from the transaction value and drawback is paid on the FOB value. In May 2000, the Department issued a circular which mandated the exporter to declare the actual freight paid or payable by him on the shipping bill. The circular, inter alia, stated that the Commissioner of Customs should also ensure that a regular test check of 10-15 percent of claims be carried out to verify the declaration of freight by the exporter and take appropriate action on misdeclaration. However, unlike Rule 10(2) of valuation rules for imports (which considers freight at 20 per cent of FOB value when not ascertainable), no floor value has been imposed in Customs Valuation rules for freight charges on exported goods.

The above provisions imply that it is possible to claim a larger sum as drawback by underdeclaring the freight value. We reviewed the freight declarations made by exporters by running SQL queries on the transactions data. The results are tabulated below:

Table 1: Freight declaration by claimants during review period

State	No. of Claims settled	No. of Claims analysed through query	No. of cases where Freight declared is below 5% of FOB value	Below 5% declaration (in % terms)
1	2	3	4	5 = (4/3)*100
Delhi	1052831	1052831	130000	12
Gujarat	98314	88000	30000	34
Punjab	76719	54633	27500	50

State	No. of Claims settled	No. of Claims analysed through query	No. of cases where Freight declared is below 5% of FOB value	Below 5% declaration (in % terms)
Tamil Nadu	1296516	519312	160000	30
Karnataka	148216	74108	15179	20
Kerala	112204	63315	15700	24

We found that the freight declared was less than five percent of FOB value in a significant number of cases in Gujarat, Punjab, Karnataka and Tamil Nadu. In 4,519 out of the 88,000 cases (5.13 percent) in Gujarat (Ahmedabad and Kandla Commissionerates) the freight declared was found to be less than 1 per cent indicating risk of underreporting of freight.

Recommendation No. 4

- *The Board may consider examining whether a suitable floor value for freight could be determined and fixed. The Board could also reiterate the instructions for sample verification of actual freight paid.*

The Ministry stated (June 2011) that it is practically not possible to fix a floor value for the freight since the rates vary from destinations to destinations, time to time, mode of transport, type of cargo etc.

In such a scenario, the sample verification assumes significance and should be implemented strictly by the Board.

2.3.4 Realisation of export proceeds

In terms of the provisions of Section 75 (1) of the Customs Act, 1962 read with sub-rules 16A (1) and (2) of the Drawback Rules 1995, whenever an exporter, who has been paid drawback, fails to produce evidence of realization of export proceeds within the period allowed under the FEMA, 1999 or as extended by the RBI, the Assistant/ Deputy Commissioner of Customs shall initiate action to recover the amount of drawback paid to the claimant.

Till January 2004, the RBI was furnishing consolidated half yearly Export Outstanding Statements (XOS) to the department, providing details of all export bills outstanding beyond the period prescribed for realization. Thereafter, the RBI discontinued tracking the realization export proceeds valued below $25000 and the department attempted to track these cases using its in-house Bank Realisation Certificate[11] (BRC) application. This application was not successful and the DG (Systems) directed (August 2005) to keep the application in abeyance. It was observed in Commissionerates at Mumbai, Chennai, Kolkata and Hyderabad that no action had been taken upto 2008 to

[11] is issued by the exporter's Bank to certify that exports proceeds are realized against a particular shipping

monitor realization of consignments valued upto $25000. Meanwhile, the DG (Systems) developed a BRC module in ICES and in February 2009, the Department issued fresh instructions for monitoring realization of export proceeds by insisting on half yearly export outstanding statements/ bank realisation certificates from the exporters along with similar statements for the past period. The statements/ certificates so received were to be reconciled with lists of pending realizations generated from the ICES system with the help of the BRC module.

During the course of the review we noticed that the instruction issued by the Board in February 2009 for monitoring realization of export proceeds through the BRC module had not been followed by the field formations uniformly. While monitoring work had been initiated and SCNs were being issued to the defaulting exporters in six commissionerates/ICDs[12], monitoring of realization through the BRC module had not been introduced in six Commissionerates, viz. Kolkata (Port), Kolkata (Airport), Hyderabad – II, Ahmedabad, Kandla and Cochin commissionerates.

In Bengaluru Commissionerate, where the monitoring had been initiated, we found that 150 letters issued to exporters, asking for submission of BRCs for exports involving drawback payment of ₹ 27.23 crore between 2004 and 2007, returned undelivered. In NCH, Delhi we were informed that the BRC module was unable to track outstanding realisations due to technical problems.

Recommendation No. 5

- *The Department must insist on timely submission of BRCs by all exporters and these needs to be entered into the system promptly to enable tracking of defaults. The special cell envisaged for monitoring needs to be set up with earnest. Periodic sample verifications on declarations given by exporters need to be carried out.*
- *The Board should ensure the implementation of the BRC module at all locations.*

The Ministry while accepting the recommendation stated (June 2011) that various instructions/circulars have been issued from time to time. The field formations are repeatedly sensitized on this issue. The Chairman, CBEC has also written (February 2011) to all field formations in this regard.

2.3.5 Declaration of value

Board Circular No.7/2003 dated 5th February 2003 stipulates that exporter has to declare Present Market Value (PMV) of the goods in every case in the shipping bills. Market verification is to be initiated in cases where specific information is available that the FOB value declared is inflated or there is prima facie evidence to suggest such over-valuation and/or where the goods are sub-standard and it appears that the acceptance of the declared FOB value would result in accrual of substantial unintended drawback benefits.

[12] Ahmedabad, Kandla, Chennai (Sea), JNCH, Mumbai, Bengaluru, ICDs at Tughlakabad, Patparganj at Delhi and ICD Rajsico, Rajasthan.

In Hyderabad-II and Visakhapatnam Customs Commissionerates, it was observed that during the period from April 2006 to September 2009, there were 984 claims where shipping bills showed PMVs that were lower than the FOB. In 221 out of these 984 cases we noted that the difference between the declared price (FOB) and the PMV was material. More than 50 per cent of the 221 SBs, the FOB declared is about 10 times the PMV of the items. Although such differences fulfilled the criteria of prima facie evidence for triggering PMV enquiry, market verification was not done in any of the 221 cases.

Recommendation No. 6

- *PMV enquiries may be done on selected sample of cases in the spirit of the circular dated February 2003.*

The Ministry stated (June 2011) that field formations are being sensitized about the need to check over valuation.

However, action was also required to be taken for the cases in which we had pointed out tenfold discrepancies.

2.3.6 Fixation of All Industry Rate (AIR) of drawback

The AIR is fixed under rule 3 of Drawback Rules by the GoI for different commodities after an assessment of average incidence of Customs and Central Excise duties suffered on inputs utilized in the manufacture of export products. For fixation, average quantity and value of each class of inputs used in manufacture of any product class along with average amount of duties paid is considered. The rates are fixed for broad categories of products. The rate for any particular product group is fixed on the basis of weighted averages of consumption of imported / indigenous inputs of a representative cross section of exporters and average incidence of duties. Normally, the rates are revised every year from 1st June, i.e. after considering changes in duty rates made in the budget presented. The AIR (All Industry Rate) is usually fixed as a percentage of FOB price of export products. However, in respect of many items specific rates are also notified to provide a ceiling on drawback.

Till 2004-05 the AIR schedule was being prepared by the Directorate of Drawback, Ministry of Finance, using data on average industry incidence of duties collected from trade councils and industry associations. In 2005-06, an independent high powered Drawback committee was set up to review and formulate the AIR Drawback Schedule in the light of changes made in the budget. This Committee is being set up every year since then. The Committee comprises of a Chairman who is a member of the Economic Advisory Council to Prime Minister and two other members. The Joint Secretary (Drawback) serves as the Secretary to the Committee.

The committee decides the modalities of holding deliberations and meetings with the stake holders and conducts field visits to study specific production processes as it may consider necessary for the formulation of AIR. It also interacts with the administrative Ministries, Export Promotion Councils, Commodity Boards, Trade Bodies and other stake holders to elicit their views on the existing Duty Drawback Scheme and the schedule (All Industry Rates).

We found that the working of the Committee to arrive at declared rates was not fully documented. The Directorate of Drawback could not produce year-wise data regarding cost sheets of various commodities, Import-Indigenous ratios of various inputs used in manufacture, details on manufacturing processes of various products, etc that would have been the basis for fixation of AIR. We found that the Committee had not submitted any calculation sheets/worksheets along with their reports to support the fixation of AIR rates. In the absence of working papers, we were not in a position to assess or verify the procedures adopted for determination of All Industry Rates of drawback. Moreover, we could not correlate the trend of rate revisions in the AIR drawback schedules vis-à-vis changes in import/ excise duty rates.

The Ministry in its reply (January 2011) stated that the methodology used by the Committee had been explained in detail in its first report (2005-06). It further stated that the audit observation relating to absence of working sheets was noted and the Drawback Committee for 2011-12 would be informed about the matter when constituted.

While we agree that the methodology was explained in detail, in the absence of any working sheets, we could not derive assurance that the methodology prescribed was actually followed in fixing the AIR.

Recommendation No. 7

- *The process of rate fixation by the Committee should be fully documented so that independent assurance can be derived on the methodology of rate fixation.*

The Ministry while accepting the recommendation stated (June 2011) that from 2010-11, fixation of AIR for major commodities is being documented.

2.3.7 Fixation of Brand Rate

2.3.7.1 Delay in fixation

As per the provisions of Rule 7 (1) of the Drawback Rules 1995, whenever an exporter finds that the amount or rate of drawback declared under the AIR schedule is less than four–fifth of taxes or duties paid on inputs, he may apply to the jurisdictional Commissioner of Central Excise for fixation of Brand rate within 60 days from the first Let Export Order date which can be extended for further period of 30 days by the Commissioner. Board Circular No.14/2003 dated 6 March 2003 prescribed that the jurisdictional Deputy Commissioner of Central Excise is required to carry out verification within a maximum period of 15 days from the date of receipt of a Brand Rate application in the Headquarters of the Central Excise Commissionerate and thereafter the brand rate is to be fixed within 10 days of receipt of verification report.

We found significant delays in Brand rate fixation across Commissionerates as detailed below:

- In Delhi, we found 17,692 claims pending settlement for more than three months as on January 2010 due to delay in fixation of brand rates.

- In Central Excise Commissionerate, Mangalore we noticed delays in 26 out of the 27 cases of Brand rate fixation during the review period. The average time taken in verification by the Divisional Office was more than three months against the norm of 15 days. After receipt of the verification report, the Commissionerate took more than 8 months, on average, to fix the brand rate against the norm of 10 days. The entire process of fixation took almost a year.
- Similarly, in Commissionerate Excise Jaipur-I –for the 35 applications examined, the average delay in verification was found to be beyond three months and delay for rate fixation after verification was close to three months. The total delay in fixation of Brand rate of drawback in each of the 35 cases examined was beyond 6 months.
- Delays upto one month were noticed 104 cases in Hyderabad IV Commisionerate as well.

Such delays went against the spirit of quick disposal of brand rate claims to facilitate exporters, which was prescribed by the circular of 2003.

2.3.7.2 Time barred applications

We found four cases in three Central Excise Commissionerates[13] where applications for fixation of Brand rate were admitted beyond the prescribed time limit of 60 days from LEO date without specific requests for condonation of delay. These cases involved drawback payment of ₹ 34.44 crore. Two illustrations are given below:

i) M/s Caterpillar India Pvt Ltd, Thiruvallur under the jurisdiction of the Commissioner of Central Excise II, Chennai, filed an application for fixation of brand rate on 11 January 2008, which was 73 days after the LEO dated 29 October 2007. There was no request for condonation of delay. We found that the Commissionerate asked the exporter to file a request for condonation along with sufficient reasons, which in turn was filed only on 11 October 2008, after a delay of 9 months. The claim was sanctioned in January 2009 for ₹ 33.79 lakh.

ii) Brand rate application for sanction of drawback amounting to ₹ 3.81 crore was filed on 7 May 2008 by M/s Indian Oil Corporation Ltd., Barauni under Central Excise Commissionerate, Patna, after a delay of 37 days after stipulated period of sixty days from the first LEO. Similarly, several brand rate applications made by the same applicant, involving drawback of ₹ 30.29 crore submitted beyond 90 days from the date of LEO were accepted and processed by the commissionerate.

2.3.7.3 Verification

As per para 3(c) of Customs Circular 14/2003, the authenticity of the data furnished by the applicant in the specified statements for fixation of Brand rate are required to be verified by the jurisdictional Central Excise authority within 15 days of filing of the application.

[13] Hyderabad-III, Chennai-II and Patna Commissionerates.

We found that there was a problem in verifying data furnished by Indian Oil authorities in their brand rate applications. Two instances are given overleaf:

i) Brand Rate of petroleum products exported by M/s Indian Oil Corporation Ltd. Barauni Refinery was fixed by Patna Central Excise Commissionerate for the period between April 2006 and June 2008. Audit scrutiny revealed that the Range Officer in charge of verification repeatedly reported that declarations relating to percentage yield of Petroleum Products (MS, HSD, SKO and LPG) and proportionate loss of crude oil in their production could not be verified, as it required technical knowledge. He recommended that the verification be done by a technical expert. Although the yield percentage and proportion of crude loss formed crucial components for calculation of brand rate, the Commissionerate never got the declarations verified by a technical expert.

ii) The Central Excise Commissionerate, Haldia issued 26 Brand rate letters for an aggregated sum of ₹ 12.93 crore between June 2006 and June 2009, in favour of Indian Oil Corporation Ltd, the exporter. We found that the exporter had claimed use of 1.04 MT and 1.08 MT of crude oil to produce 1 MT of ATF and 1 MT of SKO respectively. However, the production process indicated that a wide range of products were obtained from crude oil that together constituted the final output. It was not clear how the output of single product was worked out. This called for a detailed technical verification.

In our opinion, similar issue would arise in respect of other assesses producing petroleum products and other products having similar technical complications. We feel that some standard norms are necessary for such products to enable verification of information and ensuring uniformity.

Recommendation No. 8

- *To enable meaningful verification of information and ensure uniformity in fixation of Brand rates, the Department may consider creation of standard industry norms.*

The Ministry stated (June 2011) that the documents submitted by the assessee are duly certified by the Chartered Engineers and there are no grounds/evidence to refute this. Further, during the discussion in the exit conference held on 15 June 2011 the Ministry explained that the output norms of the petroleum products vary from refinery to refinery due to age of machinery, level of technology used in refining and quality of the crude used.

In the exit conference, we further recommended that some random check should be conducted by comparing the documents and declarations with the original production records of the refineries. The Ministry agreed to examine this suggestion.

2.3.8 Availing of cenvat credit

Drawback Schedule specifies higher All Industry Rate of drawback including central excise component if CENVAT credit is not availed by the manufacturer of export product. To avail this benefit, the exporter cannot avail Cenvat credit on inputs and input services and has to produce a non-availment certificate from the jurisdictional excise authorities.

We found 2,160 cases in nine Commissionerates namely Chennai sea, Chennai Air, Tuticorin, Kandla, Jamnagar, Ahmedabad, Bengaluru, Mangalore and Cochin where higher All Industry Rate of drawback was allowed to the exporters but the "CENVAT not availed" certificates were not available with the drawback claims files. Drawback of ₹ 5.70 crore was sanctioned in these cases.

A case is illustrated below:

M/s. Palvi Powertech Sales Pvt. Ltd was sanctioned All Industry Rate (AIR) of drawback of ₹ 59.33 lakh against export of 81 consignments of Caustic Soda Flakes cleared through Mundra, Pipavav and ICD Dasarath Customs Houses during January 2007 to September 2009. We found that the manufacturer of the export goods had availed cenvat credit on raw materials and on input services used in the manufacture. However, the exporter claimed higher rate of drawback by producing a certificate dated 21 February 2007 from central excise authorities stating that the manufacturer had reversed the cenvat credit availed on the input/packing material used in the manufacture of the goods exported. The certificate was silent on the reversal of cenvat credit on input services. We found that the credit availed on input services (₹ 6.03 lakh) were actually reversed in November 2009/February 2010. Therefore, the exporter was not entitled to drawback at higher rate in 2007. The excess payment of ₹ 48.54 lakh which was recoverable with interest and penalty.

On this being pointed out (November 2009/May 2010), the Assistant Commissioner of Customs, ICD, Dashrath stated (May 2010) that a demand-cum-show notice had been issued to the exporter for recovery of drawback of ₹ 18.90 lakh excess paid, in respect of 36 cases. The details of the remaining cases were awaited.

Recommendation No. 9

- *We found that the circular no. 64/98 dated 1 September 1998 stipulated that the manufacturer-exporter shall produce a certificate from the jurisdictional excise authorities to the effect that no cenvat credit has been availed on any input used in the manufacture of export product. In view of the requirement outlined in the notes to the drawback schedule it is recommended that the issue may be further clarified by substituting 'inputs' with "inputs and input services".*

The Ministry accepted the recommendation (June 2011).

2.3.9 Net weight declared

As per CBEC circular No. 130/95 the Exporter has to declare the net weight of the goods exported in a Shipping Bill including the unit of measurement based on the drawback schedule. The net weight of the exported goods on which drawback is claimed cannot be more than the weight of the goods exported as per the Shipping Bill.

We found that this business rule was not mapped in terms of any validation check in the drawback module of the ICES system. Thus, the system did not restrict the net weight to that declared in the shipping bill for computing admissibility of drawback.

Scrutiny at the JNCH commissionerate, Mumbai revealed that in 2.80 lakh cases settled during April 2006 to September 2009 involving drawback payment of ₹ 755.98 crore, the net weight furnished in the shipping bill was less than the net weight adopted for calculating drawback. At Tamil Nadu, the absence of this validation restriction resulted in excess grant of drawback of ₹ 2.63 crore on 644 items exported during the same period.

Recommendation No. 10

- *The requisite validation may be provided in the ICES.*

The Ministry stated (June 2011) that recommendation would be examined in consultation with DG, Systems.

2.3.10 Mismatch in related declarations

As per drawback rules, the Exporter has to furnish details of exports in the shipping bill such as Revised Indian Trade Classification (RITC) code published by Ministry of Commerce and Industries, quantity, unit of measurement and unit price including Currency Code in the declaration on *Item Details.* Similarly, in the *Drawback Details,* information like Drawback Serial Number, Drawback quantity and unit of measurement are to be furnished. The RITC code as provided in the item details should match the drawback serial number provided in the drawback details.

It was noticed in Mumbai that the system was accepting different and mismatched data furnished by exporters in the declarations mentioned above. In respect of 1,93,152 items in two commissionerates, although the quantity declared in item details and drawback details was same, the units of measurement were different. In respect of 31,060 items, the unit of measurement was same while the quantities declared did not match. Similarly, in respect of 62,811 cases in eight commissionerates, we found that drawback was allowed although the drawback serial number and the RITC code did not match. A break of the three types of mismatch identified by us is given below:

Table 2: Mismatched declarations accepted by the system

Commissionerate	Quantity same but unit of measurement differs	Unit of measurement same but quantity differs	Difference in Drawback serial number and RITC code
ACC	51656	3784	33
JNCH	141496	27276	366
Bengaluru and Mangalore	-	-	26379
Ahmedabad	-	-	1530
Kandla	-	-	5418
Visakhapatnam	-	-	99
Cochin	-	-	28986
Total	**193152**	**31060**	**62811**

This indicated that the system did not have adequate validation checks to ensure uniformity in related declarations. Absence of such checks may have led to sanction of ineligible/excess drawback to exporters.

A case is illustrated below:

As per the Drawback schedule 2006-07, 'castor oil and its fractions – edible grade' was mentioned under Sl.No. - 15153010. We found that at Kandla Customs House, 66 consignments of castor oil (edible grade) were categorized under RITC 15153010 in "item details" cleared for export between June 2006 and June 2007. However, while sanctioning drawback, the department admitted the claim under DBK serial No. 1515000099 as 'others' (as observed from "drawback details") instead of Sl.No.15153010. This resulted in sanction of excess drawback of ₹ 1.09 crore.

The Dy.Commissioner of Customs (Export) replied (December 2009) that Castor Oil being a non-edible item, no testing was conducted and the drawback sanctioned under drawback Sl. No. 151500099 was in order. The contention was not acceptable because the goods had been classified as edible grade at the time of export. Moreover, in respect of two other consignments of the same exporter, the department had sanctioned drawback under serial no.15153010.

Recommendation No. 11

- *Adequate provisions may be made in the ICES to ensure that the data entered for drawback claims is consistent with the 'shipping bills' data already available in the system.*

The Ministry stated (June 2011) that recommendation would be examined in consultation with DG, Systems.

2.3.11 Procedural issues

2.3.11.1 Restoration of scrolls

In the ICES, the Asst. Commissioner is authorized to generate a scroll enumerating all the claims sanctioned on a particular day/week. The same is sent to the Bank for direct credit to exporter's account. The Asstt. Commissioner can also restore a previous scroll for rectification of mistakes made while sanctioning the drawback amount.

We observed that the Asstt. Commissioner (DBK), Custom House Kandla restored scroll No.825/2009 on 1 April 2009. Consequently, all the drawback shipping bills in the restored scroll became ready for reprocessing. Thereafter, scroll No.845/2009 dated 8.4.2009 was re-generated and sent to the Bank. This led to double payment of drawback of ₹ 1.88 crore in 109 cases (April 2009). This was later detected and recovered in a phased manner with interest. However, this issue was not brought to the notice of DG (Systems) for rectificatory action.

On this being pointed out (February 2010), the Dy.Commissioner of Customs (Export) stated (March 2010) that the matter had now been brought to the notice of Dy.Commissioner of Customs (System). Action taken to plug the control weakness was awaited.

Recommendation No. 12

- *It is recommended that a control mechanism may be devised to rule out the risk of bulk reprocessing of shipping bills as in the instant case.*

The Ministry stated (June 2011) that recommendation would be examined in consultation with DG, Systems.

2.3.11.2 Audit Trail

We found that the drawback calculated by the system in 1482 shipping bills was more by ₹ 11.50 crore against the drawback finally sanctioned by the department in ACC and JNCH commissionerates at Mumbai. The reasons for the variation were not ascertainable from the information stored on the ICES. On further enquiry, we found that the EDI system offers a menu option for the Assessing Officer to change the drawback classification, item value and drawback rate. It allows the AO to enter proportionate rate of drawback calculated manually when the item value is changed or there is an increase / decrease in quantity.

However, there was no audit trail to track these changes and the justification/reasons for making changes. Since both items were directly related to the quantum of drawback, the information was required to be captured in the system.

We also observed that the rate of drawback for the Brand rate items was not stored in the system. Total amount of drawback sanctioned on brand rate was ₹ 455.03 crore in ACC and JNCH commissionerates.

Recommendation No. 13

- *It is recommended that provision may be made to capture brand rates and record justifications for changes made by assessing officers.*

The Ministry stated (June 2011) that recommendation would be examined in consultation with DG, Systems.

2.3.12 Monitoring of declarations

Conditions 8(e) and (f) of Notification No.103/2008-cus dated 29th August 2008 stipulated that AIR of duty drawback, including the customs component, could not be availed when the inputs used in the manufacturing of exported goods were procured either duty free under Rule 19(2) of Central Excise Rules 2002 or when rebate of duty paid on them had been taken under Rule 18 of Central Excise Rules 2002. To keep a check on the possibility of dual claim, the department had devised a mechanism in the form of declarations (ARE-1 and 2) where the manufacturer would declare the details of goods to be exported and non claiming of rebate etc under Excise rules. These declarations would thereafter be certified by both Central Excise and Customs authorities.

We found 335 cases in Customs Commissionerate, Visakhapatnam, where drawback of ₹ 6.59 crore in respect of exports of 4.89 lakh tones of soya meals falling under drawback serial No.23 was sanctioned at AIR rate. The claims of the manufacturing exporters were cleared without insisting on ARE-2 declarations on non-availment of rebate as required under the rules ibid. This resulted in irregular sanction of drawback of ₹ 6.59 crore and the risk of dual benefit was not addressed.

The department while accepting the audit observation stated (August 2010) that the matter was under investigation of the Special Intelligence and Investigation Branch (SIIB).

2.3.13 Sanction of drawback on products not specified in Brand Rate Letters

As per Duty drawback Rules, 1995, where brand rate of drawback has been determined in respect of a particular category of export goods, the drawback has to be paid as per the specifications mentioned and the terms and conditions stipulated in the brand rate letters issued by the competent authority.

In the Commissionerate of Customs (Preventive) West Bengal, drawback was sanctioned on the basis of brand rate letters issued by Commissioner of Central Excise, Chandigarh and Faridabad for export of 'agricultural tractors' of specified models. Audit scrutiny of the export documents (shipping bills, invoice, packing lists etc) revealed that the exported agricultural tractors were different from the models that were mentioned in the brand rate letters. This resulted in irregular payment of drawback amounting ₹ 45.07 lakh which was

recoverable with interest. Action taken on the departmental personnel responsible for the mistake had not been communicated.

2.3.14 Excess sanction of Drawback due to misclassification

We found 373 cases in 12 Commissionerates[14] involving excess payments of Drawback of ₹ 1.74 crore due to misclassification. An illustration is given below:

M/s Paras Arts and Crafts and 91 other exporter under ACC, New Delhi, ICD, Tughlakhabad and Patpargunj exported brass jewellery/brass cufflinks under drawback serial No. 741902/03 of the drawback schedule as other articles of brass/artware, handicrafts of brass between November 2006 and October 2009. The goods were correctly classifiable under drawback serial No. 7117909001 as brass jewellery. The misclassification resulted in excess payment of drawback of ₹ 8.91 lakh.

The ACC, New Delhi accepted the objection and reported (July 2010) that SCN are being issued to the exporters and ICD, Tughlakhabad and Patpargunj reported (July 2010) that action has been initiated in these cases.

[14] Situated in AP, Delhi, Rajasthan and Kolkata

CHAPTER 2.4
DEEMED EXPORTS

2.4.1 Drawback Claims for Deemed Export

Drawback Claims for Deemed Export are sanctioned by the Joint Director General of Foreign Trade. As per the Foreign Trade Policy (FTP) there are several categories of transactions which are eligible for deemed export. These include supplies of goods to EOU/STP/EHTP/BTPs, power projects, refineries etc. Audit findings related to payment of deemed export drawbacks are presented below:

2.4.2 Delays in claim processing:

According to Para 8.5.1 of FTP, where duty drawback (DBK)/refund of terminal excise duty (TED) is not paid within 30 days from the date of approval of the case by the Regional Licensing Authority, simple interest at 6 per cent per annum is payable to the claimant.

Scrutiny of records of the Zonal JDGFT, Kolkata, AP, Gujarat, Delhi, UP and Punjab revealed that in 1211 cases, the Regional Authority had issued cheques in settlement of the claims for refund of TED/DBK beyond 30 days from the date of approval of such claims and accrued a interest liability of ₹ 15.46 crore.

The DGFT in their reply stated (June 2011) that interest was paid as per the provisions of FTP and in all these cases the payment of interest has to be made due to non-availability of funds.

This indicated that this problem of non-availability had to be sorted out between the DGFT and RLAs, to avoid delays and payment of interest.

2.4.3 Time- barred claim

As per provisions of para 8.3.1 of Handbook of procedures Vol.I of FTP 2004-09 valid during December 2005 to July 2008, deemed export drawback claim was admissible, with extension, up to 2 years of the date of receipt of supplies by the project authority or the date of receipt of payment as per option of the applicant. In an amendment made in July 2008, this period was extended to 3 years subject to a cut of 10 per cent.

M/s GVK made supplies to the 220 Megawatt Combined Cycle Power Project at Jegurupadu during December 2004 to February 2005. The payments were made by the project authority for these supplies between October 2005 and December 2005. M/s GVK submitted a drawback claim of ₹ 16.28 crore on 26 February 2009. DGFT imposed a late cut of 10 per cent and allowed the claim.

Duty drawback of ₹ 14.66 crore and interest of ₹ 32.04 lakh were paid in August 2009 due to delay in disbursement.

Audit scrutiny revealed that the party submitted the complete claim three years and two months after the date of receipt of the payment. Therefore, it was time barred. The department stated (January 2010) that the party had submitted the claims on 26 December 2008 i.e. within three years, which was admissible following the July 2008 amendment ibid. The claim had been returned due to deficiencies and resubmitted in February 2009.The reply was not tenable. The last payment for the supplies was made in December 2005 and two years thereafter i.e in December 2007, the claim had become time barred. The July 2008 amendment came later and was not applicable in December 2007. Therefore, the claim was time barred both in December 2008 as well as February 2009 (Resubmission).

The DGFT in their reply stated (June 2011) that they are issuing necessary instructions to RLA concerned for recovery of amount.

2.4.4 Excess payments

In terms of Para 8.2 of the FTP, supplies of goods to EOU/STP/EHTP/BTP, power project and refineries etc. are treated as deemed exports and shall be eligible for 'deemed exports drawback'.

In two cases at Delhi, we found excess payments vis-à-vis actual duties paid/ claim sanctioned as illustrated below:

i) M/s Reliance Energy submitted a consolidated claim of ₹ 96.72 crore to JDGFT, New Delhi for drawback on deemed exports in September 2007. We found that the claim was sanctioned and paid in five parts which totalled to ₹ 97.09 crore. Thus, the department made an excess payment of ₹ 0.37 crore. On being pointed out in January 2010, the department recovered the amount paid in excess with interest of ₹ 2.58 lakh.

ii) M/s Dinesh Chandra R. Aggarwal Infracom Pvt. Ltd., Nagarjuna Construction Co. Ltd and Dodla Engineering supplied five consignments of High Speed Diesel (HSD) to different projects during October 2006 and March 2008. We found that these firms were sanctioned refund of TED on HSD supplies at different rates for the same period. The facts were communicated to the department in January 2010. In response to audit observation, the department stated (August 2010) that M/s Dinesh Chandra and M/s Nagarjuna Construction Co. Ltd, had been issued SCNs. It also stated that in respect of M/s Dodla Engineering, refund of drawback on HSD was given correctly. The reply of the department was contradictory as the drawback to M/s Dodla Engineering was paid at the same rate as M/s Nagarjuna Construction Co. Ltd. during the same financial year. Since the department had issued SCN to M/s Nagarjuna, it was not explained how the similar payment to M/s Dodla Engineering was correct.

The DGFT in their reply clarified (June 2011) that SCNs were issued to M/s Dinesh Chandra R. Aggarwal Infracom Pvt. Ltd. and M/s Nagarjuna Construction Co. Ltd., as these firms had not replied to RLA's letter. However, M/s Dodla Engineering Ltd. had replied to RLA's letter and thus they were not issued SCN. It was further stated that all cases of HSD are under review as per decision in the meeting of Policy Interpretation Committee of DGFT held in March 2011.

New Delhi
Dated :8 August, 2011

(SUBIR MALLICK)
Principal Director (Indirect Taxes)

Countersigned

New Delhi
Dated :9 August, 2011

(VINOD RAI)
Comptroller and Auditor General of India

Glossary

Glossary of terms and abbreviations

Abbreviated form	Expanded form
ATM	Automated teller machine
BFN	Banking and other financial services
BSNL	Bharat Sanchar Nigam Limited
CBEC	Central Board of Excise and Customs
CBLO	Collateralized Borrowing and Lending Obligations
CBS	Core Banking System
CCIL	Clearing Corporation of India Limited
CDSL	Central Depository Services (India) Limited
Cenvat	Central value added tax
CMPFO	Coal Mines Provident Fund Organisation
CMS	Cash management service
DGST	Director General of Service Tax
FCI	Food Corporation of India
FIRC	Foreign inward remittance certificate
HUF	Hindu undivided family
IDFC	Infrastructure Development Finance Corporation
IOB	Indian Overseas Bank
ISD	Input service distributor
KSFE	Kerala State Financial Enterprises
Ltd.	Limited
LTU	Large taxpayer units
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non banking financial companies
NSDL	National Security Depository Limited
P & L	Profit and Loss
PDC	Post dated cheque
Pvt.	Private
RBI	Reserve Bank of India
SBI	State Bank of India
SCN	Show cause-cum-demand notice/show cause notice
ST	Service tax
TRU	Tax research unit
UBS	United Bank of Switzerland
USD	United States Dollar