Report of the Comptroller and Auditor General of India

for the year ended March 2014

Central Excise Administration in Automotive Sector

Union Government
Department of Revenue
Indirect Taxes - Central Excise
Report No. 33 of 2014

Laid on the table of Lok Sabha/Rajya Sabha ____________

Table of Contents

	Contents	Page
	Preface	***(i)***
Executive summary		***(iii)***
Chapter 1 : Introduction		**1-3**
1.1	Automotive Industry in India	1
1.2	Auto component Industry in India	1
1.3	Why we chose this topic	2
1.4	Tariff Structure	2
1.5	Audit objectives	2
1.6	Scope and Coverage	3
1.7	Acknowledgement	3
Chapter 2 : Adequacy of existing systems and procedures		**4-19**
2.1	Trends in revenue collection	4
2.2	Scrutiny of returns and assessments	4
2.3	Internal Audit	12
2.4	Anti-evasion measures	15
2.5	Collective sharing of intelligence reports	16
2.6	Outstanding demands	16
2.7	Absence of provision in the rules	17
2.8	Splitting up of rebate claims to avoid pre-audit	19
Chapter 3 : Valuation of excisable goods		**20-27**
3.1	Central Excise liability in respect of clearance of goods to inter-connected undertakings	20
3.2	Non-payment of duty on price settlement	25
3.3	Non-inclusion of additional consideration	25
3.4	Goods cleared to sister concerns	26
3.5	Undervaluation of DEMO cars	27
Chapter 4 : Cenvat credit		**28-36**
4.1	Irregular availing of Cenvat credit	28
4.2	Non-reversal of Cenvat Credit	28
4.3	Availing of Cenvat credit on ineligible capital goods	29
4.4	Short payment of Cenvat credit on clearance of used machinery	29
4.5	Irregular availing of Cenvat credit	31
4.6	Excess availing of input service credit	32

	Contents	Page
4.7	Availing of Cenvat credit relating to commission paid to sales agents	33
4.8	Incorrect availing of Cenvat credit on exempted services	34
4.9	Irregular utilisation of Cenvat credit	35
Chapter 5 : Other topics of interest		**37-42**
5.1	Service Tax related compliance issues	37
5.2	Delay in issue of show cause notice resulting in loss of revenue	40
5.3	Incorrect utilisation of Cenvat Credit on basic Excise duty towards payment of Cess	41
5.4	Other cases	42
Abbreviations		**43**

Preface

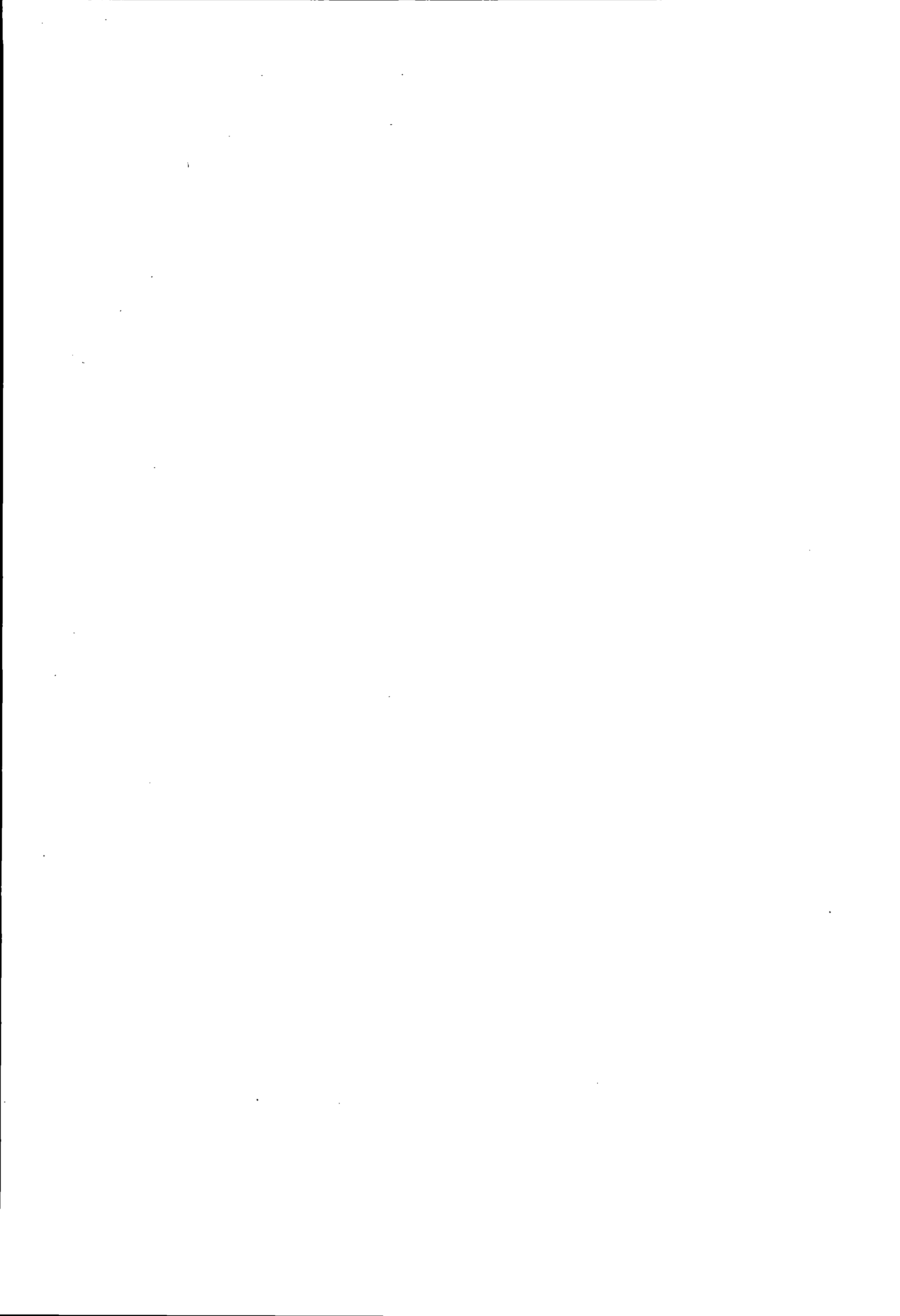
This Report for the year ended March 2014 has been prepared for submission to the President of India under Article 151 of the Constitution of India.

The Report contains significant results of the performance audit on Central Excise Administration in the automotive sector and covers the period 2010-11 to 2012-13. Matters relating to subsequent or earlier periods have also been included, wherever necessary.

The instances mentioned in this Report are those which came to notice in the course of test audit conducted during the period 2013-14.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Audit wishes to acknowledge the cooperation received from the Department of Revenue, Central Board of Excise and Customs and its field formations at each stage of the audit process.



Executive summary

We conducted a performance audit in 40 selected Commissionerates, including examination of records relating to 239 assessees manufacturing automobiles or parts thereof, to seek assurance that the indirect tax administration is adequately placed to safeguard the interests of revenue through its compliance verification mechanisms, annual analyses of tax payers and defaulters, monitoring of exemptions etc. While doing so, we also looked into the adequacy of the Rules and extant instructions in ensuring proper assessment and collection of revenues.

The performance audit revealed certain inadequacies in the extant provisions, system as well as compliance issues relating to the assessment and collection of duty from the Automotive Sector.

- Thirty-nine out of the selected 40 Commissionerates intimated that they had not undertaken any analysis of revenue collections from the sector.

  (Paragraph 2.1)

- Non-submission/delayed submission of returns prescribed under Central Excise Rules and Cenvat Credit Rules by the assessee of automotive sector.

  (Paragraph 2.2)

- We observed that master files had not been created for 1,116 assessees.

  (Paragraph 2.3.1)

- We observed delays ranging between one year and five years in adjudication of demands involving revenue of ₹ 587.56 crore.

  (Paragraph 2.6)

- Absence of provision in Cenvat Credit Rules, to reverse the proportionate Cenvat credit relating to input services at the time of clearance of input/capital goods 'as such'. We came across 44 cases involving revenue implication of ₹ 87.37 crore.

  (Paragraph 2.7)

- During the course of this audit examination, we observed 25 cases of incorrect valuation of excisable goods involving duty impact of ₹ 547.93 crore.

  (Paragraphs 3.1 to 3.5)

- During the course of this audit examination, we found 144 cases of incorrect availing of Cenvat credit with duty impact of ₹ 6.74 crore.

(Paragraphs 4.1 to 4.9)

Recommendations

- The Ministry should include a provision in the Central Excise Rules, 2002 requiring assessees to pay late fees (unless waived on showing sufficient reasons) in case of non-compliance with provisions requiring filing of periodical returns by a specified date.
- The Ministry should include a provision in the Central Excise Rules, enabling filing of revised Central Excise returns within a prescribed period.
- The Ministry may insert a provision in Cenvat Credit Rules, 2004 to reverse the proportionate Cenvat credit relating to input services at the time of clearance of input/capital goods 'as such'.
- The Ministry may consider inserting a provision in the Central Excise Rules for pre-audit of all such claims submitted on the same date (or within a prescribed period) where the total value of rebate claims exceeds ₹ 5 lakh.
- The Ministry should review rule 10 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 as it imposes an additional requirement of "holding and subsidiary relationship" not envisaged by the Act.
- Clear provisions need to be introduced indicating what would constitute "mutuality of interest in each other's business" for the purposes of clause (iv) of Section 4 (3)(b) of the Act just as the expressions "inter-connected undertakings", "group", "related persons", "under the same management" have been explained in the law.

Chapter 1: Introduction

1.1 Automotive Industry in India

The automotive industry is globally one of the largest industrial sectors and a key sector of any economy. Owing to its deep forward and backward linkages, it has a strong multiplier effect and acts as one of the important drivers of economic growth. With the gradual liberalisation of the sector in India since 1991, the number of manufacturing facilities has grown progressively into one of the most vibrant industrial sectors. It produces a wide variety of vehicles: passenger cars, light, medium and heavy commercial vehicles, multi-utility vehicles such as jeeps, two-wheelers such as scooters, motorcycles and mopeds, three-wheelers, tractors and other agricultural equipment. The contribution of this sector to the National Gross Domestic Product (GDP) rose from 2.77 per cent in 1992-93 to close to 6 per cent in mid-2012[1].

As of August 2012, there were 19 manufacturers of passenger cars and multi-utility vehicles, 14 manufacturers of commercial vehicles, 16 manufacturers of two and three wheelers and 12 manufacturers of tractors besides 5 manufacturers of engines in India. This includes most major global Original Equipment Manufacturers (OEMs) besides Indian companies. The auto industry's contribution to manufacturing GDP is approximately 25 per cent while its share to the Central Excise revenue is around 18 per cent.[2]

1.2 Auto component Industry in India

The Indian auto components industry is one of the fastest growing industries in the country. Revenue have risen from US$ 26.5 billion (₹ 1,59,159 crore) in FY08 to US$ 40.6 billion (₹ 2,43,844 crore) in FY13 - a Compound Annual Growth Rate (CAGR) of 8.9 per cent.[3] The industry has a distinct global competitive advantage in terms of cost and quality and this has aided in its transformation from a local supplier to a global auto parts supplier. The cost advantage stems from the cost-competitiveness in raw material and labour, while its established manufacturing base is a compelling attraction for global OEMs to outsource components from India.

---

1 National Electric Mobility Mission Plan, 2020, Department of Heavy Industry, Ministry of Heavy Industries and Public Enterprises, Government of India

2 Pre Union Budget 2014-15 Society of Indian Automobile Manufacturers (SIAM)'s Memorandum of Suggestions on Policy Issues: SIAM and the Automotive Component Manufacturers Association of India (ACMA) are two apex bodies appointed by the Government of India to work for the development of the automobile industry in India.

3 www.ibef.org

Investments in this sector were estimated to have been around ₹ 10,000 crore during FY11. Major foreign companies have been investing in the domestic industry through joint ventures and partnerships or by setting up their own production plants. Domestic component players are also investing heavily in the industry to reap benefits of long-term growth prospects.

1.3 Why we chose this topic

Automobile majors alongwith the auto component suppliers to the OEM manufacturers contribute to nearly 70-80 per cent of the industry's turnover. Most of the OEM manufacturers fall under Chapter 87 of Central Excise Tariff, Act, 1985. Keeping in view the significant contribution of this sector and its continuing growth, it was felt that coverage of departmental initiatives, exemptions as well as examination of records of selected assessees in this sector would enable a holistic analysis of the indirect tax administration of this important industrial segment.

1.4 Tariff Structure

With effect from 28 February 1985[4], vehicles other than railway or tramway rolling stock, parts and accessories thereof are classifiable under Chapter 87. The major products covered under Chapter 87 are tractors, motor vehicles for transport of persons and goods, motor cycles, cycles, chassis fitted with engines, bodies and other parts and accessories of these vehicles. Most of the goods manufactured under this Chapter attract 12 per cent rate of Central Excise duty and in some other cases, the rate of duty ranges from 14 per cent to 27 per cent. From 9 July 2004, education cess at the rate of two per cent of the duty and from 1 March 2007 secondary and higher education cess at the rate of one per cent of the duty is also leviable. As per Section 136 of Finance Act, 2001 a surcharge by way of duty of excise of one per cent (called the National Calamity Contingent Duty) is also leviable. An automobile cess of 1/8 per cent *ad valorem* is also leviable on automobiles (except those exported or manufactured in Government ordnance factories for use by armed forces).

1.5 Audit objectives

We conducted the performance audit to seek assurance that indirect tax administration is adequately placed to safeguard the interests of revenue relating to the automobile and auto component manufacturers through: -

a) annual analysis of tax payers and defaulters,

[4] Introduction of Central Excise Tariff Act, 1985.

b) identification of specific risks relating to the sector,

c) compliance verification mechanisms such as detailed scrutiny of returns, internal audits and anti-evasion,

d) collective sharing of intelligence reports,

e) careful monitoring of exemptions,

f) efforts to ensure adjudications without delay, and

g) widening of tax base by cross verification of services availed.

Besides, we also looked into the adequacy of rules, circulars, notifications, other extant instructions etc. in this connection.

1.6 Scope and Coverage

We carried out examination of records at selected Commissionerates (including subordinate offices) as well as at premises of automobile manufacturers besides manufacturers/ suppliers of auto components. 30 per cent of the total number of Commissionerates, Divisions and Ranges were covered during the performance study. Two hundred and thirty-nine[5] assessees who were manufacturing automobiles, automobile components and those supplying to the OEMs were selected, restricting the coverage to those who are the manufacturers/dealers of Engine Parts and Drive Transmission and Steering Parts.

The period covered in this study was 2010-11 to 2012-13. However, depending on the issues involved, we examined records of preceding years also, wherever it was felt necessary.

1.7 Acknowledgement

We acknowledge the co-operation extended by Central Board of Excise and Customs (CBEC) and its subordinate formations, in providing the necessary records for the conduct of this audit.

We discussed the audit objectives and scope of the performance audit in an entry conference with CBEC officers on 12 December 2013. We conducted the Exit Conference with CBEC on 21 October 2014.

[5] A category units (paying duty more than ₹ 100 crore annually) – 36, B category units (paying duty between ₹ 100 crore and ₹ 50 crore annually) – 26, C category units (paying duty between ₹ 50 crore and ₹ 10 crore annually) – 80 and D category units (paying duty between ₹ 10 crore and ₹ 1 crore annually) – 97.

Chapter 2 : Adequacy of existing systems and procedures

2.1 Trends in revenue collection

An effective tax administration would include systems in place to analyse trends in revenue collection including through Cenvat utilisation, particularly in major sectors. We requested the Commissionerates (November 2013) to provide us the details of any such analysis done in respect of automobiles and automotive parts manufacturing sector. Thirty-nine out of the selected 40 Commissionerates[6] intimated that they had not undertaken any analysis of the sector. Gurgaon Commissionerate informed that regular sectoral analysis of automobile industry and automotive components is being conducted.

Table No.1

Revenue collection in respect of Automotive sector

(Amount in crore of rupees)

Year	No. of units	Duty paid through PLA	Duty paid through Cenvat	Total duty paid	Percentage of Cenvat to PLA
2010-11	2,610	4,280.85	15,414.94	19,695.79	360.09
2011-12	3,018	5,184.13	20,228.60	25,412.73	390.20
2012-13	3,247	6,942.44	24,451.77	31,394.21	352.21

Source: Figures furnished by 34 Commissionerates.

Data collected from 34 Commissionerates[7] showed a decline in revenue in eight Commissionerates[8] during 2011-12 in comparison to 2010-11 and in ten Commissionerates[9] during 2012-13 in comparison to 2011-12 from this sector. Six Commissionerates[10] are yet to furnish information.

2.2 Scrutiny of returns and assessments

As per rule 12(1) of Central Excise Rules, 2002, a monthly return (Form ER- 1) is to be submitted by every assessee indicating, *inter alia*, details of production and removal of goods. This return is subjected to scrutiny by the department. The purpose of preliminary scrutiny of returns is to ensure arithmetic accuracy of duty computation, completeness (permanent account

---

6 Ahmedabad-II, Aurangabad, Bengaluru-LTU, Bengaluru-I, Bhopal, Bhubaneswar-I, Bhubaneswar-II, Calicut, Chennai-LTU, Chennai-II, Chennai-III, Chennai-IV, Daman, Delhi-LTU, Delhi-I, Delhi-II, Ghaziabad, Gurgaon, Haldia, Hyderabad-I, Hyderabad-IV, Indore, Jaipur-I, Jamshedpur, Kochi, Kolkata-II, Kolkata-IV, Kolkata-VI, Ludhiana, Meerut-I, Mumbai-LTU, Nagpur, Nasik, Noida, Pune-I, Raipur, Rajkot, Thiruvananthapuram, Vadodara-II and Visakhapatnam-II

7 Ahmedabad-II, Aurangabad, Bengaluru-LTU, Bengaluru-I, Bhopal, Bhubaneswar-I, Bhubaneswar-II, Calicut, Chennai-LTU, Chennai-II, Chennai-III, Chennai-IV, Daman, Delhi-LTU, Delhi-I, Delhi-II, Gurgaon, Haldia, Hyderabad-I, Hyderabad-IV, Indore, Jaipur-I, Jamshedpur, Kochi, Kolkata-II, Kolkata-IV, Kolkata-VI, Ludhiana, Pune-I, Raipur, Rajkot, Thiruvananthapuram, Vadodara-II and Visakhapatnam-II

8 Bhubaneswar-II, Delhi-II, Delhi-LTU, Gurgaon, Jaipur-I, Kolkata-IV, Kolkata-VI and Thiruvananthapuram

9 Ahmedabad-II, Bhubaneswar-I, Bhubaneswar-II, Calicut, Delhi-LTU, Hyderabad-I, Jamshedpur, Kochi, Kolkata-II and Vadodara-II

10 Ghaziabad, Meerut-I, Mumbai-LTU, Nagpur, Nasik and Noida

number (PAN), description of the item, registration details of the unit etc.), timeliness (timely submission of return and timely payment of duty) and to identify non-filers and stop filers. Based on identified risks, selected returns may be scrutinised in detail to ensure the correctness of assessment (correctness of classification, valuation and Cenvat credit) made. As per rule 12(2)(a) of Central Excise Rules, 2002, an Annual Financial Information Statement (Form ER-4) is to be submitted by assessees paying duty of ₹ one crore or more per annum either through Personal Ledger Account (PLA)/Cenvat or both together. As per rule 9A (1) of Cenvat Credit Rules, 2004, information relating to principal inputs (Form ER-5) is to be submitted annually by assessees paying duty of ₹ one crore or more per annum either through PLA/Cenvat or both together. As per rule 9A(3) of Cenvat Credit Rules, 2004, a monthly return of receipt and consumption of each of the principal inputs (Form ER-6) is to be submitted by assessees paying duty of ₹ one crore or more per annum either through PLA/Cenvat or both together. As per rule 12(2A)(a), all assessees, except manufacturers of *biris* and matches without aid of power and reinforced cement concrete, are required to submit an annual return (Form ER-7) regarding Annual Installed Capacity.

Non-submission of return prescribed under Central Excise Rules on or before due date is a violation of Central Excise Rules. Hence, penalty may be imposed under rule 27 of Central Excise Rules, 2002.

Audit requested selected Ranges under the identified Commissionerates to furnish the data on ER-1, ER-4, ER-5, ER-6 and ER-7 returns filed with them during the last three years, in order to seek an assurance that the scrutiny exercise of returns and assessments is properly managed . In response, Audit received data from Ranges under 39 Commissionerates (other than from Nagpur). An analysis of the data received is shown below:-

2.2.1 *ER-1 returns (Monthly return for production and removal of goods and other relevant particulars and Cenvat credit)*

Table No.2

Status of submission of ER-1 returns

(Amount in lakh of rupees)

Year	Returns due	Returns received	Returns not received	Returns received by due date	Returns received after due date	Amount of penalty	
						Levied	Recovered
2010-11	24,320	24,201	119	23,780	421	0.38	0.32
2011-12	28,423	28,338	85	27,901	437	1.35	1.00
2012-13	31,634	31,558	76	30,904	654	1.16	0.91

Source: Figures furnished by Commissionerates

We observed as follows;

- 280 ER-1 returns were not received in Gurgaon and Nasik Commissionerates, during the years 2010-11 to 2012-13.

  The Ministry intimated in respect of Gurgaon Commissionerate (October 2014) that remedial action is being taken.

- In Jaipur-I and Bengaluru-I Commissionerates, 65 and 70 ER-1 returns respectively were received after due date during the years 2010-11 to 2012-13. However, no penalty was levied in any of these cases.

  In respect of Jaipur-I Commissionerate, the Ministry intimated (October 2014) that in 48 cases, penalties have been deposited by the assessees. In the remaining cases, show cause notices have been issued.

  In respect of Bengaluru-I Commissionerate, the Ministry stated (October 2014) that late filing was not intentional or deliberate but due to lack of providing standard units of measurement in Automation of Central Excise and Service Tax (ACES).

- During the years 2010-11 and 2012-13, 96 per cent of the returns received were subject to preliminary scrutiny and 3 per cent returns were subject to detailed scrutiny.

- Only 7 Commissionerates[11] (out of the selected 40) conducted detailed scrutiny of returns during 2010-11 to 2012-13.

We also noted the following discrepancies on examining a sample of returns in the selected ranges;

(i) M/s Caparo Maruti Ltd. in Delhi-LTU Commissionerate is engaged in the manufacture of motor vehicle parts. We observed that there were differences between the closing balance and opening balance of the quantity of finished goods in ER-1 returns of June-July 2012 and December 2012- January 2013. Further, there was a difference of ₹ 0.09 lakh in respect of opening and closing balance of Cenvat credit during the months of February and March 2012.

We pointed this out in December 2013.

The Ministry intimated (October 2014) that the assessee had deposited the duty liability of ₹ 0.21 lakh and reversed the Cenvat credit of ₹ 0.09 lakh alongwith interest of ₹0.05 lakh and ₹0.04 lakh respectively.

[11] Ahmedabad-II, Bengaluru-I, Chennai-II, Chennai-III, Chennai-IV, Indore and Pune-I

(ii) During the course of scrutiny of ER 1 of M/s Denso Haryana Pvt. Ltd., Gurgaon, we noticed that the assessee paid interest on Central Excise duty paid owing to issue of supplementary invoices in March and June 2013 at the rate of 13 per cent instead of 18 per cent.

We pointed this out in December 2013.

The Ministry intimated (October 2014) that the assessee had deposited ₹0.10 lakh.

(iii) On scrutiny of ER-1 returns and challan files of M/s Kerala Automobiles Ltd., in Thiruvananthapuram Commissionerate, we observed that the assessee had not fulfilled duty liability amounting to ₹ 9.07 lakh during 2012-13.

We pointed this out in January 2014.

The Ministry admitted the audit observation (October 2014).

2.2.2 ER-4 returns (Annual financial information statement)

Table No.3

Status of submission of ER-4 returns

(Amount in lakh of rupees)

Year	Returns due	Returns received	Returns not received	Returns received by due date	Returns received after due date	Amount of penalty	
						Levied	Recovered
2010-11	737	649	88	615	34	0.23	0.23
2011-12	903	789	114	759	30	0.30	0.30
2012-13	1,049	877	172	832	45	0.05	0.05

Source: Figures furnished by Commissionerates

We observed as follows;

- In Ludhiana and Jamshedpur Commissionerates, 32 and 11 ER-4 returns respectively were received after the prescribed due date during the period 2010-11 to 2012-13. However, no penalty was levied by the department.

  The Ministry intimated (October 2014) in respect of Ludhiana Commissionerate that the divisional-in-charge had been directed to take necessary action.

- In Ludhiana Commissionerate, 26 ER-4 returns were not received. However, the department did not impose any penalty in these cases.

- In Aurangabad Commissionerate, 132 ER-4 returns were not received. However, the department imposed a meagre penalty of ₹ 0.01 lakh.

Aurangabad Commissionerate stated (August 2014) that rule 27 of Central Excise Rules, 2002 do not provide for levy of mandatory penalty for late filing or non-filing of ER-4 returns.

We note that the only provision covering imposition of penalty in such cases of delayed submission is a provision for general penalty imposable under rule 27 of the Central Excise Rules. Besides, there is no provision in the Central Excise Rules corresponding to rule 7C of the Service Tax Rules requiring payment of late fees unless waived.

Recommendation No. 1

The Ministry should include a provision in the Central Excise Rules requiring assessees to pay late fees (unless waived on showing sufficient reasons) in case of non-compliance with provisions requiring filing of periodical returns by a specified date.

We also noted the following discrepancies on examining a sample of returns in the selected ranges;

M/s Sharda Motor Industries Ltd., in Delhi-LTU Commissionerate is engaged in the manufacture of motor vehicle parts. We observed that there were differences between the closing balance and opening balance of quantity of principal inputs and finished goods in ER-4 returns of 2010-11 to 2012-13. Further, Cenvat credit figures in ER-1 and ER-4 returns for the same period also did not tally.

We pointed this out in December 2013.

Similarly, scrutiny of ER-4 returns of M/s Rasandik Engineering Industries India Ltd., in Delhi-LTU Commissionerate, revealed that the closing balance of all items of raw material consumed in the manufactured goods (i.e. C.R. Sheet, C.R. coils, etc.) as shown in ER-4 return of 2011-12 did not match with the opening balances of ER-4 return of 2012-13.

We pointed this out in February 2014.

In case of M/s Minda Industries Ltd., in Pune-I Commissionerate, while scrutinising records of ER-4 returns for 2011-12 and 2012-13, we observed that there was difference in opening and closing stock of finished goods, which resulted in improper filing of ER-4 returns.

We pointed this out in January 2014.

The Ministry stated (October 2014) that these assessees had filed the revised returns based on the audit observations.

However, it is noted that unlike the provision in rule 7B of the Service Tax Rules for filing of revised Service Tax returns, there is no provision for filing any revised returns under rule 12 of the Central Excise Rules, 2002.

Recommendation No. 2

The Ministry should include a provision in the Central Excise Rules, 2002 enabling filing of revised Central Excise returns within a prescribed period.

During the Exit Conference on 21 October 2014, Member (Central Excise), CBEC indicated that with GST due to be introduced soon, CBEC is not encouraging many changes at this point of time. Unlike Service Tax, such provisions may also not be necessary in Central Excise given the nature of assessees and the well-established systems already in place.

2.2.3 ER-5 returns (Cenvat - Annual return of information relating to principal inputs)

Table No.4

Status of submission of ER-5 returns

(Amount in lakh of rupees)

Year	Returns due	Returns received	Returns not received	Returns received by due date	Returns received after due date	Amount of penalty	
						Levied	Recovered
2010-11	697	545	152	516	29	0.05	0.05
2011-12	861	723	138	679	44	0.13	0.13
2012-13	988	772	216	734	38	0.11	0.11

Source: Figures furnished by Commissionerates

We observed as follows;

- In Gurgaon, Ludhiana and Nasik Commissionerates, 63, 34 and 63 ER-5 returns respectively were not received. However, the department did not impose any penalty on the assessees.

  The Ministry intimated (October 2014) in respect of Gurgaon and Ludhiana Commissionerates that remedial action is being taken.

- In Ludhiana Commissionerate, 41 ER-5 returns were received after the due date. However, the department does not impose any penalty in these cases.

- In Aurangabad Commissionerate, 146 ER-5 returns were not received. However, the department imposed a meagre penalty of ₹ 0.02 lakh.

Aurangabad Commissionerate stated (August 2014) that the Rules do not provide for levy of mandatory penalty for late filing or non-filing of ER-5 returns.

We note that the only provision covering imposition of penalty in such cases of delayed submission is a provision for general penalty imposable under rule 15A of the Cenvat Credit Rules. Besides, there is no provision in the Cenvat Credit Rules corresponding to rule 7C of the Service Tax Rules requiring payment of late fees unless waived.

We await the Ministry's reply (October 2014).

We reiterate the recommendation in Para 2.2.2 that the Ministry should include a provision in the relevant Rules requiring assessees to pay late fees (unless waived on showing sufficient reasons) in case of non-compliance with provisions requiring filing of periodical returns by a specified date.

2.2.4 ER-6 returns (Cenvat–Monthly return of information relating to principal inputs)

Table No.5

Status of submission of ER-6 returns

(Amount in lakh of rupees)

Year	Returns due	Returns received	Returns not received	Returns received by due date	Returns received after due date	Amount of penalty	
						Levied	Recovered
2010-11	8,217	7,215	1,002	7,015	200	0.12	0.12
2011-12	10,186	9,036	1,150	8,803	233	0.06	0.06
2012-13	11,768	10,265	1,503	9,967	298	0.26	0.26

Source: Figures furnished by Commissionerates

We observed as follows;

- In Gurgaon, Ludhiana and Nasik Commissionerates, 1,135 ER-6 returns were not received. However, the department did not impose any penalty on these cases.

  The Ministry intimated (October 2014) that in respect of Gurgaon and Ludhiana Commissionerates the department is taking remedial action.

- In Bengaluru-I Commissionerate, 330 ER-6 returns were not received. However, department did not impose any penalty on these cases.

  The Ministry intimated (October 2014) that the department is taking remedial action.

- In Pune-I Commissionerate, 271 ER-6 returns were received after due date. However, the department imposed a meagre penalty of ₹ 0.21 lakh.

  Ministry intimated (October 2014) that on reconciliation with Division's actual figure, the late filers are 322 and penalty of ₹ 0.24 lakh have been recovered in 30 cases. In the remaining cases the remedial action has been taken.

- In Jaipur-I Commissionerate, 117 ER-6 returns were received after the due date. However, the department did not impose any penalty.

- In Aurangabad Commissionerate, 1,357 ER-6 returns were not received. However, the department imposed a meagre penalty of ₹ 0.01 lakh.

  Aurangabad Commissionerate stated (August 2014) that the Rules do not provide for levy of mandatory penalty for late filing or non-filing of ER-5 returns.

We note that the only provisions which may cover imposition of penalty in such cases of delayed submission are provisions for general penalty imposable under rule 27 of the Central Excise Rules/rule 15A of the Cenvat Credit Rules. Besides, there is no provision in the Central Excise Rules/Cenvat Credit Rules corresponding to rule 7C of the Service Tax Rules requiring payment of late fees unless waived.

We await the Ministry's response (October 2014).

As indicated earlier, Audit opinion is that the Ministry should include a provision in the Central Excise Rules requiring assessees to pay late fees (unless waived on showing sufficient reasons) in case of non-compliance with provisions requiring filing of periodical returns by a specified date.

2.2.5 ER-7 returns (Annual Installed Capacity Statement)

Table No.6

Status of submission of ER-7 returns

(Amount in lakh of Rupees)

Year	Returns due	Returns received	Returns not received	Returns received by due date	Returns received after due date	Amount of penalty	
						Levied	Recovered
2010-11	1,925	1,181	744	1,124	57	0.15	0.15
2011-12	2,299	1,411	888	1,358	53	0.13	0.13
2012-13	2,576	1,607	969	1,548	59	0.07	0.07

Source: Figures furnished by Commissionerates

We observed as follows;

- In Gurgaon, Ludhiana and Nasik Commissionerates, a total of 302 ER-7 returns were not received. However, the department did not impose any penalty on these cases.

  The Ministry intimated (October 2014) in its response relating to Gurgaon Commissionerate that filing of ER-7 return is mandatory. In respect of Ludhiana Commissionerate, the Ministry stated that the department is taking remedial action.

- In Pune-I and Aurangabad Commissionerates, a total of 1,992 ER-7 returns were not received. However, the department imposed a meagre penalty of ₹ 0.08 lakh.

  Pune-I Commissionerate while admitting the observation stated (June 2014) that penalty of ₹ 0.24 lakh has been recovered in two cases.

  Aurangabad Commissionerate stated (August 2014) that rule 27 of Central Excise Rules, 2002 does not provide for levy of mandatory penalty for late filing or non-filing of ER-7 returns.

We note that the only provision covering imposition of penalty in such cases of delayed submission is a provision for general penalty imposable under rule 27 of the Central Excise Rules. Besides, there is no provision in the Central Excise Rules corresponding to rule 7C of the Service Tax Rules requiring payment of late fees unless waived.

We await the Ministry's response (October 2014).

As indicated in earlier paragraphs, the Ministry should include a provision in the Central Excise Rules requiring assessees to pay late fees (unless waived on showing sufficient reasons) in case of non-compliance with provisions requiring filing of periodical returns by a specified date.

2.3 Internal Audit

As per paragraph 9 of the Central Excise Audit Manual, 2008, the assessee master file is to be prepared and updated by audit cell in each Commissionerate. A list of documents as indicated in Annexure A therein and details of assessee as per Annexure B is to be kept in each assessee master file. Paragraph 10.1.2 of the Manual, further prescribes as follows;

(i) all units paying annual revenue over ₹ 3 crore are to be audited ever year;

(ii) units paying duty between ₹ 1 crore and ₹ 3 crore are to be audited once in two years;

(iii) units paying duty between ₹ 1 crore and ₹ 50 lakh are to be audited once in five years; and

(iv) 10 per cent of the units with revenue less than ₹ 50 lakh are to be audited every year.

2.3.1 Creation of master files

The status of creation of master files received from 30 Commissionerates is depicted below. Ten Commissionerates[12] have not furnished this information.

Table No.7

Status of creation of master files

Year	No. of units for whom the master files created	No. of units for whom the master files not created
2010-11	1,606	800
2011-12	1,908	1,018
2012-13	2,072	1,116

Source: Figures furnished by Commissionerates

We observed that Ludhiana, Chennai-III and Jamshedpur Commissionerates did not create assessee master files for 241, 372 and 269 assessees respectively.We pointed this out between December 2013 and January 2014. The department stated (March 2014) the following as reasons for non-maintenance of assessee master files (i) files not maintained in respect of non-mandatory units, (ii) data not provided by assessees, (iii) there was no static audit cell, (iv) lack of manpower etc.

The Ministry intimated (October 2014) that in respect of Chennai-III Commissionerate, master files have been created in respect of units falling under mandatory category and master files in respect of all other units would be created soon.

2.3.2 Coverage of units for internal audit

The status of coverage of units for internal audit received from 29 Commissionerates is depicted in the table furnished below. Eleven Commissionerates[13] are yet to furnish this information.

[12] Ahmedabad-II, Bengaluru-I, Bengaluru-LTU, Ghaziabad, Meerut-I, Mumbai-LTU, Nagpur, Nasik, Noida and Vadodara-II

[13] Ahmedabad-II, Bengaluru-LTU, Chennai-II, Chennai-LTU, Ghaziabad, Meerut-I, Mumbai-LTU, Nagpur, Nasik, Noida and Vadodara-II

Table No.8

Coverage of units by internal audit

Year	Units paying duty above ₹ 3 crore (PLA+ Cenvat)		Units paying duty between ₹ 1 crore and ₹ 3 crore (PLA+ Cenvat)		Units paying duty between ₹ 50 lakh and ₹ 1 crore (PLA+ Cenvat)		Units paying duty less than ₹ 50 lakh (PLA+ Cenvat)	
	No. of units due for audit	No. of units covered	No. of units due for audit	No. of units covered	No. of units due for audit	No. of units covered	No. of units due for audit	No. of units covered
2010-11	416	401	147	149	101	109	216	239
2011-12	559	537	219	206	121	116	202	175
2012-13	762	709	199	171	121	109	212	163

Source: Figures furnished by Commissionerates; categories are based on annual duty payments.

We observed as follows in respect of functioning of Internal audit wing of the Commissionerates:

(i) As per paragraph 12.3.1 of Central Excise Audit Manual, 2008 and paragraph 9.5.1 of Service Tax Audit Manual, 2011, a register of units planned for audit in the prescribed format is to be maintained in order to monitor the different stages of execution of audit, ensure that all units allotted to an Audit Group have been audited and that audit reports have been issued on time.

Bengaluru-LTU Commissionerate maintained the Audit Plan register but had no entries in it for the period January 2010 to March 2012. Further, for the period upto December 2009, the register did not contain entries relating to date of submission of Internal Audit Report (IAR) to audit cell, Audit Report Number, date of issue of IAR, actual dates of audit, date of issue of IAR. Consequently, it was not possible to monitor, from these registers, whether the mandatory units had been audited as per the guidelines (every unit to be audited once in two years for LTU) and audit reports issued on time. Further, the register was not updated and entries had been made only for the first quarter of 2013-14.

We pointed this out in July 2014.

The Ministry stated (October 2014) that the Audit Plan Register was maintained in computer and the hard copy of the same has been pasted in the prescribed register subsequently.

(ii) Further, we observed that Audit module of ACES was not being used for audit planning and execution by Commissionerates.

We pointed this out in July 2014.

The Ministry stated (October 2014) that though the audit module under ACES has been functioning, there are many lacunae which make the module

practically unworkable. Further, the hard copies of the documents received from the assessees are voluminous documents which require additional staff for digitisation.

(iii) EA2000 audit of M/s Mahindra Ugine Steel Company Ltd. of Nasik Commissionerate was conducted in September-October 2011 covering the period October 2010 to September 2011. It was observed that an audit observation was raised in the Audit Report regarding inadmissible Cenvat credit of ₹ 3.60 lakh on capital goods. The amount was paid by the assessee in September 2011 after the paragraph was raised. Accordingly, the audit paragraph was settled by the internal audit section. However, we observed that the audit paragraph was settled without recovery of interest, though interest had been recovered from the same assessee in respect of other observations on availing of inadmissible Cenvat on input services and raw material.

We pointed this out in February 2014.

The Ministry intimated (October 2014) that show cause notice is being issued.

2.4 Anti-evasion measures

Preventive and intelligence work in the Commissionerates is entrusted to officers called 'Preventive Intelligence Officers'. Generally, three to four Superintendents and 20 to 25 Inspectors are posted under one Assistant/Deputy Commissioner who supervises and monitors the day-to-day work and activities of these officers both for preventive and intelligence duties. The work of preventive officers includes collection of intelligence, transit checks, organising searches in the factory, office as well as residence, investigations and other works.

Audit sought to examine efficacy of anti-evasion measures undertaken by the selected Commissionerates particularly with reference to the automotive sector. In response to our query, Rajkot, Vadodara-II and Bengaluru-I Commissionerates intimated (January-February 2014) that three, five and four cases respectively were registered during the period 2010-13 by anti-evasion wing and show cause notices were also issued. Gurgaon Commissionerate intimated (June 2014) that on the basis of reference received from Faridabad Commissionerate, necessary investigation was conducted and Government dues of ₹ 1.09 crore recovered. The other Commissionerates reported nil cases registered during the period 2010-11 to 2012-13.

We await the Ministry's response (October 2014).

2.5 Collective sharing of intelligence reports

An important function of the Preventive Wing in Commissionerates is co-ordination of preventive intelligence activities of the officers throughout the Commissionerate, maintenance of proper liaison with other Commissionerates of Central Excise as well as Customs, the Directorate General of Revenue Intelligence and allied departments of the Government as well as building up of centralised records on anti-evasion activities at the Commissionerate Headquarters.

In order to examine the effectiveness of performance of the Preventive Wings, over the last three years, we sought certain details including aspects such as relating to information collection from own department and other departments, sharing of information etc. In response to our query, Rajkot, Ahmedabad-II and Gurgaon Commissionerates intimated (between January and July 2014) that they liaison with the Customs department, Director General Revenue Intelligence (DGRI) etc. However, the remaining Commissionerates intimated that no such exercise was undertaken by them.

We await the Ministry's response (October 2014).

2.6 Outstanding demands

Short payment or non-payment of duty on any excisable goods is to be recovered by issuing show cause notice under Section 11 A to be followed up with its adjudication and recovery proceeding. The period of limitation for issue of show cause notice is one year in normal cases and five years in case of short levy/non-levy due to fraud, collusion etc. The Central Excise officer is required to adjudicate the demand notice within six months in the former case and within one year in the latter case, where it is possible to do so, after the issue of show cause notice.

We tabulated data on outstanding demands furnished by 17 Commissionerates[14] as on 31 March 2014 is as follows;

[14] Bengaluru-I, Bhopal, Bhubaneswar-I, Chennai-IV, Delhi-LTU, Delhi-I, Hyderabad-I, Hyderabad-IV, Indore, Jaipur-I, Jamshedpur, Mumbai-LTU, Noida, Pune-I, Rajkot, Vadodara-II and Visakhapatnam-II

Table No.9

Status of outstanding demands

(Amount in crore of Rupees)

Sl. No.	Delay in adjudication	No. of cases	Amount
1.	More than 5 years	40	177.74
2.	Between 3 and 5 years	42	9.77
3.	Between 1 and 3 years	105	141.17
4.	Less than 1 year	54	258.88

Source: Figures furnished by 17 Commissionerates

Audit observed that,

- In 40 cases, revenue of ₹ 177.74 crore is pending adjudication for more than five years.
- In Indore Commissionerate, 82 cases involving ₹ 199.78 crore were pending adjudication.
- In Delhi-LTU Commissionerate, 30 cases involving ₹ 179.49 crore were pending adjudication.

The above observations indicate that notwithstanding the prescribed timelines, several instances of long delays in adjudication continue in most Commissionerates.

2.7 Absence of provision in the rules

As per rule 2(l) of the Cenvat Credit Rules, 2004, 'input service' includes services used in relation to procurement of inputs and inward transportation of inputs or capital goods and outward transportation upto the place of removal etc. Further, rule 3 (1) of the Cenvat Credit Rules, 2004, provides that the manufacturer or producer of final products or provider of taxable service shall be allowed to take credit of Service Tax on input service received by the manufacturer of final product. Although rule 3(5) provides for reversal of credit taken on inputs or capital goods removed as such, there is no corresponding provision under the Rules requiring payment of the amount equal to the credit of Service Tax paid on input services. These services could include custom house agent's services, clearing and forwarding agents' services, transportation availed for procurement/transportation of inputs or capital goods etc. Non-existence of such provision resulted in unintended benefit to the manufacturer.

During test check of records of 44 cases in 17 Commissionerates[15], we observed that assessees had cleared inputs as such and reversed the Cenvat

[15] Ahmedabad-II, Aurangabad, Chennai-ST, Daman, Ghaziabad, Gurgaon, Hyderabad-I, Jaipur-I, Meerut-I, Mumbai-LTU, Mumbai V, Nagpur, Nasik, Noida, Pune-I, Rajkot and Vadodara-II

credit availed on inputs. However, proportionate value of Service Tax credit on input services of ₹ 87.37 crore was not reversed due to absence of suitable provision in Cenvat Credit Rules, 2004. A few illustrative cases are given below:

2.7.1 M/s General Motors India Pvt. Ltd., in Vadodara-II Commissionerate, is an assessee engaged in the manufacture of motor vehicles. The assessee cleared inputs (as such) valued at ₹ 168.45 crore during the period 2010-11 to 2012-13 which constituted between 5.48 and 19.02 per cent of the total purchases of inputs. The assessee reversed the Cenvat credit of inputs availed of on these inputs. However, we observed that the assessee had not reversed the Cenvat credit on input services availed during same period due to non-existence of suitable provision for reversal of Cenvat credit of input services. This resulted in unintended benefit of ₹ 15.16 crore to the manufacturer.

We pointed this out in January 2014.

We await the Ministry's response (October 2014).

2.7.2 M/s Hero Motocorp Ltd., in Gurgaon Commissionerate, is engaged in the manufacturing of two-wheelers and parts thereof. The assessee reversed the excise duty including cess thereon of ₹ 49.45 crore on inputs cleared as such during the period 2010-11 to 2012-13. We observed that the assessee reversed the Cenvat credit equal to credit availed at the time of purchase of raw material, but the proportionate credit of Cenvat credit of input services availed at the time of purchase of raw material was not reversed. The non-existence of suitable provision in the rules for reversal of Cenvat credit of input services resulted in unintended benefit of ₹ 4.41 crore for the period from 2010-11 to 2012-13 to the manufacturer.

We pointed this out in March 2014.

The Ministry stated (October 2014) that in a few cases, clearance of inputs by this assessee to third parties, was treated as an exempted service and the assessee is reversing proportionate Cenvat credit as per rule 6(3) of Cenvat Credit Rules.

We observe that the reply of the Ministry is not specific to the lacuna pointed out in the Rules.

Recommendation No. 3

The Ministry may insert a provision in Cenvat Credit Rules, to reverse the proportionate Cenvat credit of input services at the time of clearance of input/capital goods 'as such'.

The Ministry intimated (October 2014) that the matter is under examination and decision would be intimated in due course.

During the Exit Conference on 21 October 2014, Member (Central Excise), CBEC noted that quantification of input services requiring reversal would be a tedious process and may not be significant enough to warrant such inclusion.

2.8 Splitting up of rebate claims to avoid pre-audit

CBEC Circular dated 16 May 2008 envisages that all refund/rebate claims involving an amount of ₹ 5 lakh or above should be subjected to pre-audit at the level of Jurisdictional Commissioner.

During test check of rebate claim files for the year 2012-13 of M/s Osho Gears and Pinions Ltd., and M/s Emson Gears Ltd., in Ludhiana Commissionerate, we observed that these assessees had submitted rebate claims totalling ₹ 33.95 lakh on a single day. Each individual claim was below ₹ 5 lakh. We observed that notwithstanding the fact that these claims were in respect of goods exported on the same day under the same shipping bill, these were permitted to be filed as separate claims. These claims were sanctioned by the Division concerned. We observe that the non-consideration of the total amount claimed on one day as a single claim could result in pre-audit not being conducted as per the extant provisions.

The avoidance of pre-audit not only contravenes the instructions of the Board but also increases the probability of excess grant of rebate.

We pointed this out in January and March 2014.

The Ministry stated (October 2014) that the assessees cleared their goods under various ARE-1s and various shipping bills. The goods have been exported under separate ARE-1. There is no statutory bar in filing ARE-1 wise rebate claim, irrespective of the fact that that there is only one shipping bill or more. For excise purpose, ARE-1 is the relevant statutory export document.

Recommendation No. 4

The Ministry may consider inserting a provision in the Central Excise Rules for pre-audit of all such claims submitted on the same date (or within a prescribed period) where the total value of rebate claims exceeds ₹5 lakh.

The Ministry intimated (October 2014) that the matter is under examination.

During the Exit Conference on 21 October 2014, Member (Central Excise), CBEC informed that instructions to field would be reiterated emphasizing the need to undertake pre-audit as per the Circular in all instances where risk involved was high. He stated that the automotive sector was not a sector identified as a high risk area.

Chapter 3 : Valuation of excisable goods

During the course of this audit, we observed 25 cases of incorrect valuation of excisable goods with duty impact of ₹ 547.93 crore. These had not been detected by departmental compliance verification mechanisms prior to Central Excise Receipt Audit (CERA) pointing out the same. The Ministry/department agreed with our observations/took corrective action in 10 of these cases, involving duty of ₹ 238.83 crore and recovered ₹ 68.74 lakh in nine cases. A few of these cases are elucidated in the following paragraphs.

3.1 Central Excise liability in respect of clearance of goods to inter-connected undertakings

Section 4(1) of the Central Excise Act, 1944 provides, *inter alia*, that where under the Act, the duty of excise is chargeable on any excisable goods with reference to their value, then, on each removal of the goods, such value shall, in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value. It adds that in any other case, the value shall be the value determined in such manner as may be prescribed.

Section 4(3)(b) also provides that persons shall be deemed to be "related" if -

(i) they are inter-connected undertakings;

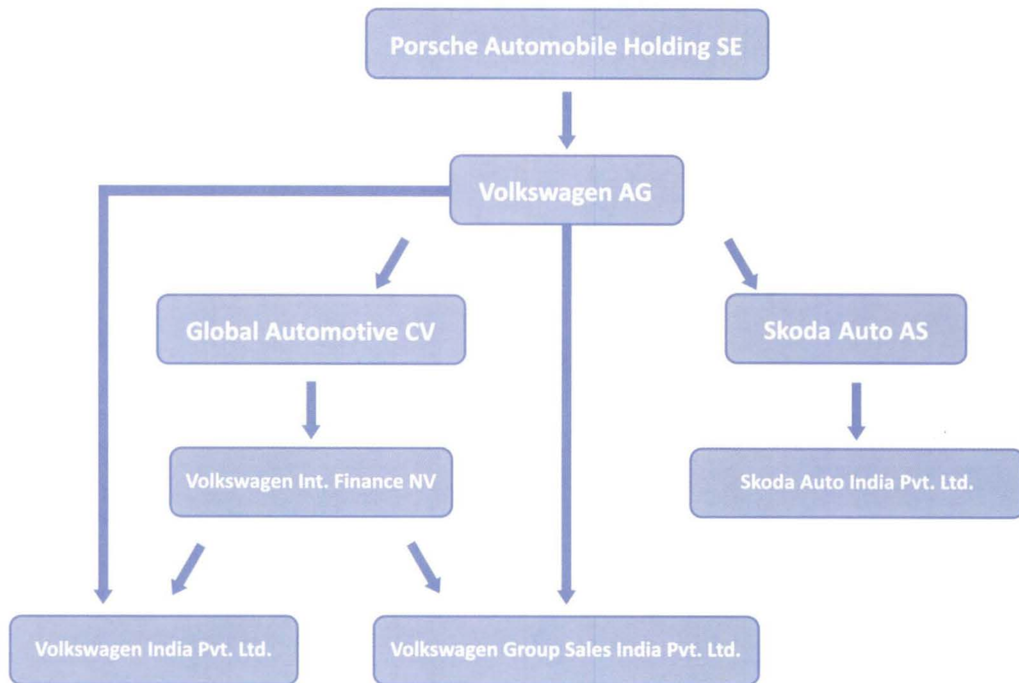
(ii) they are relatives;

(iii) amongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor; or

(iv) they are so associated that they have interest, directly or indirectly, in the business of each other.

Explanation below Section 4(3)(b) also details the circumstances in which two undertakings would be treated as 'inter-connected undertakings'.

3.1.1 Sub-clause (F) of Explanation cited above provides that if the undertakings are owned or controlled by the same person or by the same group, they would be inter-connected undertakings for the purposes of the Act. Further, vide Explanation V to Section 4, "group" includes, *inter alia*, two bodies corporate which exercise control, directly or indirectly over any body corporate.



During examination of records of Volkswagen India Pvt. Ltd. (VIPL), we observed that Volkswagen cars are manufactured in India by VIPL as well as by M/s Skoda Auto India Pvt. Ltd. (SAIPL). However, all Volkswagen cars are marketed in India through another undertaking viz. Volkswagen Group Sales India Pvt. Ltd. (VGSIPL). We also observed that both VIPL and VGSIPL are owned by two other foreign companies viz. Volkswagen AG and Volkswagen International Finance NV. M/s Volkswagen International Finance NV holds paid up shares of 23 per cent and over 99 per cent, respectively in M/s VIPL and M/s VGSIPL. The remaining shares in both companies are owned by Volkswagen AG. As M/s VIPL and M/s VGSIPL are owned and controlled by the same group, they are inter-connected undertakings vide sub-clause (F) of the cited Explanation, and hence related persons under Section 4 of the Act. Hence, the assessable value would be determined by the Rules prescribed, viz. the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

Rule 10 of the above cited Rules envisages that when an assessee so arranges that the excisable goods are sold by him only to or through an inter-connected undertaking, the value of goods shall be determined as follows : -

(a) If the undertakings are so connected that they are also related in terms of sub-clause (ii) or (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act or the buyer is a holding company or subsidiary company of the assessee, then the value shall be determined in the manner prescribed in rule 9.

(b) in any other case, the value shall be determined as if they are not related persons for the purpose of sub-section (1) of Section 4.

Further, rule 9 envisages that where excisable goods are sold by an assessee only to or through a person who is related in the manner specified in either of sub-clauses (ii), (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act, the value of the goods shall be the normal transaction value at which these are sold by the related person at the time of removal to buyers (not being related person).

In this case, we observed that the seller and buyer are inter-connected undertakings. They could also be seen to fulfil sub-clause (iv) of Section 4 (3) viz. they are so associated that they have interest, directly or indirectly, in the business of each other. Even though the two companies do not hold shares in each other, VIPL depends totally on VGSIPL for the marketing of its cars. So too, VGSIPL's marketing activities would be dependent to a significant extent, on the cars manufactured and supplied to it by VIPL (its other sources are its other Group division companies SAIPL, Audi India and Porsche India). Hence, there is a mutuality of interest and hence, the value is to be determined by applying rule 9 above.

Therefore, the value for goods realised by M/s VGSIPL on sale to its customers would be the value for the purpose of assessable value of M/s VIPL. We observed from M/s VGSIPL's balance sheets for 2011-12 and 2012-13 that disclosure of related party transactions indicated purchase of goods manufactured by M/s VIPL. Comparing the figures relating to purchase of traded motorcars by VGSIPL *vis-a-vis* the value considered for the ER-1 returns, we saw that there was a difference of ₹ 647.71 crore which would be attributable to amounts such as warranty charges, VGSIPL margin etc. Since M/s VIPL and M/s VGSIPL are related companies, the above charges are to be included in calculating the assessable value for clearances made by M/s VIPL. Non-inclusion of the same resulted in short levy of duty of ₹ 182.71 crore.

We pointed this out in January 2014.

The Ministry replied (October 2014) that though M/s VIPL and M/s VGSIPL are interconnected undertakings, clearances by M/s VIPL would not be covered under rule 10 as M/s VIPL and M/s VGSIPL do not have a holding and subsidiary relationship. Further, DGCEI, Pune Regional Unit is already undertaking investigations in respect of the undervaluation of transaction value of vehicles manufactured by M/s VIPL in relation to sales to M/s VGSIPL, hence CERA observations are being included in the scope of DGCEI's investigations.

Audit opinion is that the undertakings are not only inter-connected but also satisfy the requirement of 'mutuality of interest in each other's business' under sub-clause (iv) of Section 4(3)(b).

It is also to pointed out that that neither the Act nor the Rules provide clarity on when undertakings would be termed as being so associated that they have interest, directly or indirectly, in the business of each other.

We also observe that by including an additional requirement of "holding and subsidiary relationship" between the two parties in addition to their being inter-connected undertakings, rule 10(a) has very significantly diluted the provision of Section 4 (1) of the Act. Audit opines that the rule has gone beyond the scope envisaged in the substantive statutory provisions. What the statute intended was that in any case where the parties are deemed to be related including where the parties are "inter-connected undertakings", the value would be determined as prescribed. There was no exception made by Parliament that as regards inter-connected undertakings not fulfilling an additional criterion, such as holding-subsidiary relationship, assessable value would be the transaction value/ normal transaction value. In fact, the impact of rule 10(a) is clearly seen in the fact that it totally nullifies/makes irrelevant the existence of Section 4(3)(b)(i) and the detailed definition of inter-connected undertakings in the Explanation under Section 4(3) of the Act. Rule 10 requires that either the two parties should share holding company-subsidiary company relationship or they should meet the criterion as per one of the other three sub-clauses under Section 4(3)(b).

We emphasise that absence of clear provisions concerning what would constitute mutuality of interest for the purposes of sub-clause (iv) of Section 4(3)(b) coupled with the introduction of the additional requirement of "holding and subsidiary relationship" may in fact have resulted in providing a means for several inter-connected undertakings to pay tax on lower value than envisaged by Parliament.

It is also to be mentioned here that until July 2000 when the amended Section 4 was introduced, "related person" meant a person so associated with the assessee that they have interest, directly or indirectly, in the business of each other and includes a holding company, a subsidiary company, a relative and a distributor of the assessee, and any sub-distributor of such distributor. Thus, rule 10 in fact has had the effect of restoring/ reintroducing the previous definition of "related person".

Recommendation No. 5

(a) The Ministry should review rule 10 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, as it imposes an additional

requirement of "holding and subsidiary relationship" not envisaged by the Act.

(b) Clear provisions need to be introduced indicating what would constitute "mutuality of interest in each other's business" for the purposes of clause (iv) of Section 4 (3) (b) of the Act just as the expressions "inter-connected undertakings", "group", "related persons", "under the same management" have been explained in the law.

3.1.2 Sub-clause (G) of Explanation below Section 4 (3) (b) envisages that if one undertaking is connected with another undertaking either directly or through any number of undertakings which are inter-connected undertakings, then these two undertakings would also be inter-connected undertakings for the purposes of Section 4 (3)(b)(i) of the Act.

During examination of records of M/s SAIPL, in Aurangabad Commissionerate, we observed that the company manufactures passenger cars which were sold exclusively through M/s VGSIPL. M/s SAIPL is a subsidiary of M/s Skoda A.S., in turn a subsidiary of M/s Volkswagen AG. The ultimate holding company of M/s Volkswagen AG is M/s Porsche Automobile Holding SE, another foreign company (with over 50 per cent shares). M/s Porsche Automobile Holding SE is also the ultimate holding company for M/s Volkswagen International Finance NV. Besides, M/s Volkswagen AG holds 99.9 per cent shares in Global Automotive CV which holds 100 per cent shares of Volkswagen International Finance NV and who in turn holds over 99 per cent shares in M/s VGSIPL.

Thus, by sub-clause (G) of Explanation below Section 4 (3) (b), M/s SAIPL and M/s VGSIPL would also be inter-connected companies as the former is connected to the latter indirectly through other inter-connected undertakings.

Therefore, for the purpose of Section 4 of the Act, the value for goods realised by M/s VGSIPL shall be value of AUDI and Volkswagen cars manufactured by M/s SAIPL. We observed that M/s VGSIPL included a margin of 9.5 per cent in retail sale value of each car in respect of Audi cars and 6 per cent in respect of Volkswagen cars sold by it through its dealers. The non-inclusion of the above margin money in the assessable value resulted in short levy of duty of ₹ 121.45 crore.

We pointed this out in February 2014.

While accepting the contention that the two undertakings are inter-connected undertakings, the Ministry added (October 2014) that rule 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 is not applicable as none of the four conditions in rule 10(a) is satisfied in this case.

It is however reiterated that M/s SAIPL and M/s VGSIPL are inter-connected undertakings as explained above by sub-clause (G) of Explanation below Section 4(3)(b). Further, rule 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 would be applicable on grounds similar to those discussed in Paragraph 3.1.1.

3.2 Non-payment of duty on price settlement

Explanation to Section 4 of the Central Excise Act, 1944 envisages, *inter alia,* that the price-cum-duty of the excisable goods sold by an assessee shall include the money value of additional consideration, if any, that flows directly or indirectly from the buyer to the assessee in connection with the sale of such goods.

Test check of records of M/s Fiat India Automobiles Ltd., in Pune-III Commissionerate, revealed that the assessee had manufactured 'Manza' brand of cars for M/s Tata Motors Ltd. During the months of May and June 2012, the assessee had raised debit notes on M/s Tata Motors Ltd. towards price settlement of the above models for the years 2010-11 and 2011-12. Non-inclusion of this debit note amount of ₹ 93.54 crore towards the transaction value had resulted in short payment of duty of ₹ 21.44 crore.

We pointed this out in September 2013.

The Ministry intimated (October 2014) that DGCEI, Mumbai had undertaken investigations on broader valuation issues on the basis of incriminating documents seized in March 2013. A show cause notice was issued for ₹ 335.33 crore in June 2014 covering the period 2009-14 and the said demand of duty includes the additional consideration by way of debit notes pointed out by CERA.

3.3 Non-inclusion of additional consideration

Section 4 (1) (a) of the Central Excise Act, 1944 stipulates that when excise duty is chargeable on any excisable goods with reference to its value, then such value shall be the 'transaction value' including the additional consideration, if any, flowing directly or indirectly from the buyer to the assessee in connection with the sale of such goods. Rule 6 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, stipulates that in cases where price is not the sole consideration, the assessable value shall be based on the aggregate of the price and money value of the additional consideration flowing directly or 'indirectly' from the

buyer to the assessee. In M/s Super Synotex (India) Ltd.[16] the Honourable Supreme Court held on 28 February 2014 that unless the sales tax is actually paid to the Sales Tax Department of the State Government, no benefit towards excise duty can be given under the concept of 'transaction value'.

3.3.1 Examination of records of M/s Bajaj Auto Ltd. in Mumbai-LTU Commissionerate revealed that the assessee had received an amount of ₹ 826.82 crore and ₹ 68.95 crore during 2010-11 and 2012-13 respectively on account of deferred sales tax benefits. As per provisions mentioned above, Sales Tax amount so collected but not paid to the Government was to be taken into consideration for arriving at the assessable value. Non-inclusion of the same resulted in short levy of duty of ₹ 103.02 crore.

We pointed this out in July 2013.

The Ministry informed (October 2014) that in the light of the Supreme Court decision and based on departmental instructions dated 17 September 2014, show cause notice is under preparation for issue.

3.3.2 Similarly, M/s FIAT (I) Automobiles Pvt. Ltd., in Pune-III Commissionerate, had received ₹ 841.98 crore during 2010-11 to 2012-13 towards deferred sales tax benefits which resulted in short levy of duty of ₹ 89.72 crore.

We pointed this out in September 2013.

The Ministry intimated (October 2014) that show cause notice for ₹238.14 crore for the period from May 2009 to June 2014 was issued in June 2014.

3.4 Goods cleared to sister concerns

Section 4 of the Central Excise Act, 1944 read with rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 stipulates that where excisable goods are used for consumption by the assessee or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods. Board clarified vide its Circular dated 13 February 2003 that the cost of production of captively consumed goods will henceforth be done strictly in accordance with Cost Accounting Standard-4 (CAS-4).

3.4.1 We observed from the records of M/s Bosch Chassis Systems India Ltd., in Pune-I Commissionerate, that the assessee had cleared the goods to its sister units situated at Manesar, Sitarganj and Jalgaon during 2011-12 and 2012-13. Examination of Central Excise invoices revealed that the assessee had not paid duty as per CAS-4 valuation for the period from January 2012 to

[16] 2014 (301) ELT 273 (SC)

July 2012. This resulted in short payment of duty of ₹ 15.30 lakh (excluding interest). Differential duty would also be payable for the period from January 2013 to March 2013 for which CAS-4 valuation was yet to be finalised for this period.

We pointed this out in January 2014.

Admitting the audit observation, the Ministry stated (October 2014) that the assessee has paid duty and interest of ₹46.04 lakh during February and March 2014.

3.4.2 In 11 cases of other assessees under four Commissionerates, excisable goods were cleared to their sister units during 2010-11 to 2012-13. Examination of records revealed that CAS-4 was not prepared/ updated by the units. Hence, Audit could not quantify the short payment of duty.

We pointed this out between May 2013 and March 2014.

The department accepted the observations (May-June 2014) and intimated recovery of ₹19.83 lakh in six cases.

We await the Ministry's response (October 2014).

3.5 Undervaluation of DEMO cars

As per Board's circular dated 1 April 2003, the central excise duty payable on demo cars would be the same as that paid on similar normal cars.

M/s Hindustan Motors India Ltd (HMIL) in Chennai II Commissionerate are engaged in the manufacture of passenger cars falling under Chapter 87. During the scrutiny of invoices and list price of cars, we observed that the assessee had cleared the cars to their dealers for DEMO purposes at lesser value than the normal value. Non-adoption of normal value of cars for demo cars by HMIL resulted in undervaluation of ₹ 28.92 lakh during the year 2011-12 and consequent short payment of duty of ₹ 6.89 lakh.

We pointed this out in July 2013.

We await the Ministry's reply (October 2014).

Chapter 4 : Cenvat Credit

A manufacturer/service provider utilises capital goods such as plant and machinery, inputs such as raw material and input services such as security services, management, maintenance or repair services, etc. in the manufacture of a final product. The Central Excise Duty/Service Tax paid on any of these three items is credited into a Cenvat credit account. Accumulated credit may be used for making duty/tax on finished goods/output services subject to fulfilment of certain conditions. This ensures that the inputs are taxed only once.

During the course of this audit, we found 144 cases of incorrect availing of Cenvat credit with duty impact of ₹ 6.74 crore. The Ministry/department agreed with our observations in 72 of these cases, involving duty of ₹ 3.50 crore and recovered ₹ 3.33 crore in 70 cases. We have illustrated a few of these cases in the following paragraphs.

4.1 Irregular availing of Cenvat credit

Rule 3(1) of the Cenvat Credit Rules, 2004, specifies the duties of excise and Service Tax, which can be availed as Cenvat credit by the manufacturer or service provider. There is no provision to avail credit of basic customs duty. Further, rule 14 of Cenvat Credit Rules, 2004, provides for the recovery of interest for wrong availing and utilisation of Cenvat credit.

We observed from the input Cenvat credit registers and invoices of M/s J. P. Enterprises, a manufacturer of excisable goods under Chapter 87, in Nasik Commissionerate, that the assessee availed Cenvat credit of basic customs duty on imported inputs of ₹ 20.17 lakh for the period during 2010-11 to 2012-13 which is inadmissible. This resulted in irregular availing of Cenvat credit of ₹ 20.17 lakh.

We pointed this out in March 2014.

The Ministry stated (October 2014) that an amount of ₹20.17 lakh was paid by the assessee alongwith interest of ₹6.86 lakh and penalty of ₹4.64 lakh in March 2014.

4.2 Non-reversal of Cenvat credit

As per rule 3(5B) of the Cenvat Credit Rules, 2004, where any provision is made to write off the value of inputs or capital goods, on which Cenvat credit has been taken, the manufacturer shall pay an amount equivalent to the Cenvat credit taken in respect of said input/capital goods. If the said inputs

or capital goods are subsequently used in the manufacture of final products, the manufacturer shall be entitled to take credit of the amount paid earlier.

We observed that M/s Dymos Lear Automotive India Pvt. Ltd., (Unit II), in Chennai-IV Commissionerate, a manufacturer of automobile seats, availed Cenvat credit on input, capital goods and input services and utilised the same for payment of duty on their final product. The assessee created a provision to write off the value of obsolete inventories amounting to ₹ 1.73 crore in the accounts for the year 2012-13. The assessee deducted the said amount from the total value of inventories without reversing the Cenvat credit taken.

We pointed out the non-reversal of Cenvat credit of ₹ 21.40 lakh in December 2013.

The Ministry intimated (October 2014) the reversal of ₹23.50 lakh including interest by the assessee.

4.3 Availing of Cenvat credit on ineligible capital goods

The Board in its instructions dated 8 July 2010 clarified that Cenvat credit on capital goods is available only on items which are excisable goods covered under the definition of capital goods under the Cenvat Credit Rules, 2004 and used in the factory of the manufacturer. 'Capital goods' are defined in rule 2(a) of the Cenvat Credit Rules, 2004.

M/s Atharva Foundries Pvt. Ltd., in Kolhapur Commissionerate, engaged in manufacture of articles of Chapter 87, availed Cenvat credit of ₹ 10.94 lakh on items such as MS channel, MS Angle and HR coil during the period from 2011-12 to 2012-13 treating them as capital goods. Since these items are not covered under the definition of capital goods, the availing of Cenvat credit of ₹ 10.94 lakh was not admissible and was reversable.

We pointed this out in June 2013.

Accepting the audit observation, the Ministry intimated (October 2014) that a show cause notice for ₹10.94 lakh had been issued.

4.4 Short payment of Cenvat credit on clearance of used machinery

Rule 3(5A) of Cenvat Credit Rules, 2004 provides that if capital goods on which Cenvat credit has been taken, are removed after being used, the manufacturer or provider of output services shall pay an amount equal to the Cenvat credit taken on the said capital goods reduced by 2.5 per cent for each quarter of a year or part thereof from the date of taking Cenvat credit. However, if the amount so calculated is less than the amount equal to the

duty leviable on transaction value, the amount to be paid shall be equal to the duty leviable on transaction value.

4.4.1 During scrutiny of records of M/s Majestic Auto Ltd., in Ludhiana Commissionerate, engaged in the manufacturing of auto parts/motor vehicle parts, we observed that the assessee transferred used machinery for ₹ 12.79 crore to M/s Majestic Auto Ltd., Noida during the year 2012-13, by paying excise duty of ₹ 113.77 lakh instead of ₹ 158.03 lakh leviable on transaction value. This resulted in short payment of duty of ₹ 44.26 lakh.

We pointed this out in March 2014.

The Ministry contested the observation stating (October 2014) that had the assessee paid the higher duty, the other unit would have availed the higher credit and that the entire exercise would have been neutral. The Ministry also cited certain Tribunal decisions in support of the payment as effected by the assessee.[17]

The reply is not acceptable because as per provision of 3 (5A)(a)(ii) of Cenvat Credit Rules, 2004 if the amount calculated is less than the amount equal to duty leviable on transaction value, the amount to be paid shall be equal to the duty leviable on transaction value. It is also pointed out that CBEC has not issued any instructions based on the cited Tribunal decisions to guide assessees as well as adjudicating officers in similar situations.

4.4.2 Scrutiny of records of M/s Rico Auto Industries, in Gurgaon Commissionerate, engaged in the manufacturing of parts and accessories of the motor vehicles, revealed that a fire accident had occurred in December 2012 wherein plant and machinery worth ₹ 4.27 crore was destroyed. We observed that Cenvat credit of ₹ 44.55 lakh had been availed on the same. The assessee had received insurance claim of ₹ one crore on the destroyed plant and machinery. However, the assessee did not pay the proportionate credit of ₹ 10.80 lakh after allowing the permissible deduction at 2.5 per cent of credit availed for every quarter of use from the date of installation to the date of destruction in fire.

We pointed this out in January 2014.

The Ministry intimated (October 2014) that show cause notice for ₹10.80 lakh is under issue.

[17] Ideal Components Pvt. Ltd. Vs. CCE {2009 (244) ELT 589} and Wolfra Tech. Pvt. Ltd. Vs. CCE {2012 (284) ELT 89}

4.5 Irregular availing of Cenvat credit of Service Tax on inadmissible input services

As per rule 2 (l) of the Cenvat Credit Rules, 2004, 'input Service' includes, *inter alia*, any service, used by a manufacturer, whether directly or indirectly, in or in relation to the manufacturer of final products and clearances of final products up to the place of removal, and includes services used in relation to setting up, modernisation, renovation or repairs of factory, premises of the provider of output service or an office relating to such factory or premises, advertisement, sales promotion, market research, storage up to the place of removal, procurement of inputs, activities relating to business such as accounting auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry and security inward transportation of input or capital goods and outward transportation up to the place of removal.

4.5.1 M/s Toyoda Gosei Minda India Pvt. Ltd. and M/s Visteon Climate Systems India Ltd., in Jaipur-I Commissionerate, engaged in the manufacture of automobile parts paid Service Tax of ₹ 1.46 crore during the period from 2010-11 to 2012-13 on freight outward and availed Cenvat credit of the above amount. The outward freight charges are not eligible input service. This resulted in irregular availing of Cenvat credit of ₹ 1.46 crore.

We pointed this out in January 2014.

The Ministry intimated (October 2014) that M/s Toyoda Gosei Minda India Pvt. Ltd. deposited the entire amount. Further, show cause notice is being issued to M/s Visteon Climate Systems India Ltd.

4.5.2 During the test check of Cenvat credit records of M/s India Yamaha Motor Pvt. Ltd., in Noida Commissionerate, we observed that the assessee availed Cenvat credit of Service Tax of ₹ 18.72 lakh paid on the services of rent, repair and maintenance services for its unit at Kolkata, West Bengal during the year 2012-13. The rent, repair and maintenance services were not related to the manufacturing activity and did not relate to the assessee premises as well. This resulted in irregular availing of Cenvat credit of ₹ 18.72 lakh.

We pointed this out (January 2014), the reply of the Ministry/department is still awaited (October 2014).

4.5.3 Other cases of irregular availment of Cenvat credit

Besides the above cases, we observed that the assessee availed Cenvat credit irregularly in the following cases:

Table No.10

Illustrative cases of irregular availment of Cenvat credit

Name of assessee	Commissi-onerate	Period	Cenvat credit availed irregularly as observed by CERA	Reply of Ministry/department
M/s Sun Beam Auto Pvt. Ltd.	Jaipur-I	2011-12 to 2012-13	₹ 18.08 lakh	The Ministry intimated (October 2014) reversal of credit amounting to ₹ 17.91 lakh.
M/s Gestamp Automative India Pvt. Ltd.	Pune-I	2012-13	₹ 5.56 lakh	The Ministry intimated (October 2014) recovery of ₹ 6.16 lakh including penalty.
M/s Alicon Castalloy Pvt. Ltd.	Pune-III	2011-12 to 2012-13	₹ 8.65 lakh	The Ministry intimated (October 2014) recovery of ₹ 13.07 lakh including interest and penalty.
M/s Sharda Motors Industries Ltd.	Delhi-LTU	2010-11 to 2012-13	₹ 37.64 lakh	The Ministry intimated (October 2014) that the assessee had made a part payment of ₹ 10.00 lakh.
M/s Minda Corporation Ltd.	Noida	2010-11	₹ 17.93 lakh	The Ministry stated (October 2014) that SCN was being issued.

4.6 Excess availing of input service credit

As per rule 2(l) of the Cenvat Credit Rules, 2004, 'input service' means any service used by the manufacturer in or in relation to the manufacture of final products and clearance thereof up to the place of removal. Under reverse charge mechanism, person receiving certain services which, *inter alia,* includes sponsorship service, is liable to pay tax as per provisions contained in rule 2(1)(d) of Service Tax Rules, 1994.

4.6.1 Examination of records of M/s Force Motors Ltd. in Pune I Commissionerate revealed that the assessee had received sponsorship services from various entities for which the payments were made by the assessee. The unit located at Akurdi has discharged the Service Tax liability and availed input service credit. We observed that the assessee has more than one unit at different locations in the country, manufacturing various vehicles such as traveller, tempos, tractors etc. Since the sponsorship services were incurred for the company as a whole and were used directly or indirectly for the entire company, the availing of Cenvat credit alone by Akurdi unit was not proper. The assessee had availed the input service credit of ₹ 13.12 lakh on sponsorship service during the year 2012-13. The input service credit attributable to Akurdi unit works out to only ₹ 1.89 lakh. This resulted in excess availing of Cenvat credit of ₹ 11.23 lakh.

We pointed this out in February 2014.

Accepting the observation, the Ministry intimated (October 2014) that show cause notice had been issued for ₹12.30 lakh.

4.6.2 Notification dated 16 December 2002, exempts the taxable services provided by a consulting engineer to a client on transfer of technology from so much of the Service Tax leviable thereon under Section 66 of the Finance Act, 1994, as is equivalent to the amount of cess paid on the said transfer of technology under the Section 3 of the Research and Development Cess Act, 1986.

During test check of records of M/s Mitsubishi Electric Automotive India Pvt. Ltd. in Gurgaon Commissionerate, Audit observed that the assessee had paid Service Tax of ₹ 61.20 lakh on royalty and technical fee on a value of ₹ 5.93 crore during the period 2010-11 to 2011-12 and availed Cenvat credit of the full amount. We observed that out of ₹ 61.20 lakh, an amount of ₹ 28.40 lakh was deposited against R and D cess by the assessee. Hence, availing of full credit without deducting the R and D cess amount as per notification dated 16 December 2002 resulted in excess availing of Cenvat credit of ₹ 28.40 lakh.

We pointed this out in February 2014.

The Ministry intimated (October 2014) that a show cause notice is under process for issue.

4.7 Availing of Cenvat credit relating to commission paid to sales agents

As per rule 2(l) of the Cenvat Credit Rules, 2004, sales promotion is included in the definition of input service. The Hon'ble High Court of Gujarat held in M/s Cadila Healthcare Ltd. that Cenvat credit of Service Tax paid on the commission to the commission agents causing sale of goods, is ineligible for input service credit[18]. Commission Agent is a person who is directly concerned with the sale or purchase of goods and is not connected with the sales promotion. Hence, activity of sales commission does not fall under the category of sales promotion in "input service" definition.

We observed the following instances where Cenvat credit was availed in respect of Service Tax paid to commission agents/ on sales commission. We pointed out that this was to be reversed alongwith interest.

[18] {2013 (30) STR 3 (Gujarat)}

Table No.11

Illustrative cases relating to commission paid to sales agents

Name of assessee	Commissi-onerate	Period	Cenvat credit availed irregularly as observed by CERA	Reply of Ministry/department
M/s Maini Materials Movement Pvt. Ltd.	Bengaluru -I	2011-12 to 2012-13	₹ 5.33 lakh	Ministry intimated (October 2014) that show cause notice is under issue.
M/s Remsons Industries Ltd.	Daman	2010-11 to 2012-13	₹ 10.76 lakh	Ministry intimated (October 2014) that show cause notice is under issue.
M/s Sealtite Dichtungs Pvt. Ltd.	Bengaluru - I	2012-13	₹ 2.55 lakh	Ministry intimated (October 2014) that the assessee reversed the irregular Cenvat credit of ₹ 3.41 lakh alongwith interest under protest.
M/s Honda cars (India) Ltd.	Delhi-LTU	2010-11 to 2012-13	₹ 4.72 lakh	Department replied (May 2014) that credit of ST on sales commission is admissible in view of the definition of 'business auxiliary services' and 'commission agent' given in the Finance Act, and specific clarification given by Tax Research Unit (TRU) on the subject. **Audit remarks**: The reply is not acceptable in view of the judgement of the Gujarat High Court.

4.8 Incorrect availing of Cenvat credit on exempted services

As per rule 6 of Cenvat Credit Rules, 2004, where a manufacturer manufactures dutiable as well as exempted goods, separate accounts shall be maintained for the receipt and use of input services used for the provision of exempted services. Alternatively, the manufacturer or service provider shall pay an amount as per rule 6(3) of Cenvat Credit Rules, 2004. Rule 2(e) of Cenvat Credit Rules as amended with effect from 1 April 2011 states that 'exempted service' also includes trading. Further, as per Explanation I(c) to rule 6(3A), in case of trading, value of 'exempted service' shall be the difference between the sale price and the purchase price of the goods traded or ten per cent of the cost of goods sold, whichever is more.

4.8.1 During test check of records of M/s Savita Auto Industries in Nagpur Commissionerate, we observed that the assessee carried out, *inter alia*, trading activity. The assessee also availed Cenvat credit on common input services such as security, transportation, computer maintenance etc. used both for manufacturing of excisable goods as well as trading of goods. This amounted to ₹ 59.72 lakh during the period 2010-11 to 2012-13. The assessee had not maintained separate accounts as required under the Rules. Since trading is an exempted service, the assessee was not eligible to avail Cenvat credit of the input services used for providing the exempted services and was liable to pay duty.

We pointed this out in December 2013.

The Ministry admitted (October 2014) the observation.

We await further progress (October 2014).

4.8.2 Similarly, M/s India Yamaha Motors (P) Ltd., in Noida Commissionerate was engaged in the manufacturing of two-wheelers as well as in their trading. During 2011-12 and 2012-13, the assessee availed common input services for manufacturing and trading activities but did not maintain separate account. Since trading is an exempted service, the assessee was not eligible to avail Cenvat credit of the input services used for providing the exempted services and was liable to pay duty.

In the absence of adequate data for quantification, Audit could not quantify the non-payment of duty.

We pointed this out in December 2013. We await the Ministry's response (October 2014).

4.9 Irregular utilisation of Cenvat credit

As per rule 3(4) of the Cenvat Credit Rules, 2004, Cenvat credit shall be utilised only to the extent such credit is available on the last day of the month or quarter, as the case may be, for payment of duty or tax relating to that period. Board's circular dated 28 March 2012 clarifies that the above rule provision is applicable for the normal payment of duty after due date.

4.9.1 During test check of records of M/s M&M Machine Craft Ltd. in Gurgaon Commissionerate, we observed that the assessee paid Central Excise duty of ₹ 37.42 lakh on account of issuance of supplementary invoices for the period 2010-11 to 2012-13 by utilising Cenvat credit earned subsequent to the respective periods. The Cenvat credit available for the respective months had already been utilised at the time of payment of Central Excise duty at the

time of issuing original invoices. This resulted in irregular utilisation of Cenvat credit of ₹ 37.42 lakh.

We pointed this out in January 2014.

The Ministry intimated (October 2014) that show cause notice for ₹42.42 lakh has been issued to the assessee.

4.9.2 M/s Natesan Synchrocones Pvt. Ltd. in Chennai IV Commissionerate availed an excess Cenvat credit of ₹ 7.58 lakh due to double credit on 31 July 2012 and utilised an amount of ₹ 6.77 lakh towards payment of duty for the month of July 2012. The Internal Audit wing has pointed out this mistake and assessee has reversed an amount of ₹ 7.58 lakh in the Cenvat account on 15 March 2013 and paid ₹ 0.12 lakh towards interest.

Since the excess Cenvat credit of ₹ 6.77 lakh was already utilised by the assessee for duty payment, the amount of ₹ 6.77 lakh should be payable by cash and not to be reversed in the Cenvat account. This resulted in irregular utilisation of ₹ 6.77 lakh.

We pointed this out in December 2013.

The Ministry contested the observation stating (October 2014) that the assessee reversed the excess credit when the mistake was pointed out in internal audit and there is no default in payment of excise duty as per rule 8(3A) of Central Excise Rules, 2002.

The reply of the Ministry is not tenable since our audit observation was that had the assessee not taken credit twice, there would not have been enough credit at the end of July 2012 to adjust the duty of ₹ 6.77 lakh.

Chapter 5 : Other topics of interest

5.1 Service Tax related compliance issues

5.1.1 Import of services

Section 66A of Finance Act, 1994 (prior to 1 July 2012) and rule 2(1)(d)(G) of Service Tax Rules, 1994 envisage that where any service is provided by a person who has established a business in a country other than India/outside the taxable territory which is received by a person within India/taxable territory, the service recipient shall be liable for payment of Service Tax in relation to any taxable service provided.

(i) Test-check of records of M/s GKN Driveline (I) Ltd. in Delhi-LTU Commissionerate revealed that the assessee's balance sheets for the years 2010-11, 2011-12 and 2012-13 depicted reimbursement of expenses of ₹ 1.42 crore, ₹ 1.37 crore and ₹ 2.66 crore respectively. We observed that the reimbursement of expenses included the charges of Mr. Deog Woo Jung of M/s GKN Driveline Korea Ltd., South Korea and Mr. Raj Kalra of M/s GKN Automotive Ltd., United Kingdom who were working for assessee on contract basis under the secondment. However, the assessee had not paid the Service Tax of ₹ 61.56 lakh on the reimbursement of expenses made to foreign companies.

We pointed this out in February 2014.

We await the response of the Ministry (October 2014).

(ii) Test check of records of M/s Tata Cummins Ltd. in Jamshedpur Commissionerate revealed that the assessee had paid Service Tax under reverse charge mechanism for gross value of services amounting to ₹ 28.95 crore and ₹ 17.12 crore against the royalty paid to M/s Cummins Inc., USA for the period 2011-12 and 2012-13. However, as the assessee had depicted ₹ 30.38 crore and ₹ 17.98 crore in the trial balance during the period 2011-12 and 2012-13 against royalty, the resultant short payment of Service Tax was ₹ 25.26 lakh (worked out on the differential amount of ₹ 2.28 crore).

We pointed this out in January 2014.

We await the response of the Ministry (October 2014).

5.1.2 Service Tax on remuneration to Directors

As per notification dated 20 June 2012, as amended vide notification dated 7 August 2012, Service Tax is leviable at the applicable rates (on reverse

mechanism basis) in respect of services provided or agreed to be provided by a director of a company to the said company.

Examination of records of three assessees revealed that the assessees had made payment of remuneration to its Director(s) under the period covered in audit. However, scrutiny of Service Tax returns and related records revealed that the companies had not paid Service Tax on the remuneration paid. We have depicted the findings in the table below;

Table No.12

Illustrative cases relating to Service Tax on remuneration to Directors

Name of assessee	Commissi-onerate	Period	Remuneration paid to Directors	ST liability*	Reply of Ministry/ department
M/s Supreme Treves Pvt. Ltd.	Daman	2012-13	₹ 5.49 crore	₹ 67.81 lakh	The Ministry intimated (October 2014) that issue of show cause notice was under process.
M/s Asia Motor Works Ltd.	Rajkot	2012-13	₹ 2.51 crore	₹ 31.05 lakh	Ministry intimated (October 2014) that the matter is under examination.
M/s Shivam Motors Pvt. Ltd.	Raipur	2012-13	₹ 1.55 crore	₹ 19.20 lakh	Ministry intimated (October 2014) that SCN for ₹ 19.20 lakh has been issued to the assessee.

* excluding interest and penalty.

5.1.3 Irregular availing of abatement on goods transport agency services

Notification No. 26-ST dated 20 June 2012 specified the percentage of abatement/exemption on the value of service received for the purpose of Service Tax payable under Section 66B of the Finance Act. The abatement is subject to the condition as mentioned against such services received. In case of goods transport agency services (GTA), the abatement of 75 per cent of the value of service was subject to the condition that service provider has not availed Cenvat credit on inputs, capital goods and input services used for providing the taxable service under the provisions of the Cenvat Credit Rules, 2004.

(i) During test check of records of M/s Jamna Auto Industries Ltd. in Jamshedpur Commissionerate, we observed that the assessee had availed abatement of ₹ 3.18 crore on GTA services during the period from July 2012 to March 2013. Since the assessee has not shown any proof regarding non-availing of Cenvat credit from the service providers, the availing of abatement is not correct. This resulted in short payment of Service Tax of ₹ 39.26 lakh.

We pointed this out in March 2014.

The Ministry intimated (October 2014) that the matter is under examination at the concerned range. Some of the service providers have since submitted certificates of non-availment of credit.

(ii) M/s Denso India Ltd., in Noida Commissionerate, manufacturer of auto parts had availed abatement of ₹ 2.06 crore on GTA services during the period from July 2012 to March 2013. Since the assessee has not shown any proof regarding non-availing of Cenvat credit from the service providers, the availing of abatement is not correct. This resulted in short payment of Service Tax of ₹ 25.40 lakh.

We pointed this out in April 2014.

The Ministry stated (October 2014) that there is no requirement of furnishing any proof as per clarification dated 29 February 2008.

The reply of the Ministry is not acceptable since the above exemption notification imposes a condition as a pre-requisite for claiming the abatement viz. non-availing of Cenvat by service provider. Hence, submission of proof by service receiver is required to avail abatement with effect from 1 July 2012. Further, the Ministry has confirmed ongoing examination of certificates since received at Jamshedpur Commissionerate as pointed out in the previous case.

5.1.4 Irregular adjustment of R and D cess

Notification dated 10 September 2004 allowed the set-off of Research and Development (R and D) cess paid against the Service Tax payable under Section 66. Until Notification dated 19 September 2011 became effective, cess had to be paid before the benefit of the exemption could be taken. Notification dated 19 September 2011 stipulated that the exemption is allowable if the cess is paid within six months from the date of invoice or in case of associated enterprises, the date of credit in the books of accounts.

Test check of records of M/s Luk India Pvt. Ltd., in Chennai III Commissionerate, revealed that the assessee paid Service Tax on various services rendered by their holding company and other associated companies from outside India, as a service recipient. During the period from October 2011 to March 2013, the assessee discharged their Service Tax liability on intellectual property service taking the benefit of the exemption without complying with the provisions cited. We pointed out the resultant short payment of Service Tax of ₹ 54.17 lakh.

We pointed this out in February 2014.

The Ministry intimated (October 2014), that an amount of ₹13.60 lakh with interest of ₹4.22 lakh was so far recovered. Show cause notice is under issue for the balance amount.

5.1.5 Non-payment of Service Tax

Service Tax is leviable on Renting of Immovable Property with effect from 1 June 2007. Further, as per Explanation (v) to Section 65(105)(zzzz) of the Finance Act, 1994 inserted with effect from 1 July 2010, "immovable property" includes vacant land, given on lease or license for construction of building or temporary structure at a later stage to be used for furtherance of business or commerce. Further, department vide Para 10 of Annexure-B to JS (TRU-II) letter D.O.F.No. 334/1/2010-TRU dated 26 February 2010 had also clarified that Service Tax is payable on rent of a vacant land if there is an agreement or contract between the lessor and lessee that a construction on such land is to be undertaken for furtherance of business or commerce during the tenure of the lease. Again, as per Section 67 of the Finance Act, 1994, as amended, Service Tax is payable on gross amount charged by service provider for service provided or to be provided. Thus, Service Tax is payable as soon as advance is received.

M/s Mahabharat Motors Manufacturing Company Pvt. Ltd. (MMMCPL), in Haldia Commissionerate, was registered in Kolkata ST Commissionerate as it provided renting of immovable property services alongwith its manufacturing activities. Scrutiny of Balance Sheet and Ledgers of Premium on Licensing of Land and Agreement thereof for the period 2011-12 revealed that the assessee had received a sum of ₹ 6.00 crore as an advance from M/s BOC India Ltd., for granting license to set up a facility, *inter alia*, for production and distribution of industrial gases. We observed that the assessee did not pay Service Tax on amount so received. This resulted in non-payment of Service Tax of ₹ 61.80 lakh.

We pointed this out in March 2014.

We await the reply of the Ministry (October 2014).

5.2 Delay in issue of show cause notice resulting in loss of revenue

Section 73 of the Finance Act, 1994, envisages the issue of show cause notice on a person chargeable with Service Tax within the prescribed time specified therein. Further, vide Circular dated 10 February 1997, the Board had reiterated extant instructions to its field formations on this issue.

During scrutiny of records of M/s Munjal Showa Ltd., in Gurgaon Commissionerate, engaged in the manufacture of motor vehicle parts, we

observed that the Commissioner, Service Tax, Delhi dropped the Service Tax demand of ₹ 79.17 lakh for the period from October 2007 to September 2008 and ₹ 4.53 crore for the period from May 2008 to March 2010. The reason cited was that the cases had become time-barred as show cause notices had been issued only on 8 September 2009 and 8 October 2010 respectively. Non-issuance of show cause notices within the prescribed time resulted in loss of revenue of ₹ 5.33 crore.

We pointed this out in February 2014.

The department intimated (June 2014) that the case under reference had been adjudicated by Commissioner (ST), Delhi, hence no further comments could be offered.

We note that the department's reply is silent on the reason for the departmental lapse as to why the show cause notices had been issued belatedly.

We await the Ministry's reply (October 2014).

5.3 Incorrect utilisation of Cenvat Credit on basic excise duty towards payment of Cess

As per sub-rule 7(b) of rule 3 of the Cenvat Credit Rules 2004, Cenvat credit of basic excise duty cannot be utilised for payment of Education Cess.

5.3.1 During scrutiny of ER-1 returns of M/s H. D. Motor Company India, in Gurgaon Commissionerate, we observed that the assessee had utilised Cenvat credit of ₹ 24.50 lakh paid on basic excise duty towards payment of Education Cess and Secondary and Higher Education Cess during the year 2012-13.

We pointed this out in March 2014.

The Ministry intimated (October 2014) that show cause notice for ₹2.56 crore has been issued to the assessee based on the audit observation.

5.3.2 Similarly, on scrutiny of ER-1 returns of M/s NGK Spark Plugs (India) Pvt. Ltd., in Gurgaon Commissionerate, engaged in the manufacturing of spark plugs, we observed that the assessee had utilised Cenvat credit of ₹ 43.04 lakh during the years 2010-11 to 2012-13 incorrectly as in the previous instance.

We pointed this out in March 2014.

The Ministry intimated (October 2014) that show cause notice for ₹63.92 lakh has been issued to the assessee.

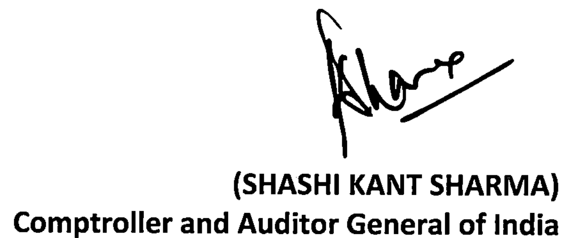
5.4 Other cases

Besides the instances discussed above, we also observed 103 other cases involving non/short payment of Central Excise duty/Service Tax/interest of ₹ 7.12 crore. The Ministry/department accepted the observations in 51 cases where revenue implication of ₹ 1.98 crore had been pointed out. The Ministry/department intimated recovery of ₹ 2.26 crore (including interest and penalty) in 49 of these cases.

New Delhi
Dated: 26 November 2014

(SANJEEV GOYAL)
Principal Director (Central Excise)

Countersigned



New Delhi
Dated: 26 November 2014

(SHASHI KANT SHARMA)
Comptroller and Auditor General of India

Abbreviations

ACES	Automation of Central Excise and Service Tax
ACMA	Automotive Component Manufacturers Association
CAGR	Compound Annual Growth Rate
CAS	Cost Accounting Standard
CBEC	Central Board of Excise and Customs
CENVAT	Central Value Added Tax
CERA	Central Excise Receipt Audit
CR coils	Cold Rolled Coils
CR sheets	Cold Rolled Sheets
DGCEI	Directorate General of Central Excise Intelligence
DGRI	Director General Revenue Intelligence
DO	Demi-official
ELT	Excise Law Times
ER	Excise Return
FY	Financial Year
GDP	Gross Domestic Product
GST	Goods and Services Tax
GTA	Goods Transport Agency
IAR	Internal Audit Report
Ltd.	Limited
LTU	Large Taxpayer Unit
NCCD	National Calamity Contingent Duty
OEM	Original Equipment Manufacturer
PAN	Permanent Account Number
PLA	Personal Ledger Account
Pvt.	Private
R and D	Research and Development
SIAM	Society of Indian Automobile Manufacturers
SC	Supreme Court
SCN	Show Cause Notice
ST	Service Tax
STR	Service Tax Reporter
TRU	Tax Research Unit
US$	United States Dollar