Report of the Comptroller and Auditor General of India

for the year ended March 2008

Union Government

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

(Performance Audit)

No. PA 24 of 2009-10

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

CONTENTS

SECTION 1 - CENTRAL EXCISE

SECTION 2 - SERVICE TAX

SECTION 3 - CUSTOMS

PREFACE

This report for the year ended 31 March 2008 has been prepared for submission to the President of India under Article 151(1) of the Constitution of India.

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

The report is arranged in three sections. While section 1 of the report contains a review relating to central excise receipts, section 2 has a review on service tax receipts and section 3 includes two reviews on customs receipts, under the following chapters:-

Section 1	**Central Excise**
Chapter I:	Excise duty on iron and steel and articles of iron and steel
Section 2	**Service Tax**
Chapter II:	Service tax on business auxiliary services
Section 3	**Customs**
Chapter III:	Indian customs electronic data interchange system (ICES)
Chapter IV:	Project imports

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

OVERVIEW

This report is presented in three sections: -

Section 1	**Chapter I**	**Central Excise**
Section 2	**Chapter II**	**Service Tax**
Section 3	**Chapters III and IV**	**Customs**

This report has four systems appraisals with a total revenue implication of Rs. 3,238.34 crore. Twenty nine recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. Twenty six (90 per cent) of these recommendations have been agreed to, by the Ministry.

SECTION 1 – CENTRAL EXCISE

This section contains a review on:-

Excise duty on iron and steel and articles of iron and steel

The audit review has revealed a few systems as well as compliance deficiencies.

The payment of duty through cenvat rather than by cash is excessive indicating possible misuse of cenvat credit facility. This is an area of concern, which the Ministry needs to address after investigating the reasons for such excessive cenvat credit use by these sectors and include this criterion (cenvat to PLA ratio) as a risk factor for investigation/internal audit of the assessees.

Further, while many products are cleared from stockyards (and not factory gates where duty is paid) after undergoing value addition through customisation, this value addition escapes duty as 'cutting and bending' has not been declared as 'manufacture'. Accordingly, there is a need to amend the chapter notes appropriately.

Furthermore, absence of a restrictive clause on the quantity of inputs cleared 'as such' vis-à-vis procured and used in the manufacture of final products could lead to misuse of the cenvat scheme as some manufactures

could buy/procure huge quantities of inputs after availing quantity discounts, much in excess of their own requirement for manufacturing finished goods, and clear the inputs 'as such' at a premium. The Government should consider amending the Act and applicable rules to restrict the percentage clearance of inputs cleared 'as such' which have been procured by the manufactures. Alternatively, the duty reversal/payment should be at the enhanced sale value of the inputs cleared 'as such'.

Audit further observed that in a few cases the production declared on which duty was paid was substantially lower than the declared capacities. The Government should institute an internal control which should trigger audit/investigation of units which declare their production and pay duty on the declared production below a pre-defined percentage of installed capacity. The Government has since amended the rules to require the assessees to declare its production capacity which would enable the department to scrutinise the declared production vis-à-vis the production capacity to trigger investigation in deserving cases.

Additionally, in the absence of standard input-output norms (SION) for the domestic industry, the risk of suppression of production has not been adequately mitigated. The Government should prescribe indicative input-output norms for domestic industries which can act as a benchmark against which the actual production could be measured, and cases of significant variations should act as a trigger for detailed investigation/ internal audit for detecting suppression of production and revenue loss.

There is a need for the Government to amend the Act suitably to make 'Zinc dross' excisable and the process of obtaining 'Zinc dross' as manufacture in view of the value and marketability of the commodity.

A few compliance issues like suppression of production by showing reduced sales, undervaluation on account of incorrect determination of cost of production, incorrect availing of and use of cenvat credit and non-payment of service tax, etc. were also noticed.

While the total financial implication of this audit intervention is Rs. 1,373.94 crore, the direct additional revenue which could come to the Government is Rs. 904.67 crore. Of these, observations with money value of Rs. 25.32 crore had been accepted (till November 2008) by the department and Rs. 6.12 crore recovered.

Seven specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. Five of these recommendations have been agreed to, by the Ministry.

SECTION 2 – SERVICE TAX

This section contains a review on:-

Service tax on business auxiliary services

The audit review has revealed a few systems as well as compliance deficiencies.

A review of the tax administration and the internal controls relating to a selected service was conducted to evaluate whether this was effective in identifying and bringing into tax net potential assessees and were efficient in ensuring regular and correct payment of service tax by registered service providers.

Audit review has revealed that the internal control mechanism existing in the department to bring unregistered service providers into tax net were ineffective and inadequate. Key performance indicators (KPIs) like minimum surveys to be conducted by a commissionerate to identify potential assessees were not prescribed, in the absence of which their performance could not be evaluated. Consequently, a large number of active unregistered service providers were escaping from the service tax net and audit could identify 1,193 of these, with actual loss of service tax of Rs. 123.87 crore and further an estimated service tax loss of Rs. 15.21 crore. (This is approximately 6.03 per cent of the total revenue collected from this service).

The Board should require the commissionerates to establish 'Key performance indicators' in relation to the minimum surveys to be conducted in a year to identify/register assessees and garner additional revenue. Subsequently, the Board should evaluate the performance of the commisionerates based on this criterion too. Further, the procedure for conducting survey needs to be streamlined to collect information about potential assessees from various sources including from income tax department. In all the cases identified by audit, of service providers who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by these service providers and take appropriate action. Additionally, inter-governmental and inter-departmental coordination and control mechanism to ensure that only registered assessees provide services and pay applicable tax, needs to be strengthened, which would mitigate the risk of evasion of tax by service providers to the Government sector.

Further, the Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.

Furthermore, internal controls to detect and take proactive action against 'stop filers' were ineffective and resulted in evasion of actual revenue of Rs. 170.26 crore and estimated revenue of Rs 38.08 crore. The department needs to devise an appropriate and effective mechanism to detect in time 'stop-filers' of returns and collect revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.

Additionally, the internal control mechanism to verify the correctness of returns filed was inadequate and ineffective and audit noticed several cases of short levy of service tax and evasion of service tax by suppression of value of services. The short levy worked out to Rs. 111.70 crore. To address the root cause of these irregularities, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This checking may be reinforced by detailed scrutiny. The selection of cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.

The adjudication officers are not required to finalise a demand case relating to service tax, within a prescribed time frame, which could lead to delays in finalisation of cases and recovery of service tax. The Government should prescribe a time-limit for adjudicating demand cases relating to service tax, through appropriate legislation. This would mitigate the risk of delay in adjudication of such cases and consequential risk to revenue.

Audit also observed incorrect and excess availing and utilisation of cenvat credit by providers of business auxiliary services. The Government should amend the ST-3 return to include relevant information regarding the receipt/provision of non taxable/exempt services to mitigate the risk of utilisation of cenvat credit in excess of the prescribed limit.

Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.

The database of registered assessees needs to be maintained exhaustively, updated continually to remove inconsistent data and improve the reliability of available data. This would assist the department to administer the service tax in an improved and more efficient manner.

While the total financial implication of this audit intervention (review) is Rs. 999.44 crore, the direct additional revenue which could come to the Government is Rs. 892.86 crore.

Twelve specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have

been included in this report. All the twelve recommendations were agreed (November 2008) to, by the Ministry.

SECTION 3 - CUSTOMS

This section contains two reviews on:-

1. Indian customs electronic data interchange system (ICES)

The audit review has revealed deficiencies in design, application and validation controls of the system (ICES).

There were deficiencies in the system design leading to incomplete capture of relevant data leading to manual interventions and incorrect levy of customs duty. Further, business rules were incorrectly mapped leading to excess sanctions of drawback, duty credits and short levy of countervailing duty. Accordingly, there is an urgent need to review the business rules mapped in the system. Further, any changes built into the system should be documented and conformity of the changes to the business rules ensured. An audit trail of the changes made to the system and the data should be maintained. For centralised applications, a centralised change management system should be in place.

Appropriate input controls and validation checks were absent in a few cases and these need to be built into the system.

Wastage of resources was also noticed as the data available in the system was not utilised and manual processes were resorted to instead. The system should be modified to use the available data fully so that all business processes are done through the system instead of resorting to manual procedures.

The short levy, non-levy etc. of the customs duty due to these system deficiencies was Rs. 220.50 crore. Of these, observations with money value of Rs. 76.44 crore had been accepted (till December 2008) by the department.

Five specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. All of these recommendations were acceptable to the Ministry.

2. Project imports

The audit review has revealed some systems as well as compliance weaknesses relating to grant of project import benefits and finalisation of project import cases.

A need for developing an appropriate accounting and monitoring modules integrated with the EDI system to facilitate effective monitoring of cases relating to project imports.

The need of fixation of a realistic time frame for finalisation of assessments relating to project contracts after receipt of the reconciliation statements.

Absence of penal provisions for non-submission/delay in submission of reconciliation statements and other requisite documents which had facilitated delays in finalisation of project import cases.

Inappropriate splitting up of items under project imports to get benefit of lower merit rate assessment.

A few other compliance issues were also noticed which had resulted from a weak and ineffective internal control mechanism relating to the administration of project imports. The Board should undertake a comprehensive review of the working of the scheme including the internal control and monitoring mechanism which govern the project imports and strengthen these.

The total financial implication of this audit intervention is Rs. 644.46 crore.

Five specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. While four of these had been accepted (November 2008) by the Ministry, the remaining recommendation was reported to be under its consideration.

Glossary of Terms and Abbreviations

Expanded form	Abbreviated form
Air Cargo Complex	ACC
Anti-dumping Duty	ADD
Assistant Commissioner	AC
Associated Cement Company	ACC
Automation of Central Excise and Service Tax	ACES
Bangalore Metropolitan Transport Corporation	BMTC
Bank Guarantee	BG
Basic Customs Duty	BCD
Bill of Entry	BE
Business Auxiliary Services	BAS
Carbon Black Feed Stock	CBFS
Central Board of Excise and Customs	Board or CBEC
Central Excise	CE
Central Excise and Custom	CE & CUS
Central Excise and Gold Appellate Tribunal	CEGAT
Central Excise Tariff Act, 1985	CETA
Central Excise Tariff Heading	CETH
Central Excise Value Added Tax	CENVAT/cenvat
Chhattisgarh State Electricity Board	CSEB
Commissionerate of Central Excise	CCE
Corporation of Chennai	COC
Cost Accounting Standards	CAS
Cost Insurance Freight	CIF
Countervailing Duty/Additional Duty	CVD
Custom House Agent	CHA
Customs Tariff Act, 1975	CTA
Customs Tariff Heading	CTH
Customs, Excise & Service Tax Appellate Tribunal	CESTAT
Director General of Foreign Trade	DGFT
Director General of Service Tax	DGST
Directorate General of Systems and Data Management	DGS&DM
Duty Entitlement Pass Book	DEPB
Duty Exemption Entitlement Certificate	DEEC

Expanded form	**Abbreviated form**
Duty Free Replenishment Certificate	DFRC
Electronic Data Interchange	EDI
Excise and Custom Reporter	ECR
Excise Law Times	ELT
Export Import Policy	EXIM
Export Oriented Unit	EOU
Export Promotion	EP
Export Promotion Capital Goods	EPCG
Extra Duty Deposit	EDD
Foreign Currency Convertible Bond	FCCB
Free on Board	FOB
Goa Electronics Limited	GEL
Goods and Service Tax	GST
Goods Transport Agency	GTA
Government of India	GOI
High Sulphur Diesel/Low Sulphur Diesel	HSD/LSD
Income Tax/Information Technology	IT
Indian Customs Electronic Data Interchange System	ICES
Indian Institute of Technology	IIT
Indian Iron and Steel Company	IISCO
Indian Made Foreign Liquor	IMFL
Indian Oil Corporation	IOC
Indian Seamless Metal Tubes Limited	ISMTL
Information and Communication Mobile System	ICM
Information and Communication Network System	ICN
Inland Container Depot	ICD
Jawahar Lal Nehru Custom House	JNCH
Key Performance Indicators	KPIs
Limited	Ltd.
Maximum Retail Price	MRP
Memorandum of Understanding	MOU
Metric Tonne	MT
Monthly Technical Report	MTR
National Calamity Contingencies Duty	NCCD
National Informatics Centre	NIC
New Custom House	NCH

Expanded form	**Abbreviated form**
Non-Tariff	NT
Oil and Natural Gas Corporation	ONGC
Oil Country Tubular Limited	OCTL
Pay and Accounts Officer	PAO
Per Metric Tonne	PMT
Permanent Account Number	PAN
Personal Ledger Account	PLA
Petroleum, Oil and Lubricants	POL
Principal Chief Controller of Accounts	PCCA
Private	Pvt.
Project Imports Regulations, 1986	PIR
Public Accounts Committee/Committee	PAC
Rashtriya Ispat Nigam Limited	RINL
Registration certificate	RC
Retail Sale Price	RSP
Revised Indian Trade Classification Code	RITC
Risk Management System	RMS
Seagram India Private Limited	SIPL
Secondary and Higher Education	SHE
Service Tax	ST
Service Tax Code/State Trading Corporation	STC
Service Tax Revenue Monitoring System	STREMS
Shipping Bills	SBs
Show Cause-cum-Demand Notice/Show Cause Notice	SCN
Special Additional Duty	SAD
Standard Input Output Norms	SION
Steel Authority of India Limited	SAIL
Supreme Court	SC
Target Plus Scheme	TPS
Tata Iron and Steel Company	TISCO
Tribunal	TRI
Videsh Sanchar Nigam Limited	VSNL

SECTION 1 - CENTRAL EXCISE

CHAPTER I
EXCISE DUTY ON IRON AND STEEL AND ARTICLES OF IRON AND STEEL

Executive summary

A review of 457 units manufacturing Iron and Steel and articles of Iron and Steel was conducted in audit to evaluate at the macro level the adequacy of provisions of the Act, Rules and instructions issued by the Ministry of Finance/Central Board of Excise and Customs (CBEC) in ensuring proper assessment, collection and allocation of revenue from these commodities and further whether the applicable Valuation Rules, Cenvat Credit Rules, existing instructions and orders of the department relating to the manufacture, classification and service tax on services provided/received by these manufacturers, were complied with.

Audit review has revealed a few system as well as compliance weaknesses relating to the assessment and collection of duty from Iron and Steel sector. The payment of duty through cenvat rather than by cash is excessive indicating possible misuse of cenvat credit facility. This is an area of concern, which the Ministry needs to address after investigating the reasons for such excessive cenvat credit use by these sectors and include this criterion (cenvat to PLA ratio) as a risk factor for investigation/internal audit of the assessees. Furthermore, while many products are cleared from stockyards (and not factory gates where duty is paid) after undergoing value addition through customisation, this value addition escapes duty as 'cutting and bending' has not been declared as 'manufacture'. Accordingly, there is a need to amend the chapter notes appropriately. Absence of a restrictive clause on the quantity of inputs cleared 'as such' vis-à-vis procured and used in the manufacture of final products could lead to misuse of the cenvat scheme as some manufacturers could buy/procure huge quantities of inputs after availing quantity discounts, much in excess of their own requirement for manufacturing finished goods, and clear the inputs 'as such' at a premium. The Government should consider amending the Act and applicable rules to restrict the percentage clearance of inputs cleared as such which have been procured by the manufacturers. Alternatively, the duty reversal/payment should be at the enhanced sale value of the inputs cleared 'as such'.

Audit further observed that in a few cases the production declared on which duty was paid was substantially lower than the declared capacities. The Government should institute an internal control which should trigger audit/investigation of units which declare their production and pay duty on the declared production below a pre-defined percentage of installed capacity. The Government has since amended the rules to require the assessees to declare its production capacity which would enable the department to scrutinise the declared production vis-à-vis the production capacity to trigger investigation in deserving cases.

Additionally, in the absence of standard input-output norms (SION) for the domestic industry, the risk of suppression of production has not been adequately mitigated. The Government should prescribe some indicative

input-output norms for domestic industries which can act as a benchmark against which the actual production could be measured and cases of significant variations should act as a trigger for detailed investigation/internal audit for detecting suppression of production and revenue loss.

There is a need for the Government to amend the Act suitably to make 'Zinc dross' excisable and the process of obtaining 'Zinc dross' as manufacture in view of the value and marketability of the commodity.

A few compliance issues like suppression of production by showing reduced sales, undervaluation on account of incorrect determination of cost of production, incorrect availing of and use of cenvat credit and non-payment of service tax, etc. were also noticed.

The irregularities discussed in this report can easily go undetected due to ineffective internal control mechanism relating to valuation, classification, verification of end use based exemptions, procedures of payment of duty, cenvat procedures, exports/imports and ineffective internal audit. The Government, therefore, needs to strengthen the existing internal control mechanism to ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.

While the total financial implication of this audit intervention is Rs. 1,373.94 crore, the direct additional revenue which could come to the Government is Rs. 904.67 crore. Of these, observations with money value of Rs. 25.32 crore had been accepted (till November 2008) by the department and Rs. 6.12 crore recovered.

Seven specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. Five of these recommendations have been agreed to, by the Ministry.

1.1 Highlights

System issues:-

- **The percentage of cenvat to duty paid in cash was high in iron and steel industry indicating possible misuse of cenvat credit facility. The Government needs to investigate the reasons and plug loopholes to address this risk.**

(Paragraph 1.6.1.1)

- **As the process of cutting and bending undertaken at stockyards did not amount to manufacture, the additional amounts charged at stockyards for cutting and bending were not includible in assessable value. Consequently, the Government is losing revenue as these charges realised by the iron and steel units are outside the indirect tax net.**

(Paragraph 1.6.1.2)

- **No restriction on the quantity of inputs cleared 'as such' vis-à-vis procured for use in the manufacture of final products led to misuse of the cenvat credit scheme by a few manufacturers.**

(Paragraph 1.6.1.3)

- **Under-utilisation of installed capacity creates a risk of suppression of production and corresponding loss of revenue. The Government has since amended the rules to require the assessees to declare its production capacity which would enable the department to scrutinise the declared production vis-à-vis the production capacity to trigger investigation in deserving cases.**

(Paragraph 1.6.1.4)

- **Standard input-output norms (SION) are not prescribed for domestic production, in the absence of which the risk of suppression of production and consequent revenue loss has not been fully mitigated. The Government may consider fixing standard input-output norms for domestic production on the lines of SION for exports. Any significant fluctuation in actual production from these norms should act as a trigger for further detailed investigation/internal audit.**

(Paragraph 1.6.1.5)

Compliance issues: -

- **Suppression of production by manufacturers of iron and steel resulted in evasion of duty totalling Rs. 331.86 crore.**

(Paragraphs 1.7.1.1 to 1.7.1.5)

- **Undervaluation of goods, due to non-inclusion of additional considerations, resulted in revenue loss of Rs. 17.80 crore.**

(Paragraph 1.7.2.1)

- **Duty of Rs. 1.72 crore was levied short due to undervaluation of inputs by reducing the price and ignoring the increased value of inputs.**

(Paragraph 1.7.2.5)

- **Duty of Rs. 1.99 crore was levied short due to undervaluation of goods sold at depots in two cases.**

(Paragraph 1.7.2.7)

- **In 307 cases, the assessees had availed of cenvat credit totalling Rs. 407.16 crore incorrectly.**

(Paragraph 1.7.3)

- **Incorrect grant of exemption benefit in 30 cases resulted in revenue loss of Rs. 18.40 crore.**

(Paragraph 1.7.4)

- **Non-levy of interest and penalty in a few cases resulted in revenue loss of Rs. 6.88 crore.**

(Paragraph 1.7.9)

- **A few manufacturers of iron and steel did not pay applicable service tax totalling Rs. 83.88 crore.**

(Paragraph 1.7.10)

1.2 Introduction

Iron and Steel and its articles is one of the twenty commodities yielding major revenue (Rs. 15,117.71 crore, Iron and Steel=Rs. 12,685.20 crore and articles of Iron and Steel=Rs. 2,432.51 crore, during the year 2006-07) to the Government. While 'Iron and Steel' is classified under Chapter 72, the articles of 'Iron and Steel' are classified under Chapter 73 of Central Excise Tariff Act (CETA), 1985. The percentage share in the total collection of central excise receipts under both the chapters was 12.96 per cent during 2006-07. From the budget 1999-2000, duty at the rate of 16 per cent was levied on 'Iron and Steel and its articles'. There has been no change in the rate of duty since then. From 10 September 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.

1.3 Audit objectives

Records of selective units manufacturing Iron and Steel and/or articles of Iron and Steel and concerned departmental offices were scrutinised in audit to examine: -

- At the macro level, adequacy of provisions of the Act, Rules and instructions issued by the Ministry of Finance/Central Board of Excise and Customs (CBEC) in ensuring proper assessment, collection and allocation of revenue from these commodities and
- At the micro level, to seek assurance that: -

(i) Records of the goods manufactured and cleared were properly maintained;

(ii) Valuation of goods was done in accordance with provisions of section 4 of the Act and Central Excise Valuation Rules as amended from time to time and correctly classified;

(iii) Credit of duty paid on inputs/capital goods under Cenvat was taken correctly;

(iv) Service tax on services provided/received by manufacturers were paid correctly; and

(v) Internal controls were effective to safeguard the interest of revenue.

1.4 Scope of audit

During 2007-08, duty paying units of Iron and Steel and/or articles of Iron and Steel in 80 out of 93 commissionerates were 10,384. Records of 457 manufacturing units as well as selected range offices for the period 2004-05 to 2007-08 (up to September 2007) were test checked in audit. The audit sample size was 4.40 per cent of the population.

1.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in October 2008 and the exit conference was held with the Ministry officials in November 2008. The responses of the Ministry to the recommendations received in November 2008 and responses of the department, wherever received, have been incorporated appropriately.

AUDIT FINDINGS AND RECOMMENDATIONS

1.6 System Issues

1.6.1 Valuation

1.6.1.1 Excessive Cenvat to PLA ratio in Iron and Steel sector

The amount of duty discharged by the assessees through cash payment by debiting the 'Personal Ledger Account (PLA)' and by debiting the cenvat credit account constitutes the gross revenue of the Government. Under the cenvat scheme, subject to certain conditions, a manufacturer of final products while discharging the central excise duty on final products can take credit for the excise duty/service tax paid on any inputs used in the manufacture of the final products. Thus, on the final products, the manufacturer needs to pay the duty in cash after adjusting any cenvat credits, which the assessee may have in its account. In other words, only the value addition at each stage is taxed. Accordingly, in an ideal tax structure, the duty payment through cash would be more than the payment made through cenvat credit, given positive value additions at stages of manufacturing cycle and duty rates on the final products not being lower than that on the inputs.

The trend of central excise duty relating to Iron and Steel and articles thereof (Chapter 72 & Chapter 73) under 80 commissionerates is summarised in the following table: -

Table no. 1
Central Excise revenue data relating to iron and steel

(Amount in crore of rupees)

Commodity and Chapter	Year	No. of units	Duty paid through PLA	Duty paid through cenvat	Total duty paid	Percentage of cenvat to PLA	All commodities percentage of cenvat to PLA
Iron & Steel (Chapter 72)	2004-05	4,940	7,048.65	9,685.06	16,733.71	137.40	77.34
	2005-06	5,794	10,426.09	13,840.03	24,266.12	132.74	86.36
	2006-07	6,298	11,992.52	17,702.37	29,694.89	147.61	109.42
	2007-08	5,892	5,193.95	8,770.99	13,964.94		
Articles of Iron & Steel (Chapter 73)	2004-05	3,765	2,276.57	2,479.89	4,756.46	108.93	77.34
	2005-06	4,213	1,924.56	3,942.37	5,866.93	204.85	86.36
	2006-07	4,698	2,381.82	5,306.70	7,688.52	222.80	109.42
	2007-08	4,492	903.44	2,576.37	3,479.81		

Figures furnished by commissionerates. Figures for the year 2007-08 are upto September 2007 only.

Audit observed that:-

- The percentage of cenvat availed of, to duty paid in cash in respect of iron and steel and articles thereof had been consistently and significantly higher than the all India figures for all commodities.
- The percentage of duty paid through Cenvat to PLA ranged between 132.74 (2005-06) to 147.61 (2006-07) in respect of Iron and Steel under Chapter 72 and from 108.93 (2004-05) to 222.80 (2006-07) in respect of articles of Iron and Steel under Chapter 73.
- In Ahmedabad III and Kolkata VII commissionerates, percentage of cenvat to duty paid in cash in respect of iron and steel products under chapter 72 during the year 2006-07 was as high as 3,488 per cent and 4,242 per cent, respectively.
- In Siliguri and Raigad commissionerates, percentage of cenvat to duty paid in cash in respect of articles of iron and steel manufactured under chapter 73 during the year 2006-07 was as high as 1,202 per cent and 2,812 per cent, respectively.

Thus, in the iron and steel sector, audit has observed that duty payment through cash (PLA) has been far less than the duty payment made through use of cenvat credit. The excessive use of cenvat credit indicates the likelihood of misuse of cenvat credit by these manufacturers. This is further elaborated by the fact that this audit review has identified Rs. 407.16 crore of cenvat credit which had been incorrectly used by these manufacturers. Even earlier, cases of Rs. 110.73 crore cenvat being incorrectly used by the manufacturers of this sector, had been noticed by audit and pointed out through the Audit Reports 2004 to 2008 on Union Government - Indirect Taxes (Central Excise, Service Tax and Customs).

Recommendation No. 1

- *The Government may investigate/ascertain the exact reasons for such a high duty payment by cenvat rather than by cash in iron & steel sectors and based on such investigation (i) plug the loopholes to avoid misuse of cenvat by Iron & Steel sector and (ii) incorporate cenvat to PLA ratio as a risk factor based on which internal audit/investigation of a unit should be undertaken.*

Responding to the first part of the recommendation, the Ministry clarified (November 2008) that the cenvat to PLA ratio of iron and steel sector is in consonance with the all India ratio of cenvat to PLA if 'Petroleum oil lubricants (POL)' commodities are excluded. It added that as the value addition in the downward industry of iron and steel is very less, this ratio is adverse in this sector, compared to other sectors.

Agreeing to the second part of the recommendation, the Ministry informed (November 2008) that cenvat to PLA ratio of a unit, its periodic variance and its value vis-à-vis the all India ratio of the commodity manufactured by the unit are few factors based on which the identification/selection of the unit is made for internal audit. The Ministry also indicated a few steps which it had taken in line with the recommendation of the audit.

1.6.1.2 Opportunity to augment revenue from a value adding process

Integrated steel plants are marketing bulk of their products through stockyards located throughout the country. At the stockyards points, certain processes like cutting and bending are undertaken on iron and steel products according to customers needs. Additional amounts are being charged from the customers at the stockyards over and above the value on which duty liability was being discharged at the factory gate. The CESTAT-Bangalore in a judgment dated 30 July 2004 in the case of M/s Rashtriya Ispat Nigam Ltd. (RINL) Visakhapatnam (2005) 179 ELT 65 (Tribunal-Bangalore) held that the process of cutting and bending undertaken at stockyards did not amount to manufacture and that the goods sold at stockyards being the same goods as cleared from the factory, the additional amounts charged at stockyards for cutting and bending were not includible in assessable value. Subsequent to this decision, suitable amendment to chapter notes notifying these processes as amounting to manufacture were not considered by the Ministry despite the fact that these processes undertaken at stockyards to customise the products add to the value of the products sold at depots/stockyards and bulk of the products are cleared only from such depots/stockyards.

Audit noticed that M/s Rashtriya Ispat Nigam Ltd. (RINL), Visakhapatnam, through their two integrated steel plants at Nagpur and Faridabad, had collected (during the period from August 2004 to December 2007) cutting and bending charges amounting to Rs. 21.30 crore as additional consideration from their customers. However, in the absence of appropriate provisions in section/chapter notes in the Act, declaring the process of cutting/bending as amounting to 'manufacture', revenue of Rs. 3.29 crore could not be levied and collected from these three units alone. The impact of the absence of provision to charge duty on the process of bending, cutting and the resultant value addition at an all India basis would be much larger.

Recommendation No. 2

- *The Government may consider inserting an appropriate chapter/section note to deem the process of cutting and bending as 'manufacture' to augment revenue from a value adding process.*

The Ministry stated (November 2008) that the recommendation was not feasible as these processes are carried out by a large number of small job workers and such processes are used in other sectors as well, inserting chapter/section notes making these processes as 'manufacture' would require a large number of job workers requiring registration.

1.6.1.3 Misuse of cenvat scheme as no restrictions/cap on inputs cleared 'as such'

Under Rule 3(1) of Cenvat Credit Rules, 2004, a manufacturer or producer of final products or a provider of taxable service shall be allowed to take credit of duty of excise and service tax paid on input/capital goods and used for manufacture of final products. However, Rule 3(4) of the Cenvat Credit Rules, 2004 allows clearance of inputs as such by requiring reversal of cenvat credit availed.

There is, however, no restriction on the quantity of inputs cleared as such vis-à-vis procured and used in the manufacture of final products. The absence of such a restrictive clause could lead to misuse of the scheme as few manufacturers could buy/procure huge quantities of inputs after availing quantity discounts, much in excess of their own requirement for manufacturing finished goods and clear the inputs as such (after reversing the cenvat credit availed) at a premium. A few of such cases are discussed in the following paragraphs:-

Three assessees in Rohtak commissionerate and one assessee in Faridabad commissionerate, engaged in manufacture of steel tubes and pipes, purchased HR coils, MS strips and skelp from Steel Authority of India for manufacturing of final products and had availed cenvat credit. They had purchased 5,73,964.413 MT of material, out of which 2,56,492.495 MT was cleared 'as such' after reversing the availed cenvat credit of Rs. 92.87 crore. The credit was passed on to the downstream buyers/manufacturers. The percentage clearance of the raw materials/inputs 'as such' compared to raw material/inputs procured was 100, 66, 45 and 31 per cent. It was clear that the major activity of these so called 'manufacturers' was trading rather than manufacturing. Additionally, it was observed that while the purchase price of these inputs by these manufacturers was Rs. 592.83 crore, these were cleared 'as such' at a combined sale price of Rs. 656.95 crore (premium of Rs. 64.12 crore). Obviously, this profit element remained out of the central excise tax net by resorting to this modus-operandi.

On this being pointed out (October 2007), the department admitted the observation in one case and stated (January 2008) that in order to avail the quantity discount, M/s Bansal Poles Ltd., Bahadurgarh had procured enhanced quantity of raw material than the actual requirement for use as input for manufacturing purposes from SAIL every year and sold the inputs 'as such'.

Recommendation No. 3

- *The Government should consider amending the Act and applicable rules to restrict the percentage clearance of inputs cleared 'as such' which have been procured by the manufacturers. Alternatively, the duty reversal/payment should be at the enhanced sale value of the inputs cleared 'as such'.*

The Ministry did not agree with the recommendation and stated (November 2008) that this is not in line with business practices and central excise duty is to be levied on manufacturing and not trading activities. However, the concern flagged by audit will be taken care of, when 'Goods and Services Tax, (GST)' on all transactions is introduced by the Government.

1.6.1.4 Need for probing units where the capacity has been substantially under-utilised

Audit is of the opinion that where installed capacity has been substantially under-utilised, there is a risk of suppression of production and corresponding loss of revenue, in cases where such short utilisation cannot be explained. A few of such cases where there could be suppression of production as capacity was grossly under-utilised and probable loss of corresponding revenue are given in the following table: -

Table no. 2

(Amount in crore of rupees)

Name of the assessee	Period involved	Short utilisation of capacity (%)	Probable suppression (in MT)	Probable loss of revenue
M/s Rungta Mines Ltd., Bhubaneshwar	2004-05 to 2006-07	21 per cent to 55 per cent	1,46,402	20.93
M/s IDCOL Kalinga I.W. Ltd., Bhubaneshwar II	2004-05 to 2006-07	22 per cent to 46 per cent	1,68,001	44.77
M/s MSP Sponge Iron Ltd., Bhubaneshwar	2005-06 to 2006-07	32 per cent to 39 per cent	30,538	4.94

Recommendation No. 4

- *Government should institute an internal control which should trigger audit/investigation of units which declare their production and pay duty on the declared production below a pre-defined percentage of installed capacity.*

The Ministry accepted (November 2008) the recommendation and stated that the Government had inserted a new sub-rule (2A) in rule 12 of the Central Excise Rules, 2002 (notification dated 29 September 2008) prescribing an annual installed capacity statement from the assessees, which will be compared by the jurisdictional officers with the actual production data as reported by the assessees in its excise returns for further investigation, wherever necessary.

1.6.1.5 Need of assigning input-output norms to act as a control against suppression of production

(i) Section 37(2) (v) of the Central Excise Act, 1944, empowers the Government to make rules to regulate the production or manufacture of excisable goods. In the erstwhile Central Excise Rules, 1944, the department was empowered to fix input-output norms. But in the revised Central Excise Rules, 2002, no such provisions were made. Furthermore, no standard input-output norms have been prescribed for domestic production on the pattern of standard input-output norms (SION) fixed by Director General of Foreign Trade (DGFT) for similar export items.

M/s Bindal Sponge Ltd., in Bhubaneshwar-I commissionerate, and SAIL, Rourkela Steel Plant, in Bhubaneshwar-II commissionerate, engaged in production of sponge iron and slabs respectively, did not file any declaration about input-output ratio during 2004-05 to 2006-07. These assessees produced 53,19,088 MT as against a possible production of 57,89,823 MT if SION norms were made applicable. There could be a probable short accountal of 4,70,735 MT of finished goods involving excise duty of Rs. 121.95 crore including education cess.

While the local conditions and various other factors can affect the volume of production of a commodity, if some indicative input-output norms are prescribed for domestic industry as well, this can act as a benchmark against which the actual production could be measured and in cases of extreme variations, should trigger a detailed investigation/internal audit.

(ii) In 24 other cases, the production of iron and steel was not commensurate with the SION norms, resulting in probable suppression of production with duty implication of Rs. 236.69 crore including education cess.

1.6.1.6 Probable suppression of production with reference to standard electricity norms

A technical opinion report of IIT, Kanpur made available to the department during year 2000, established a relation between the consumption of electricity to the production of iron and steel and articles thereof. As per these norms, a maximum of 1,046 electricity units were required for production of 1 MT of mild steel ingots. Besides 1,046 units, nearly 200 units of electricity were required on a comparative basis for conversion of ingots into bars/rods.

(i) Audit scrutiny of the records of M/s Adithya Ferro Alloys Pvt. Ltd., a mini plant in Karaikal, in Trichy commissionerate, engaged in manufacture of both ingots from scraps and bars/rods from ingots, revealed that the consumption of electricity exceeded 1,246 units per MT resulting in difference of production of 17,871.72 MTs during the period 2004-05 to 2006-07 with a corresponding duty effect of Rs. 5.64 crore.

On this being pointed out (November 2007), the department stated (January 2008) that the production might not be normal at all times and tend to vary due to difference in power supply, labour problem and quality of raw material used.

The reply is not consistent and convincing as the department had itself conducted raids three times during July 2003 to July 2005 and had established

suppression of production and issued show cause notices (SCNs) which were not adjudicated as yet.

(ii) In 27 other cases, the assessees had shown less manufacturing of finished products than that obtainable as per the prescribed norm of electricity consumption with corresponding probable duty loss of Rs. 29.96 crore including education cess.

Recommendation No. 5

- *The Government should prescribe indicative input-output norms for domestic industries which can act as a benchmark against which the actual production could be measured and cases of significant variations should act as a trigger for detailed investigation/internal audit for detecting suppression of production and revenue loss.*

The Ministry stated (November 2008) that general input-output norms for an industry cannot be prescribed as these norms vary from unit to unit based on the capacity of the machines, quality of inputs used and other related factors. However, instructions have been issued to the jurisdictional officers to compare the input-output norms as declared by the assessee in an annual excise return (ER 5) with the norms given in the SION published by DGFT.

1.6.1.7 Need to collect duty on 'Zinc dross'

Section 2(d) of Central Excise Act, 1944, stipulates that the 'excisable goods' means goods specified in the first schedule and the second schedule to the Central Excise Tariff Act, 1985 as being subject to a duty of excise.

Zinc dross and ash come into existence during the course of manufacture of castings and also during galvanizing of steel pipes and tubes. Zinc dross is classifiable under chapter heading 7902 of 'Central Excise Tariff Act (CETA)' and was chargeable to excise duty. Zinc dross is sold extensively in India and the percentage of recovery of zinc from Zinc dross ranges up to 90 per cent.

The Supreme Court decision in the case of CCE Patna Vs M/s Tata Iron and Steel Co. Ltd. {2004 (113) ECR 408 (SC)} dismissed the appeal of the Government and held that Zinc dross is not an excisable good and hence not chargeable to duty.

(i) M/s Bhusan Power & Steel Ltd., in Chandigarh commissionerate, engaged in manufacture of iron and steel products under chapter 72 was clearing zinc dross on payment of duty upto 31 August 2005. Thereafter, it stopped paying duty in the light of the above decision of the Supreme Court. During the month of September 2005, the assessee cleared Zinc dross valuing Rs. 2.58 crore without payment of duty of Rs. 42.13 lakh including education cess.

(ii) In another case, M/s Ganges International (P) Ltd., in Puducherry commissionerate, took cenvat credit on Zinc ingots at the time of purchase for galvanizing steel structure. But the zinc dross of Rs. 3.02 crore, obtained while galvanization during the period February 2006 to September 2007 was sold without payment of duty. This resulted in non levy of duty of Rs. 49.53 lakh including education cess.

On this being pointed out (January 2008) the department stated (February 2008) that as per the Supreme Court judgment in the case of TISCO 2004 (165) ELT 386 (SC), Zinc dross was not goods because it was not marketable. However, it was further stated that as it appeared marketable and was a high value input for rubber industry, zinc electro plating and paint industries, the Board was considering the revenue impact as it had considerable commercial value.

(iii) Similarly, in two other cases viz. M/s Rawalwasia Ispat Udyog Ltd. and M/s Sahni Strips &Wires Ltd., in Rohtak commissionerate, had also not paid duty on Zinc dross and ash valuing Rs. 1.05 crore during the period January 2005 to September 2007. This resulted in non payment of duty of Rs. 17.26 lakh including education cess.

Recommendation No. 6

- *The Government may, amend the Act suitably to make 'Zinc dross' excisable and the process of obtaining 'Zinc dross' as manufacture in view of the value and marketability of the commodity.*

The Ministry informed (November 2008) that an amendment has since been carried out in section 2 of the Central Excise Act, 1944 vide section 78 of the Finance Act of 2008, and accordingly duty is payable on zinc dross.

1.7 Compliance issues

1.7.1 Manufacture

1.7.1.1 Suppression of production by showing reduced sales

Rule 10 of Central Excise Rules, 2002, provides that every assessee shall maintain proper records on a daily basis indicating therein particulars regarding description of goods produced, opening balance, quantity manufactured, quantity removed, assessable value, duty payable and particulars regarding amount of duty actually paid. Sub rule (1) of rule 9(A) of the Cenvat Credit Rules, 2004, stipulates that a manufacturer of final product shall furnish a declaration in the prescribed form (ER-5) to the department in respect of each of the excisable goods manufactured or to be manufactured by him, the principal inputs and the quantity of such inputs required for use in the manufacture of unit quantity of such final product. Sub rule 2 of the above rule further stipulates that all alteration in the information to the Central Excise Officer together with the reasons for such alteration should be submitted before the proposed change or within fifteen days of such change in the form specified by the Board under sub rule(1).

(i) M/s Jindal Steel and Power Ltd., in Raipur commissionerate, engaged in manufacture of sponge iron, were selling sponge iron by packing it in HDPE bags of capacity of 50 kilogram each. During 2004-05 to 2006-07, 17,83,292.350 MT of sponge iron was shown as sold for which 3,56,65,847 bags were required for packing. However, 5,44,06,460 bags were issued from the store. Thus, there was an excess issue of 1,87,40,613 bags, the use of which in any other department/section of the factory could not be explained. Under these circumstances, the possibility of suppression of production and

subsequent clandestine removal of sponge iron could not be ruled out. This involved 9,37,030.650 MT of sponge iron on which duty payable works out to Rs. 137.39 crore (approximately) including education cess.

(ii) In eight other cases, the assessees had short accounted for their production which resulted in loss of revenue of Rs. 19.44 crore. In one case, SCN for Rs. 47.56 lakh was issued (May 2008).

1.7.1.2 Escapement of central excise duty due to short production

As per norms fixed by M/s Steel Authority of India Ltd., the production of MS bar/TMT bar from billets and ingots should be 95 per cent per MT of ingots. All ISO licence holder companies have to observe these norms of production.

(i) M/s Sri Rathi Steels Ltd., Ghaziabad, in Meerut-II commissionerate, engaged in manufacture of M.S. Bar from ingots was an ISO licence holder company. While the assessee had consumed 2,18,808.790 MT of ingots, only 2,01,329.830 MT of MS Bars produced, during the years 2003-04 to 2007-08 against the normative production of 2,07,963.350 MT. Accordingly, there was a short production of 6,633.516 MT of MS Bars with an assessable value of Rs. 16.15 crore and duty involvement of Rs. 2.64 crore including education cess.

On this being pointed out (January 2008), the department stated (May 2008) that SCN for Rs. 2.64 crore had been issued in April 2008.

(ii) In 21 other cases, there was short production of TMT/MS Bar and other final products during the period 2004-05 to 2007-08 (up to September 2007) resulting into probable evasion of duty of Rs. 31.94 crore including education cess.

1.7.1.3 Production shown less in excise records/returns than in annual accounts

Rule 4 of Central Excise Rules, 2002 stipulates that no excisable goods on which duty is payable shall be removed from a factory or warehouse without payment of the requisite duty. Duty not paid, short paid by suppressing of facts or by fraud, misstatement etc. attracts penalty under section 11 AC of the Central Excise Act, 1944.

(i) M/s Ghaziabad Precision Products Pvt. Ltd., in Ghaziabad commissionerate, is engaged in manufacture of Rocker soft, lever assembly and adjusting screw falling under chapter 73 of CETA, 1985. Scrutiny of records revealed that the assessee had shown less production in RG 1/ER-1 against the production shown in the balance sheet in respect of rocker soft-53,216, lever assembly-4,29,331 and adjusting serve-4,10,622 during the year 2006-07. This short accountal of production resulted in non-levy of central excise duty of Rs. 6.37 crore including education cess. The assessee is also liable to pay an equal amount of penalty. The total amount of duty along with penalty foregone was Rs. 12.74 crore including education cess.

(ii) In another case, M/s Sree Lakshmi Industrial Forge and Engineers Ltd., in Bangalore I commissionerate, engaged in manufacture of articles of iron and steel under chapter 73, had also shown less production in ER-1 vis-à-vis balance sheet which resulted in short payment of duty of Rs. 81.25 lakh including education cess, during the year 2006-07.

1.7.1.4 Suppression of production with reference to assessee's own norms of production

Some units manufacturing articles of iron and steel under chapter 73 had fixed its own norms of production on the pattern of SION.

(i) During the scrutiny of records, it was noticed that vis-à-vis norms of production fixed by M/s Sundaram Fastners, Chennai, in Chennai-II commissionerate itself, there was a shortage of production of 2,149.000 MT of finished goods, during the period 2005-06 to 2006-07 resulting in a probable loss of duty amounting to Rs. 3.92 crore including education cess.

On this being pointed out (December 2007), the department stated (April 2008) that the assessee reconciled its records and paid duty of Rs. 59.63 lakh pertaining to the year 2005-06 and a part period of 2006-07. Reply on the balance amount of duty of Rs. 3.32 crore pertaining to remaining period of 2006-07 had not been received (November 2008).

(ii) Two other assessees viz. M/s Wichitra Auto Ltd. and M/s Ganges International Pvt. Ltd., in Chennai II and Puducherry commissionerates respectively, have shown less production of goods in spite of the norms which were fixed by them, this resulted in a probable revenue loss of Rs. 56.58 lakh.

(iii) M/s Bokaro Steel Plant (SAIL), in Ranchi commissionerate, engaged in the manufacture of crude steel, saleable steel etc. under chapter 72, manufactured these products as per their own production norms. Test check of the records of the assessee revealed that as per consumption figure of raw materials appearing in cost sheet, there should be higher quantity of production as per the norms than that shown in the accounts during the years 2004-05 to 2006-07. The short accountal of production of saleable steel of Rs. 747.86 crore resulted in escaping of duty of Rs. 122.04 crore including education cess.

1.7.1.5 Non levy of duty on final products found short

Rule 10 of Central Excise Rules, 2002, provides that every assessee shall maintain proper record of goods produced or manufactured, quantity removed, assessable value and amount of duty actually paid. Further, rule 4 of the above Rules stipulates that no excisable goods on which duty is payable shall be removed from a factory or warehouse without payment of the requisite duty. However, rule 21 provides for remission of duty in case where it is shown to the satisfaction of the commissioner that goods have been lost or destroyed by natural cause or on unavoidable accident or became unfit for human consumption/marketing before their removal. Duty not paid, short paid by suppressing of facts or by fraud, misstatement etc. attracts penalty under section 11 AC of Central Excise Act, 1944.

Scrutiny of records of M/s Hi-Tech Pipes Ltd., in Noida commissionerate, engaged in manufacturing of pipes, revealed that there was shortage of pipes in the years 2004-05 and 2005-06 as certified by Accountant in Tax Audit Report issued under section 44AB of Income Tax Act, 1961 but the assessee adjusted these shortages in the books of accounts without assigning any reason. Such adjustment was not permissible as per the Excise Rules and the assessee was liable to pay duty of Rs. 18.44 lakh including education cess with

an equal amount of penalty. The duty and penalty amounting to Rs. 36.88 lakh needs to be recovered.

1.7.2 Valuation

1.7.2.1 Short payment of duty of Rs. 54.02 lakh due to non addition of additional consideration in the assessable value

Rule 6 of the Central Excise Valuation Rules, 2000, stipulates that where the excisable goods are sold in the circumstances specified in section 4(1)(a) of the Central Excise Act, 1944 except the circumstances where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee.

(i) In December 2003, M/s Amitasha Enterprises Pvt. Ltd., in Nagpur commissionerate, engaged in manufacture of angles/TMT bars and transmission line tower parts under chapters 72 and 73, received purchase order from M/s Tata Power Company Ltd., Mumbai for supplying transmission line tower parts for Vishnu Prayag line, falling under CETH 73082011. During the period 2004-05 and 2005-06, the assessee supplied 5,660.65MT of tower parts to the buyer on contracted value for which the buyer made advance payment as material advance. This advance accounted for more than 80 per cent of the total payment made for inputs supplied and the assessee retained the advance for more than a year. The contracted value was less than the comparable price of the goods supplied. Audit observed that due to non-addition of the interest amounting to Rs. 3.31 crore on the advance, a flow back to the assessee, there was a short payment of duty of Rs. 54.02 lakh including education cess.

(ii) In 74 other cases of undervaluation/incorrect valuation, duty of Rs. 17.26 crore including education cess was short paid/short levied. The department accepted the audit observations in 11 cases involving duty of Rs. 1.56 crore out of which duty of Rs. 60.24 lakh had been recovered.

1.7.2.2 Undervaluation on account of incorrect determination of cost of production

Rule 8 read with rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 envisages that where excisable goods are not sold by the assessee but are consumed by the assessee or on behalf of the assessee by a related person for manufacture of other articles, the assessable value of such goods shall be one hundred and fifteen per cent (one hundred and ten per cent from 6 August 2003) of the cost of production of manufacture of such goods. Further, the Board had clarified on 30 June 2000 that the value of goods consumed captively should be determined on cost construction method only.

(i) M/s IISCO Steel Plant (a unit of SAIL with effect from 16 February 2006), Burnpur, in Bolpur commissionerate, engaged in manufacture of iron and steel products under chapters 72 and 73 cleared MS ingots to M/s Durgapur Steel Plant, Durgapur, a unit under Steel Authority of India Ltd., at a

price which was much lower than its cost of production during the year 2006-07 though the cost data was available with the assessee. As the clearances were inter unit transfer of goods for consumption in the manufacture of other articles, its valuation was to be done at the rate of 110 per cent of the cost of production. This incorrect valuation resulted in short levy of duty of Rs. 1.26 crore including education cess during April 2006 to March 2007.

Further, the assessee made clearances of angles, channels, TMT Bars, etc., for its own consumption during 2006-07 and 2007-08 (up to August 2007). However, the assessable value for such clearances were much lower than their respective cost of production (instead of 110 per cent of cost of production) for the year 2006-07. Adoption of incorrect valuation had resulted in short levy of duty of Rs. 74.24 lakh including education cess.

On this being pointed out (September 2007), the department accepted (February 2008) both the observations and stated that SCNs were being issued.

(ii) In another case relating to M/s Sree Rengaraj Ispat Ltd., in Salem commissionerate, it was seen that the goods were valued at a lower rate based on transaction value instead of the value required to be arrived by cost construction method during the period 2005-06 and 2006-07. On this being pointed out to the department (October 2007), the assessee re-worked the cost of goods and paid Rs. 87.50 lakh towards duty including education cess on 28 January 2008 and interest of Rs.16.90 lakh in March 2008.

(iii) M/s Ennore Foundries Ltd., in Chennai I commissionerate, is engaged in manufacture of cast articles of iron under chapter 73. The assessee undervalued goods as it did not add ten per cent of value to the cost for the purpose of calculation of excise duty while clearing the goods valuing Rs. 469.19 crore for captive consumption, to a fellow subsidiary company (related person in terms of section 4(3)(b) of Central Excise Act, 1944) M/s Ashok Leyland during the period 2004-05 to 2006-07. The additional duty which needs to be paid up worked out to Rs. 7.65 crore including education cess.

On this being pointed out (February 2008), the department stated (March 2008) that the observation was not accepted as these companies were not related persons as defined in clause (b) of sub-section (3) of section 4 of Central Excise Act, 1944. However, the Ministry of Law and Justice, GOI in their U.O. dated 13 July 2004 held that they were related parties and hence, additional duty pointed out by audit was recoverable.

1.7.2.3 Undervaluation and short payment of duty due to clearance of goods as scrap

Rule 10 of Central Excise Rules, 2002, provides that every assessee shall maintain proper records on a daily basis, of goods produced or manufactured, quantity removed, assessable value and the amount of duty actually paid.

M/s IDCOL Kalinga Iron Works Ltd., in Bhubaneshwar II commissionerate, manufacturing pig iron, deducted pig iron from the daily stock account and sold the same as scrap during April 2004 to September 2007 at a lesser price than the price of pig iron. Price of pig iron varied between Rs. 11,892 to Rs. 16,452; price of pig iron cleared as scrap varied from: Rs 7,765 to Rs. 12,589 which resulted in undervaluation of the goods by Rs. 2.48 crore

and consequential short payment of duty of Rs. 38.54 lakh including education cess.

On this being pointed out (December 2007), the department stated (February 2008) that the scarps deducted from the stock were pig iron with some metals attached to it in addition to small particles of scrap at stockyard. The reply is not tenable in view of the fact that the full quantity of pig iron was shown as 'production' during the years 2004-05 to 2006-07 in the R.G-1 (Stock Accounts) and then a reduction entry made, subsequently to adjust pig iron as scrap.

1.7.2.4 Short payment of duty due to non-inclusion of cost of waste and scrap retained by job worker

Rule 6 of the Central Excise Valuation Rules, 2000 read with CBEC circular dated 19 February 2002 stipulates that in respect of goods manufactured on job work basis, assessable value would be the job charges plus the cost of the materials used in the manufacture of the item. Further, as per SC's judgment in the case of M/s General Engineering Works Vs CCE Jaipur 2007(212) ELT 295 SC which was also relied in the case of M/s Llyods Steels Industries Ltd. 2007 (213) ELT 339 (SC), the cost of waste and scarp retained by the job worker is to be included in the assessable value.

M/s Amitasha Enterprises Pvt. Ltd., in Nagpur commissionerate, engaged in manufacturing of angles/TMT bars under chapter 72 and transmission line tower parts under Chapter 73 on conversion basis, retained waste & scrap generated during the manufacture of finished goods from raw materials supplied by the principal manufacturer during the period from June 2003 to March 2006 and cleared the finished goods on the value intimated by the principal manufacturer instead of adopting the value in accordance with Board's instructions and SC judgment quoted above. This resulted into undervaluation of goods by Rs. 1.38 crore and short payment of duty of Rs. 22.04 lakh including education cess.

On this being pointed out (October 2006), the department accepted (October 2007) the objection and partially recovered Rs. 17.12 lakh pertaining to the period April 2003 to March 2005. It further intimated that the SCN for the balance amount was being issued.

1.7.2.5 Short levy of duty due to undervaluation of inputs by reducing the price and ignoring the increased value of inputs

Where excisable goods are not sold by the assessee but are used for consumption by the assessee or on behalf of the assessee by a related person for manufacture of other articles, the assessable value is to be determined under section 4(1) (b) of the Central Excise Act, 1944, read with rule 8 of Central Excise (Valuation) Rules, 2000 on the basis of one hundred and ten per cent (from 5 August 2003) of the cost of production or manufacture of such goods. Further, the Board clarified on 30 June 2000 that the value of goods consumed captively shall be determined on cost construction method only.

(i) M/s Jai Balaji Industries Ltd., in Bolpur commissionerate, engaged in manufacture of iron and steel products of chapter 72, had cleared steel ingots meant for further manufacture to its sister units on payment of duty on a

provisional value. On finalisation of annual account, however, the assessee re-determined the cost of production of such steel ingot for the relevant period and accordingly, paid the differential duty on the value so determined. Scrutiny of records revealed that actual cost of raw material consumed in production had been reduced by deducting an amount of Rs. 14.69 crore to absorb the price variation of steel ingots which was incorrect as per cost accounting standards 4 (CAS 4) and additionally did not include Rs. 2.81 crore paid for raw materials through supplementary invoices. Thus, the incorrect application of cost construction method for valuation led to undervaluation of steel ingots and consequential short payment of duty of Rs. 1.32 crore including education cess during the period 2005-06.

(ii) In a similar case M/s MSP Steel (P) Ltd., in Bhubaneshwar II commissionerate, engaged in manufacture of MS ingot and MS round under chapter 72, procured sponge iron from its related unit M/s MSP Sponge Iron Ltd. during 2004-05 to 2006-07 for manufacture of MS ingots which were captively consumed in manufacture of MS round. The rate of sponge iron supplied by the above related unit was subsequently revised on the basis of cost sheet prepared under CAS-4 and duty paid on such differential value of Rs. 246 crore. The incidence of duty was passed on to the assessee unit through supplementary invoices on which cenvat credit was availed of during October 2005, October 2006 and February 2007. Though the cost of sponge iron (input) was increased, the same was not taken into account by the assessee as no cost sheet was prepared in respect of MS ingots as required under the rules, which were captively consumed for manufacture of MS rounds. Thus, non addition of cost of raw material led to undervaluation of finished goods to that extent and consequential short levy of duty of Rs. 40.07 lakh including education cess. Further, it was observed that the assessee procured MS ingots from the market for manufacture of MS round at prices ranging from Rs. 19,999 to Rs. 20,751 PMT during 2005-06 and 2006-07, whereas the average sale price of MS round of the assessee was Rs. 16,776 and 15,994 PMT during the said period which confirms the fact of undervaluation.

1.7.2.6 Short levy of duty due to exclusion of retained sale tax from transaction value

Section 4(3)(d) of Central Excise Act, 1944, stipulates that transaction value of goods chargeable to central excise duty shall not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods. The CEGAT in the case of M/s Andhra Oxygen Pvt. Ltd. Vs CCE (Tribunal-Kolkata) 2003 (156) ELT 283 held that sales tax collected from buyers and not paid to the sales tax department when it was exempted under Sales Tax Act shall be considered as additional consideration flowing to assessees.

M/s Tata Metaliks Ltd., in Haldia commissionerate, engaged in manufacture of pig iron under chapter 72, had enjoyed the benefit of sales tax remission under section 41 of West Bengal Sales Tax Act, 1994. Scrutiny of records revealed that the assessee had collected sales tax of Rs. 1.87 crore from the buyers during April 2003 and March 2005 and had retained the tax so collected. The non inclusion of the retained sales tax in the assessable value

led to undervaluation and consequent short levy of duty of Rs. 29.90 lakh including education cess during the said period.

1.7.2.7 Short levy of duty due to undervaluation of goods sold at depots

Rule 7 of Central Excise (Valuation) Rules, 2000, as amended, provides that where the excisable goods are not sold at the time and place of removal but are transferred to depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the place of removal and where the assessee and the buyer of the said goods are not related and the price is the sole consideration for the sale, the value shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of goods under assessment.

(i) M/s IISCO Steel Plant (a unit of SAIL), in Bolpur commissionerate, engaged in manufacturing iron and steel products under chapter 72, transferred stock of TMT bars, angles etc. to its depots located at different places all over India after paying duty at the plant's (factory) gate. Scrutiny of records revealed that these goods were sold at higher prices than the assessable value at which duty was paid. This resulted in undervaluation of goods with duty implication of Rs. 15.78 lakh including education cess during the period from January 2006 to March 2006.

(ii) M/s Concast Ferro Inc., in Visakhapatnam I commissionerate, engaged in the manufacture of pig iron under chapter 72 of CETA, cleared major part of their manufactured goods to their depots/consignment agents at or about the same time on which duty was payable at the time of removal from the factory was not available. In the absence of the relevant information/invoices of the consignment agents/depots, the correctness of the values adopted for payment of duty at the time of removal from factory was not established by the assessee. As the value of goods cleared at depots/consignment agents gets added up with freight, depot expenses, agencies commission and other incidentals, the differential duty liability on the goods cleared through depots/consignment agents during the years 2006-07 and 2007-08 worked out to be Rs. 1.83 crore.

On this being pointed out (December 2007), the department reported (December 2007) that the assessee had paid Rs. 18.96 lakh on 11 December 2007 in respect of two consignment agents and promised to recover the balance amount of differential duty of Rs. 1.64 crore, the recovery particulars of which are awaited (March 2008).

1.7.3 Cenvat credit

Under the cenvat scheme, credit is allowed for duty paid on 'specified inputs' and 'specified capital goods' used in the manufacture of finished goods and service tax paid on any input or capital goods or any input service. The cenvat credit can be utilised towards payment of duty on finished goods and service tax on output service subject to fulfilment of certain conditions. A few cases of incorrect availing of cenvat credit and utilisation to the extent of

Rs. 407.16 crore were noticed in cases test checked in audit. Some of these are elucidated in the following paragraphs: -

1.7.3.1 Irregular utilisation of cenvat credit

Rule 3(4) of Cenvat Credit Rules, 2004, stipulates that cenvat credit may be utilised for payment of any duty of excise on any final product or on input/capital goods cleared as such and also for service tax on any output service.

M/s Bhusan Power and Steel Ltd., Hoogly, Kolkata-IV commissionerate, engaged in manufacture of H.R. Coil, Galvanized Plain Sheet etc., preferred an appeal to the CESTAT against an order of the Commissioner (Appeal). The CESTAT directed the assessee to pre-deposit the amounts of Rs. 20.92 lakh and Rs. 45.59 lakh in dispute, as a pre-condition to hear the case. Further, the assessee filed a writ petition before the High Court at Kolkata after debiting the amount of Rs. 66.51 lakh as pre-deposit from the Cenvat credit account instead of by cash.

Payment of pre-deposits by debiting cenvat account instead of through PLA/cash was not permissible and resulted in irregular utilisation of credit.

1.7.3.2 Inputs used in manufacture of exempted final products

Rule 6(1) of the Cenvat Credit Rules, 2004, stipulates that no credit of specified duty shall be allowed on inputs which are used in the manufacture of final products which are exempt or are chargeable to 'nil' rate of duty.

Rule 6(3)(b) of the Cenvat Credit Rules, 2004, provides that if cenvat credit is availed of on common inputs which are used in manufacture of exempted goods as well as in dutiable goods and separate accounts of their use are not maintained, then the manufacturer shall pay an amount equal to eight per cent (ten per cent from 10 September 2004) of the total price excluding taxes, charged at the time of its clearance.

(i) M/s National Steel & Agro Industries Ltd., in Indore commissionerate, engaged in manufacture of CR coils/sheets and GP coils/sheets availed cenvat credit on inputs and utilised it towards payment of duty on dutiable final products. The assessee was engaged in the manufacture of dutiable as well as exempted goods. The assessee cleared zinc dross valuing Rs. 23.42 crore as non excisable goods during the period April 2004 to March 2007 but had not maintained separate account of inputs used for exempted goods. However, an amount of Rs. 2.30 crore equivalents to eight per cent (ten per cent from 10 September 2004) of value of the zinc dross was not paid.

(ii) In another case, M/s Neelachal Ispat Nigam Ltd., in Bhubaneshwar I commissionerate, engaged in production of pig iron (chapter 72), BF coke and crude tar (chapter 27), availed of cenvat credit on inputs and did not maintain separate account of inputs. The assessee partly used coke in the manufacture of pig iron and partly sold it and crude tar in the market during the period 2005-06 and 2006-07 without payment of excise duty. The assessee was required to pay an amount of Rs. 61.42 crore being ten per cent of the total price of Rs. 614.27 crore of these exempted goods at the time of their clearance. The assessee was also liable to pay interest and penalty.

(iii) M/s Nava Bharat Venture Ltd., in Hyderabad commissionerate, engaged in the manufacture of ferro alloys, produced electricity in their captive generation units and utilised it partly in the manufacture of final products and sold a part to Reliance Industries and others. The assessee utilised cenvat credit on inputs like carbon paste and input services like manpower engaged in coal dozing, boiler scrap removal, laying of pipeline-oil cooler, turbo generator maintenance etc. but did not maintain separate inventory and accounts for such inputs/input services used in generation of electricity cleared for sale. Out of the total electricity produced, 78,71,588 units during 2005-06 and 2006-07 were sold to outside agencies. Hence, the assessee was required to reverse or pay 10 per cent on the value of electricity sold amounting to Rs. 10.53 crore.

On this being pointed out (November 2007), the department contended (February 2008) that since electricity was not an excisable item covered by schedules to CETA, 1985, that could not be considered either as an exempted product or a product which attracted 'nil' rate of duty and hence the provisions of rule 6 (3) (b) of Rules above were not applicable.

The contention of the department is not tenable in as much as electrical energy of 1,000 KWH has been notified in the schedules to the CETA as an excisable item carrying no rate of duty with effect from 1 April 2005 vide entry no. 27160000 of first schedule and, therefore, cenvat provisions are applicable to electricity.

(iv) In other three cases, M/s Jindal Steel & Power Ltd., M/s Singhal Enterprises (P) Ltd. and M/s Mahendra Sponge & Power Ltd., in Raipur commissionerate, generated electricity and sold a part of that valuing Rs. 800.21 crore from April 2004 to July 2007 to Chhattisgarh Electricity Board and others but did not pay duty of Rs. 80.02 crore, being ten per cent of the amount of sale, as the assessees had not maintained separate accounts of the common inputs.

1.7.3.3 Irregular availing of service tax credit

Section 66 of the Finance Act, 1994, covers leviability of service tax on the value of specified taxable services and the person providing the service is liable to pay such tax. However, section 66 A provides that such liability of tax is on the recipient of services who receives such services in India from a foreign service provider.

Rule 3(1) (ix) of Cenvat Credit Rules, 2004, allows credit of service tax leviable only under section 66 of the Finance Act, 1994, but not on such credit of service tax leviable under section 66 A of the above Act.

(i) M/s Durgapur Steel Plant (a unit of SAIL), in Bolpur commissionerate, manufacturing iron and steel, made a payment of service tax during the period from November 2006 to March 2007 as a recipient of service for consulting engineering service provided by different foreign companies. The payment was made in foreign currency.

Audit scrutiny revealed that the assessee took credit of service tax paid on such services in contravention of above stated rules which resulted in irregular availing of cenvat credit to the tune of Rs. 2.12 crore including education cess.

(ii) Three other assessees, M/s Ruchi Strips & Alloys Ltd. and M/s National Steel & Agro Ltd., in Indore commissionerate and M/s Good Luck Steel Tubes Ltd. in Noida commissionerate, also irregularly availed cenvat credit of Rs. 1.78 crore of service tax paid under section 66 A of the above Act.

1.7.3.4 Irregular availing of cenvat credit on capital goods used in manufacture of final product

Rule 4(2)(b) of Cenvat Credit Rules, 2004, stipulates that the balance 50 per cent of cenvat credit paid on capital goods may be taken in any subsequent financial year to the financial year in which the capital goods were received in the factory of manufacturer, if the capital goods are in possession.

M/s Southern Iron and Steel Company Ltd., in Salem commissionerate, engaged in manufacture of Iron and Steel availed 50 per cent of cenvat credit in the first financial year during the period 2004-05 to 2007-08 and the balance 50 per cent in the subsequent years on lancing pipes which were capital goods as per rule 2 (a) of the above Rules. As the said capital goods were used in the manufacture of final products and not in possession in the subsequent financial years, the assessee was not eligible for cenvat credit of remaining 50 per cent credit. This resulted in irregular availing of credit for Rs. 14.24 lakh.

On this being pointed out in audit (December 2007), the department accepted (May 2008) the observation.

1.7.3.5 Suo moto credit instead of following prescribed refund procedures

Section 11B of the Central Excise Act, 1944, provides for claiming refund of the excise duty by an application for refund before the expiry of one year from the relevant date. There is, however, no provision in the Act/Rules under which suo moto credit of the excise duty/cenvat can be taken. CESTAT in the case of M/s Comfit Sanitary Napkins(I) Ltd. {2004(174) ELT 220} also held that the assessee could not take suo moto refund/credit but should follow the procedure laid down under section 11 B of the above Act.

Audit noticed that M/s Southern Iron and Steel Company Ltd., in Salem commissionerate, engaged in manufacturing of Iron and Steel had debited the cenvat account for the wrong availing of credit of Rs. 41.10 lakh. The department insisted to reverse the amount by remittance through PLA instead of debiting the cenvat account. Accordingly, the assessee paid the entire amount of duty through PLA but took suo moto cenvat credit after five days without following the procedure of section 11 B.

On this being pointed out (December 2007), the department accepted the observation (March 2008) and stated that action was being taken to protect the Government revenue.

1.7.3.6 Incorrect availing of service tax credit on wind mill

Sub-rules (1) and (4) of rule 4 of Cenvat Credit Rules, 2004, stipulate that cenvat credit paid on inputs, capital goods and service tax paid on service received by a manufacturer can be utilised against payment of duty on the manufactured final products. The Board clarified in March 2006 that the cenvat credit will not be allowed on service tax paid on erection and

commissioning of wind mills located outside the factory as no nexus existed between the wind mill and the production process. Therefore, the service tax paid on lease rentals of wind mills situated outside the factory was also not admissible.

Audit scrutiny of records of M/s Ennore Foundries, in Chennai commissionerate, engaged in the manufacture of rough iron castings, revealed that they had availed service tax credit of Rs. 2.47 crore during June 2006 and September 2007 towards lease rent for the wind mills located outside the factory which was not in order as per the above clarification of the Board.

On this being pointed out (February 2008), the department accepted (March 2008) the observation and stated (July 2008) that SCN for Rs. 2.47 crore had been issued in June 2008.

1.7.3.7 Irregular availing of cenvat credit on outward freight

Rule 2(1) of Cenvat Credit Rules, 2004, stipulates that input service means any service used by the manufacturer in or in relation to manufacture of final products and clearance of final product from the place of removal and includes inward transportations on inputs or capital goods and outward transportation up to the place of removal. Under rule 3(1) (ix) of the above said Rules, the service tax paid on input service can be taken as cenvat credit.

(i) Audit scrutiny of the records of M/s Electro Steel Castings Ltd., in Chennai commissionerate, engaged in manufacture of cast iron pipes and ductile iron fittings, revealed that they had availed cenvat credit of Rs. 20.29 lakh paid on outward transportation of finished goods, ex-factory, beyond place of removal, during the period March 2005 to September 2007, which was not covered by the input service. Availing of credit was irregular.

On this being pointed out (September 2007), the department stated (February 2008) that SCN had been issued in January 2008.

(ii) In three other cases, assessees in Kanpur, Luchnow and Ghaziabad commissionerates, incorrectly availed cenvat credit of service tax of Rs. 4.93 lakh on outward transportation beyond place of removal during the period January 2005 and September 2007 in contravention of above Rules.

1.7.3.8 Incorrect availing of credit on inputs cleared as such

Rule 2(k) read with rule 2 (1) of Cenvat Credit Rules, 2004, defines that input/input service means all input/input services that are used in or in relation to the manufacture of final goods. Further, rule 3(5) of the above Rules stipulates that where inputs or capital goods are removed as such by a manufacturer he shall reverse an amount equal to the credit availed of on such inputs/capital goods.

(i) Audit scrutiny of records of M/s Sree Rangaraj Ispat (P) Ltd., in Salem commissionerate, engaged in manufacture of sponge iron, revealed that the assessee had availed of cenvat credit of Rs. 11.10 lakh on inward freight of coal and stevedoring[1] charges on imported coal. The coal was not utilised in the production of final product but sold. The availed cenvat credit was required to be reversed.

[1] Loading and unloading of ships at a dock

(ii) In three other cases, the assessees M/s Mahalakshmi Profiles (P) Ltd., M/s Dilpreet Tubes Pvt. Ltd. and M/s Sarita Steel Industries Ltd., in Hyderabad I, IV and Visakhapatnam II commissionerates respectively, availed service tax credit of Rs. 10.26 lakh on input services which were cleared as such but the credit was not reversed at the time of clearance of such input services. On this being pointed out (November 2007), the department reported (February 2008) that a total recovery of Rs. 9.44 lakh had been made in the cases of M/s Mahalakshami Profiles and M/s. Sarita Steel Industries Ltd.

(iii) M/s Beehive Foundry Engineering Work, in Chennai I commissionerate, engaged in the manufacture of fabricated structural materials purchased input structural materials, in terms of actual weight of materials received which were cleared as such. While clearing the materials, these were weighed in section weight which was found to be lower than the actual weight by one to three per cent and duty was discharged on the section weights. During the period from 2004-05 to 2007-08 (up to September 2007), a total quantity of 16,883.925 MT of input materials were cleared as such by adopting section weight resulting in understatement of weight to the extent of 358.070 MT. Since the duty credit was taken based on actual weight, the duty credit reversible on the differential quantity worked out to Rs. 14.92 lakh approximately.

On this being pointed out (January 2008), the department accepted (April 2008) the objection and reported the recovery of Rs. 14.32 lakh along with interest.

1.7.3.9 Incorrect availing of cenvat credit based on ineligible documents

Rule 9(1) (a) of Cenvat Credit Rules, 2004, stipulates that the assessee is eligible to take cenvat credit based on an invoice issued by a manufacturer or an importer. M/s Concast Ferro Industries and M/s KGN Deccan Engineering Industries Pvt. Ltd., in Visakhapatnam I and Hyderabad IV commissionerates respectively, availed cenvat credit of Rs. 16.56 lakh based on invalid documents. The assessees need to reverse this credit.

1.7.3.10 Premature availing of cenvat credit of service tax paid on Goods Transport Agency service

Sub rule 7 of rule 4 of Cenvat Credit Rules, 2004, provides that the cenvat credit on input service shall be allowed on or after the day on which payment is made of the value of input service and service tax.

M/s Bindal Sponge Iron Ltd., in Bhubaneshwar I commissionerate, engaged in manufacture of sponge iron paid service tax for GTA service for April 2006 to September 2007 through TR-6 challans on the 4th or 5th day of subsequent month but took the credit during the month prior to the payment of the service tax. This resulted in premature availing of service tax credit of Rs. 99.20 lakh which was irregular.

1.7.3.11 Excess availing of cenvat credit on capital goods

As per Rule 2(a) of Cenvat Credit Rules, 2004, capital goods include refractory bricks, refractory materials, pipes, moulds and spares, accessories like belts, impeller etc. Rule 4(2)(a) stipulates that credit in respect of capital goods received in a factory or in the premises of the provider of output service

at any point of time in a given financial year shall be taken only for an amount not exceeding 50 per cent of the duty paid on such capital goods in the same financial year.

(i) M/s Neelachal Ispat Nigam Ltd. and M/s Shree Metaliks Ltd., in Bhubaneshwar I commissionerate, engaged in manufacture of pig iron and sponge iron, availed 100 per cent cenvat credit of Rs. 46.62 lakh on capital goods viz. refractory bricks, refractory material, pipes, moulds and spares, accessories like belts, impeller, etc. during 2006-07 treating them as inputs. This resulted in excess availing of credit of Rs. 23.31 lakh which needs to be reversed along with interest and penalty.

(ii) In 64 other cases, the assessees availed/utilised cenvat credit on capital goods incorrectly which resulted in misuse of cenvat credit amounting to Rs. 6.79 crore. On the observations being pointed out, 24 observations involving a duty of Rs. 37.42 lakh were accepted by the department and of these in 22 cases the department recovered a sum of Rs. 33.56 lakh. In four cases the department issued SCNs for Rs. 35.08 lakh.

1.7.3.12 Incorrect availing of cenvat credit on input services having no nexus with manufacturing activity and clearance of final product

Rule 2(l) of Cenvat Credit Rules, 2004, stipulates that input service means any service used by a provider of taxable service for providing an output service or used by manufacturer in or in relation to the manufacture of final products and clearance of final products from the place of removal. The CESTAT, Ahmedabad in the case of Ultratech Cement Ltd. Vs CCE Bhavnagar {2007(6) STR-364-Tri Ahd.} stated that activities relating to business used in relation to manufacture and clearance of final products from the place of removal to be considered. In this regard the CESTAT in another judgment of Excel Crop Care Ltd. Vs CCE Ahmedabad {2007(6) STR-451-Tri Ahmedabad} held that credit of service tax paid on custom house agent services was not admissible.

(i) M/s Shah Alloys Ltd., in Ahmedabad III commissionerate, engaged in the manufacture of excisable goods under chapter 72 and 73 of schedule to CETA, availed customs house agent service and clearing & forwarding services for export of goods during July 2006 and April 2007 and paid Rs. 2.51 crore towards these services. The assessee paid service tax of Rs. 30.78 lakh on these services and took cenvat credit of the same. In view of the above stated CESTAT judgments, availing of cenvat credit was incorrect.

On this being pointed out (July 2007), the department stated (August 2007) that SCN had since been issued.

(ii) Similarly in another case, M/s Essar Steel Ltd., in Surat I commissionerate, paid Rs. 228.92 crore to non residents as commission, during November 2005 to September 2007. The assessee paid service tax and education cess of Rs. 27.29 crore on the amount of commission and took cenvat credit. This availing of cenvat credit of Rs. 27.29 crore was incorrect as this service had no nexus with the production activities of the assessee.

1.7.3.13 Irregular availing of cenvat credit on unspecified input services

As per rule 3 of Cenvat Credit Rules, 2004, the assessee was entitled to avail cenvat credit of specified duties on inputs/input services as specified in rule 2 of the above Rules.

M/s Maharashtra Seamless Ltd., in Raigad commissionerate, engaged in manufacturing of goods under chapters 72 & 73, availed credit of service tax of Rs. 15.30 lakh paid on construction of residential buildings during 2006-07. The service rendered was not in or in relation to manufacturing activity and was not a specified input service. This led to irregular availing of service tax credit.

On this being pointed out (October 2007), the department admitted (November 2007) the observation and intimated that the credit had since been reversed.

1.7.3.14 Excessive availing of credit and utilisation thereof

Rule 3(4) read with rule 14 of Cenvat Credit Rules, 2004, provides that while paying duty, the cenvat credit should be utilised to the extent such credit is available on the last day of the month for payment of duty relating to that month. Wrongly utilised credit shall be recovered along with interest from the manufacturer.

(i) M/s Vipras Castings Ltd., in Raigad commissionerate, engaged in the manufacture of goods falling under chapters 72 & 73, in their excise records had reversed excess cenvat credit of Rs. 49.69 lakh on six occasions. Interest leviable thereon was also paid.

On scrutiny of records, it was found that assessee had availed excess cenvat credit which was ten times more than the duty actually paid and the same was reversed at a later date. Frequent availing of excess credit clearly showed the intention of avoiding payment of duty in cash. Had the incorrect credit not been availed, then the assessee would have paid duty through PLA. Although the excess credit taken was reversed subsequently, yet the fact remains that no SCN was issued. The assessee was also liable for equivalent penalty of Rs. 49.69 lakh.

On this being pointed out (September 2007), the department accepted the observation and stated (February 2008) that SCN was being issued.

(ii) In 198 other cases, cenvat credit on inputs/input services was incorrectly taken by the assessees which resulted in misuse of cenvat credit of Rs. 58.20 crore. In 90 cases valuing Rs. 8.05 crore, the department accepted the audit observations and of these in 68 cases the department further recovered a sum of Rs. 1.44 crore. In 17 other cases, SCNs for Rs. 1.12 crore were issued.

1.7.3.15 Irregular transfer of cenvat credit

Rule 10 of Cenvat Credit Rules, 2004, provides that if a manufacturer shifts his factory to another site or the factory is transferred on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of the factory to the joint venture with the specific provision for transfer of liabilities of such factory, then the manufacturer shall be allowed to transfer the cenvat credit lying unutilised in his accounts to such transferred, sold,

merged, leased or amalgamated factory. Further, as per rule 3 of the above Rules, the transfer of the cenvat credit shall be allowed only if the stock of inputs as such or in process, or the capital goods are also transferred along with the factory or business premises to the new site or ownership and the inputs, or capital goods, on which credit has been availed of are duly accounted for, to the satisfaction of the Central Excise Officer.

(i) Audit scrutiny of the records of M/s KEC International Ltd., in Nagpur commissionerate, revealed that on 21 January 2006 the assessee informed the CE Division II that due to composite scheme of arrangement between its sister units, their power transmission business was sold to M/s KEC Infrastructure Ltd. from 1 April 2005. Further, the names of said two companies were interchanged. Hence, prima facie there appeared to be no change as all assets and liabilities along with share capital were transferred to M/s KEC Infrastructure Ltd. which was renamed as M/s KEC International Ltd.

Further, as per paragraph 1.7.2 (g) of the above scheme, liabilities of Rs. 25 crore relating to Power transmission business of KEC was excluded from the scope of such transfer. Hence, the condition of rule 10 was not fulfilled as transfer of liabilities was not effected. The assessee had un-utilised cenvat credit of Rs. 39.42 lakh on 1 April 2005 which was transferred. This transfer of credit of Rs. 39.42 lakh was irregular because (i) the condition of rule 10 was not fulfilled and (ii) such transfer was not done after obtaining the permission from the department.

On this being pointed out (March 2007), department issued SCN for reversal of credit (October 2007).

(ii) In another case, M/s Orange City Alloys Pvt. Ltd. which was originally registered as M/s Saggu Castings Pvt. Ltd. prior to 26 September 2005, in Nagpur commissionerate, transferred cenvat credit of Rs. 42.31 lakh as there was a change in ownership and the name of the assessee, attracting the provisions of rule 10 of the above Rules. As the cenvat credit balance was carried forward to the new entity without following the procedure i.e. obtaining prior permission of transfer of cenvat credit and getting stock verified by the department, it was irregular.

On this being pointing out (November 2007), the department admitted (January 2008) that there was a procedural lapse.

1.7.3.16 Incorrect availing of credit on inputs

The CBEC, in consultation with the Ministry of Law, clarified on 4 January 1991 that in the event of manufacturer availing cenvat credit and paying duty on exempted/nil rate of duty final products on his own volition, the payment would not be in the nature of duty and were to be treated as deposits and hence credit of duty paid on such inputs was not admissible. Further, the Kolkata Tribunal in their decision -Commissioner Vs Steel Authority of India- 2003(154) ELT 65 (Tri-Kolkata) held that the iron ore mining from mines and then subjecting to process of crushing, grinding, screening and washing with a view to remove foreign materials and to concentrate such ores do not result in the manufacture of different commercial commodity, hence no central excise duty is leviable on iron ore concentrate under heading 26.01 of the Central Excise Tariff Act, 1985.

(i) M/s Tata Steel Ltd., Bistupur, in Jamshedpur commissionerate, engaged in manufacture of pig iron, hot metal, billets, H.R. coils, wire rods etc under chapter 72, availed of cenvat credit on iron ore concentrate of its own captive mines at Noamundi and iron ores purchased from TISCO Mines Ltd., Joda for Rs. 127.73 crore. This resulted in irregular availing of cenvat credit of Rs. 127.73 crore. The utilisation of cenvat credit of the same amount subsequently in payment of duty on the final product was also incorrect.

On this being pointed out, the department intimated (May 2006) that SCN had been issued on 23 March 2006 for Rs. 33.25 crore.

(ii) In another case, M/s Singhal Enterprises Pvt. Ltd., Raigarh, in Raipur commissionerate, availed of cenvat credit of duty of Rs. 1.38 crore paid on iron ore during 2004-05 and 2005-06 which was to be treated as 'deposits'. This resulted in incorrect availing of credit of Rs. 1.38 crore.

1.7.3.17 Incorrect availing of cenvat credit on non-taxable input service

According to Finance Act (No. 2) 2004, as made effective from 10 September 2004, business auxiliary service means any service in relation to production of goods on behalf of the client but does not include any activity that amounts to 'manufacture' within the meaning of Section 2(f) of the Central Excise Act, 1944.

M/s Gandhi Special Tubes Ltd., in Vadodara-II commissionerate, engaged in the manufacture of seamless steel tubes, ERW precision, nuts and sleeves falling under chapter 73, engaged job workers for production of goods on behalf of the clients. The job workers dealt with activities which were manufacturing in nature and not covered under business auxiliary services. The assessee paid Rs. 2.34 crore to them during September 2004 to September 2007 and paid service tax of Rs. 21.33 lakh also. The assessee availed cenvat credit of this service tax of Rs. 21.33 lakh which was incorrect.

1.7.3.18 Inadmissible cenvat credit on unspecified inputs

As per rule 2(k) of Cenvat Credit Rules, 2004, input means all goods except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to manufacture of final products whether directly or indirectly and whether contained in the final product or not and includes lubricating oils, greases, cutting oils, coolants, accessories of the final products cleared along with the final products, goods used as paints or as packing material or as fuel or for generation of electricity or steam used in or in relation to manufacture of final products or for any other purpose, within the factory of production.

As per Indian Oil Corporation (IOC), carbon black feed stock (CBFS) is the raw material used by tyre industry for the manufacture of carbon black or used by processors to make various downstream chemicals like agarbati oil, white oil or used for manufacture of rubber process oils, etc.

Scrutiny of records of M/s Hisar Metal Industries, in Rohtak commissionerate, engaged in manufacture of CR strips under chapter 72 of CETA, revealed that the assessee availed credit of Rs. 1.13 crore during the period from April 2004 to September 2007 on CBFS used as fuel in the furnace. CBFS fell neither in the category of inputs specified for iron and steel industry for use in or in

relation to manufacture of final products nor in the category of fuel. Credit availed by the assessee on CBFS was, therefore, not admissible. This resulted in inadmissible availing of credit of Rs. 1.13 crore.

1.7.3.19 Irregular availing of cenvat credit on capital goods

Rule 2 of Cenvat Credit Rules, 2004, defines capital goods as those which are used/installed in the factory of the manufacturer of final products. The Tribunal in the case of M/s Madras Cement Ltd. Vs CCE Hyderabad (1998 (99) ELT 395 (T)) held that mining is not a part of the manufacture of cement, hence capital goods used in mines are not eligible for credit.

M/s Tata Steel (Mining Division), in Jamshedpur commissionerate, engaged in extracting and selling iron ore, availed cenvat credit of Rs. 4.47 crore and Rs. 9.13 crore on capital goods used on the surface of own iron ore mines during 2000-01 to 2003-04 and 2004-05 to 2006-07, respectively. The iron ore was shipped to the factory and cenvat credit of the same was availed of by M/s Tata Steel Ltd., Jamshedpur. Credit of Rs. 13.60 crore availed of on capital goods was incorrect and recoverable along with interest.

On this being pointed out (April 2006) the department intimated (May 2006) that SCN for the period from February 2005 onwards has been issued.

1.7.3.20 Simultaneous availing of cenvat credit on capital goods and depreciation under Income Tax Act

Rule 4(4) of Cenvat Credit Rules, 2004, stipulates that cenvat credit in respect of capital goods shall not be allowed in respect of that part of the value of capital goods which represents the amount of duty on such capital goods, which the manufacturer claims as depreciation under section 32 of Income Tax Act, 1961.

M/s Tyco Electronics System India Pvt. Ltd. (Energy Division), in Bangalore II commissionerate, engaged in manufacture of double tension string and single suspension string falling under chapter 73 of CETA, received capital goods (rubber injection moulding machine etc.) during 2005-06 and 2006-07 on which cenvat credit of Rs. 25.76 lakh was availed. Scrutiny of records revealed that they have claimed depreciation on the entire value of capital goods under section 32 of Income Tax Act, 1961 also. The availing of cenvat credit of Rs. 25.76 lakh was, therefore, incorrect and the assessee was liable to reverse the credit and pay interest of Rs. 3.46 lakh and also penalty under section 11C of Central Excise Act, 1944, equivalent to duty amount.

1.7.3.21 Irregular utilisation of cenvat credit on input GTA service

Rule 3(4) of Cenvat Credit Rules, 2004, stipulates that cenvat credit may be utilised for payment of any duty of excise on any final product or on input/capital goods cleared as such and also for service tax on any output service.

(i) M/s Kesoram Spun Pipes and Foundaries, Hooghly, in Kolkata IV commissionerate, engaged in manufacturing spun pipe falling under chapter 73, utilised the cenvat credit for payment of service tax payable by the manufacture on input GTA service which was not correct. Service tax in such cases was required to be paid through PLA. The irregular utilisation of cenvat

credit worked out to Rs. 12.57 lakh (including education cess) during April 2005 to September 2006.

(ii) In a similar case, M/s Bhusan Power and Steel Ltd., in Kolkata IV commissionerate, had also irregularly utilised cenvat credit of Rs. 58.82 lakh (including education cess) during the period from January 2005 to October 2005.

1.7.3.22 Pre-mature availing of cenvat credit on inputs stored outside the factory premises

Rule 14 of Cenvat Credit Rules, 2004, stipulates that where the cenvat credit has been taken or utilised wrongly, the same along with interest shall be recovered from the manufacturer and the provisions of section 11A and 11AB of the Central Excise Act, 1944, shall apply mutatis mutandis for affecting such recoveries. Further, rule 8 of the above Rules, provides that the Deputy Commissioner/Assistant Commissioner of Central Excise, having jurisdiction over the factory of manufacturer of final products may permit the manufacturer to store cenvatable inputs outside the factory subject to certain limitations and conditions as he may specify to safeguard revenue. The Board has issued clarification vide Ahmedabad commissionerate Trade Notice No. 93/2004-2005(179) ELT (T-16) prescribing the procedures for the assessees willing to store cenvatable inputs outside the factory premises. The cenvat credit in such cases shall be taken in the books of accounts by the manufacturer only when the entire inputs covered by an invoice are received in the factory.

M/s SPS Rolling Mills Ltd., Durgapur, in Bolpur commissionerate, engaged in manufacture of enrolled products of iron and steel under chapter 73, got permission for storing a consignment of 3,691.4 MT of raw materials involving cenvat credit of Rs. 72.29 lakh outside the factory premises on 23 August 2005. The entire consignment of the raw material stored outside the factory premises was received in the factory during the period between 11 August 2005 to 18 June 2006 in a phased manner. But the assessee availed entire cenvat credit on the said consignment on 31 August 2005 though the credit should have been availed only after 18 June 2006 and utilised the same towards payment of duty. This resulted in premature availing of cenvat credit of Rs. 72.29 lakh and consequent benefit to the assessee. The duty should have been paid through PLA only. Interest amounting to Rs. 7.44 lakh is also recoverable from the assessee.

1.7.3.23 Non payment of duty on the clearance of capital goods as waste and scrap

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

M/s Durgapur Steel Plant, (a unit of SAIL), in Bolpur commissionerate, engaged in manufacture of iron and steel products falling under chapter 72 and 73, availed cenvat credit on various capital goods including goods under chapter 69 i.e. refractory bricks used as lining material for their furnaces. Scrutiny of their records revealed that the assessee cleared large quantity of

such bricks after its uses without discharging duty leviable on the transaction value. This resulted in non payment of duty of Rs. 56.69 lakh during the period between April 2005 and March 2007.

1.7.3.24 Inadmissible availing of cenvat credit on inputs not used in manufacture

Section 2(f) of Central Excise Act, 1944, defines 'manufacture' as any process which incidental or ancillary to the completion of a manufactured product and which is specified in relation to any goods in the section or chapter notes of the first schedule to the CETA, as amounting to manufacture. In the case of M/s Hindustan Zinc Ltd. Vs CCE-2005(181)ELT 170(SC), the Supreme Court held that before central excise duty can be imposed on any articles, it must satisfy two basic conditions that (i) the article should be goods and (ii) it should have come into existence as a result of manufacture.

M/s Surya Roshni Ltd., in Rohtak commissionerate, engaged in manufacture of CR sheet, black and galvanized pipes under chapter 72, procured HR sheets and after pickling sold it as pickled HR sheets during April 2006 to September 2007. Since the process of pickling of HR sheets did not amount to manufacture, cenvat credit of Rs. 2.54 crore availed was not admissible to the assessee which needs to be reversed.

On this being pointed out (February 2008), the department stated (July 2008) that SCN for Rs. 2.42 crore for the period May 2006 to September 2007 has been issued.

1.7.4 Exemptions

1.7.4.1 Incorrect availing of exemption by person other than Goods Transport Agency (GTA)

Service tax on transport of goods by road has been re-imposed with effect from 1 January 2005. Goods Transport Agency (GTA) is liable to pay service tax on gross transportation charges collected from customer in relation to transport of goods by road. However, vide notification no. 35/2004-ST dated 3 December 2004, liability to pay service tax has also been cast on the recipient of services from GTA, when recipient of services is consignor or consignee of the goods and falls under any one of the seven categories mentioned therein (a factory, company, corporation, society, cooperative society, dealer of excisable goods or a corporate body). By notification no. 32/2004-ST dated 3 December 2004, 75 per cent value of the taxable service provided by GTA to a customer is exempt from levy of service tax subject to the conditions that credit of duty paid on inputs or capital goods used for providing such taxable service is not taken and benefit of notification no. 12/2003-ST dated 20 June 2003 is not availed by GTA.

(i) Test check of records of 16 manufacturers, in Kanpur, Lucknow, Meerut-II, Noida and Ghaziabad commissionerates, engaged in manufacturing of iron and steel and articles of iron and steel falling under chapters 72 and 73, revealed that they received services from GTA and paid these agencies transportation charges amounting to Rs. 64.88 crore during the period January 2005 to September 2007. Though the service tax was payable on gross

transportation charges, yet they paid service tax of Rs. 1.86 crore at 25 per cent amount of freight charges after claiming exemption under notification No. 32/2004-ST instead of Rs. 7.54 crore. The claiming of exemption was incorrect as they failed to produce a certificate from GTA on consignment notes for not availing cenvat credit on inputs/ capital goods used for such services and have not availed the benefit of notification No. 12/2003-ST dated 20 June 2003. These companies were liable to pay the balance service tax of Rs. 5.68 crore with interest of Rs. 78.86 lakh and penalty of Rs. 5.68 crore also.

On this being pointed out (February 2008), the department issued SCN for Rs. 1.74 crore in three cases.

(ii) In another case, the department issued SCN (April 2007) to M/s Southern Iron and Steel Company, in Salem commissionerate, for alleged non payment of service tax on GTA service for the period from January 2005 to September 2006 on the freight charges paid but SCN for the subsequent period (October 2006 to September 2007) was not issued on the freight value of Rs. 13.91 crore for which service tax of Rs. 1.70 crore including education cess was payable.

On this being pointed out (February 2008), the department issued SCN for Rs. 1.05 crore. Action taken for the balance amount was not furnished.

1.7.4.2 Incorrect grant of exemption

(i) Notification No.67/95-CE dated 16 March 1995 specified that inputs manufactured in a factory and used within it are exempt from duty, provided the final product is not exempt or chargeable to 'nil' rate of duty other than those goods which are cleared (i) to a unit in Free Trade Zone, (ii) to a hundred per cent export oriented undertaking, (iii) to a unit in an Electronic Hardware Technology Park, (iv) to a unit in a Software Technology park, (v) under notification No.108/95-CE and (vi) by a manufacturer of dutiable and exempted final products after discharging obligation under rule 6 of Cenvat Credit Rules. Thus, clearance of goods under Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2001 or under notification No. 43/2001-NT is not covered under the above-mentioned exemption notification. Notification No. 43/2001-NT stipulates that the goods manufactured or processed using the excisable goods so procured without payment of duty under this notification shall be exported in terms of sub-rule (1) of rule 19 of the Central Excise Rules, 2002.

M/s SAIL, Rourkela Steel Plant, in Bhubaneshwar-II commissionerate, consumed 9,615.419 M.T of slabs valuing Rs. 21.28 crore captively (during 2005-06 and 2006-07) availing exemption under the above mentioned notification dated 16 March 1995 for manufacture of 9,377.683 MT of H.R Strips and Plates and cleared the same to a domestic unit, M/s Anurag Ferro Products Ltd. without duty under notification No. 43/2001-NT. As notification dated 16 March 1995 has no connection with notification No. 43/2001-NT, availing of exemption for captive consumption is irregular and the assessee is required to pay duty of Rs. 2.53 crore including education cess leviable on the intermediate goods i.e. slabs consumed captively.

(ii) As per notification No. 67/95-CE dated 16 March 1995, as amended from time to time, capital goods and specified inputs manufactured in a factory and used within the factory of production in or in relation to the manufacture of final products are exempted from paying central excise duty provided that manufactured final products are not exempted or chargeable to 'nil' rate of duty.

M/s IISCO Steel Plant, Burnpur, in Bolpur commissionerate, engaged in the manufacture of iron and steel products under chapter 72 and 73 entered into an agreement with M/s Associated Cement Company (ACC) for delivery of molten slag from the Blast Furnace within the plant premises to the receiving troughs of the granulation Plant of M/s ACC through rail-run rakes of 'ladles/slag pot'. The assessee manufactured such slag pot/ladles falling under chapter heading 7325 and cleared the same without payment of duty in terms of the said notification. However, the assessee did not utilise the said slag pot for the manufacture of their own final products but put it to use only for delivering non-excisable 'molten slag' to M/s ACC for the manufacture of 'granulated slag' belonging to the buyer. Thus, the slag pot/ladles manufactured in the factory were not used in further manufacture within the factory of production and so the assessee was not entitled to the benefit of exemption under the said notification. This resulted in non-levy of duty of Rs. 64.12 lakh including education cess during the period from July 2006 to August 2007.

On this being pointed out (September 2007), while not admitting the audit observation, the department contended (February 2008) that the exemption under the notification was applicable only to inputs for its use in dutiable products and not to capital goods which was exempt unconditionally for its use in the manufacturing process. The contention of the department is not tenable since the capital goods, 'slag pot/ladles' were not utilised for production of any goods within the factory and thus, the primary condition of the above notification had not been fulfilled.

(iii) In 11 other cases, the assessees were irregularly granted exemptions under various notifications for duty totalling Rs. 1.39 crore.

1.7.5 Export

1.7.5.1 Non levy of duty

Rule 19 of Central Excise Rules, 2002 stipulates that excisable goods can be exported without payment of duty subject to the condition and procedure as laid down in the notification dated 26 June 2001 as amended, issued under this rule; One of the conditions stipulates that the goods should be exported within six months from the date on which these were cleared for export or such extended period as might be allowed in any particular case.

M/s Shree Metaliks Ltd., in Bhubaneshwar II commissionerate, engaged in manufacture of MS billets, cleared their products in February 2007 for export through merchant exporter. Scrutiny revealed that billets valuing Rs. 1.15 crore were not exported till December 2007. As no extension of time was obtained from the competent authority, the assessee was liable to pay duty of Rs. 18.85 lakh involved therein since more than six months had elapsed. The

department was required to recover the duty of Rs. 18.85 lakh alongwith interest of Rs. 2.17 lakh upto September 2007.

In another case, the assessee did not fulfil their export obligations and was liable to pay customs duty/additional duty of excise amounting to Rs. 4.22 lakh and interest of Rs. 0.96 lakh. The department accepted (December 2007) the observation and reported the recovery of Rs. 5.18 lakh.

1.7.5.2 Non payment of duty on export rejects

Rule 19(1) of the Central Excise Rules, 2002, provides for exports of excisable goods without payment of duty and such exports shall be subject to such conditions, safe guards and procedures specified in the notifications issued thereunder and also governed by the supplementary instructions issued by the Board.

(a) M/s Sundaram Fastners, in Chennai commissionerate, engaged in manufacture of articles of iron and steel under chapter 73, exported their finished goods to other countries. During the years 2005-06 and 2006-07, goods exported valued at Rs. 48.69 lakh were rejected by foreign buyer and the same were accounted for under 'export rejects' in the trial balance, but the goods were not brought back to factory on cost grounds. In respect of similar exports during the years 2001-02 to 2004-05, the department had issued three SCNs of Rs. 24.31 lakh. In the Board's supplementary instruction regarding simplified procedure, it was specified that foreign remittance certificate was accepted as proof of export, besides producing copy of shipping bill and bill of loading attested by the customs authorities. Further, according to Export-Import (EXIM) Policy, 2001, foreign remittance had to be received within 360 days from the date of export of goods.

Since the foreign remittance has not been received in all these cases, the assessee was required to pay Rs. 7.95 lakh for foreign rejects and Rs. 24.31 lakh covered by SCNs mentioned above.

On this being pointed out (November 2007), the department stated (December 2007) that as against the projected duty of Rs. 7.95 lakh for the export rejects for the period 2005-06 and 2006-07, the assessee had paid Rs. 3.31 lakh on 14 November 2007 but regarding the balance amount Rs. 4.64 lakh and Rs. 24.31 lakh in respect of the period covered in SCNs, the details were not furnished. Thus, the duty of Rs. 32.26 lakh alongwith interest was due from the assessee.

(b) Further, in 16 other cases of export by this assessee, sale proceeds of Rs. 1.68 crore for the period 2004-05 to 2006-07, were pending realisation for period of more than 360 days as prescribed in the EXIM Policy, 2001. The un-realised duty worked out to Rs. 27.49 lakh.

1.7.5.3 Non-receipt of proof of export

Para 13.2 of Chapter 7 of Central Excise Manual stipulates that the manufacturer exporter is required to furnish a statement in Annexure-19 specified alongwith copies of ARE 1, bill of lading and shipping bills. In case of non export within six months from the date of clearance, the exporter shall deposit excise duty along with interest.

M/s Siscol, an integrated steel plant, in Salem commissionerate, engaged in manufacture of MS Bars, flats and billets, etc. under chapter 72, exported their

products of Rs. 9.69 crore involving central excise duty of Rs. 1.58 crore during the year 2006-07. Test check of records revealed that even after the expiry of six months of export, the proof of export for these cases had not been received and the annexure 19 statement had also not been furnished. The assessee was, therefore, required to pay duty of Rs. 1.58 crore but the department had not recovered the duty so far.

1.7.5.4 Other cases

In seven other cases where export lapses had been noticed, loss/ short payment of duty of Rs. 45.23 lakh was observed. In two cases, the department accepted the audit observation of Rs. 2.02 lakh and reported recovery.

1.7.6 Cases pending adjudication

Section 11 A of Central Excise Act, 1944, stipulates that where SCNs had been issued, central excise officer was required to adjudicate these within six months in normal cases and within one year, in cases of non levy/short levy due to fraud, collusions, etc. where it was possible to do so.

Test check of relevant records revealed that in 40 commissionerates of central excise, 272 cases of adjudication of SCNs issued to manufacturers of iron and steel and articles of iron and steel involving revenue of Rs. 248.48 crore were pending for adjudication. Fifty per cent of the cases constituting 56 per cent of the total revenue were more than a year old. Approximately, 31 per cent of the cases, involving 21 per cent of the value of all outstanding cases were pending adjudication for more than three years.

1.7.7 Refunds

1.7.7.1 Inadmissible refund

According to CEGAT judgment in the case of M/s Mohta Ispat Ltd. Vs CCE Indore {1996(63) ECR 201 (T)}, runners and risers arising in the course of manufacture of ingots are not manufactured products and these are neither ingots nor melting scrap, hence neither covered under CETA nor are these liable to duty.

M/s Narbada Steel Ltd., in J&K commissionerate, engaged in the manufacture of MS ingots under chapter 72, cleared 500.637 MT runners and risers during the period September 2004 to March 2007 on payment of duty of Rs. 13.17 lakh and subsequently claimed for the refund of duty. The refund was allowed to the assessee in terms of notification dated 15 November 2002 (regarding the area based exemption). As the effect of duty wrongly paid had already been passed on to the buyer, this refund was not permissible under the aforesaid notification.

1.7.7.2 Suo-moto availing of refund

Section 11B of the Central Excise Act, 1944, provides for claiming refund of the excise duty by making an application for refund before the expiry of one year from the relevant date. However, there is no provision for suo-moto availing of refund of duty.

(i) Test check of records of M/s KEC International Ltd., in Nagpur commissionerate, revealed that the assessee raised the bill on Power Links Transmission Ltd., Lucknow vide bill dated 20 March 2006 and paid duty of Rs. 30.49 lakh through cenvat credit from their own account though the bill pertained to their sister unit at Jabalpur. Subsequently, the said duty was paid from Jabalapur unit on 12 June 2006 and assessee suo moto took the credit of Rs. 30.49 lakh without filing refund claim which was irregular. The period of filing refund claim was also over.

On this being pointed out (February 2007), the department accepted (June 2007) the observation and agreed to issue a SCN.

(ii) Three other assessees, M/s Ratnami Metal and Tubes Ltd., Suraj Stainless Ltd. and M/s Panchmahal Steel Ltd., in Ahmedabad III and Vadodara II commissionerates, engaged in manufacture of iron and steel products under chapters 72 & 73, suo moto took cenvat credit of Rs. 29.26 lakh of duty without following the provisions of section 11B which resulted in incorrect availing of refund of Rs. 29.26 lakh.

On the observations being pointed out (August 2007), the amount of Rs. 7.81 lakh was recovered from M/s Suraj Stainless Ltd.

1.7.8 Physical verification of records

1.7.8.1 Escapement of duty on goods found short

Rule 10 of Central Excise Rules, 2002 provides that every assessee shall maintain proper records on the basis of goods produced, quantity removed, assessable value and amount of duty actually paid. In terms of rule 4 of Rules above, no excisable goods on which duty is payable shall be removed from a factory or warehouse without payment of duty. However, rule 21 of the Rules above provides for remission of duty in case where it is shown to the satisfaction of the commissioner that goods have been lost or destroyed by natural cause or on unavoidable accident or become unfit for consumption/marketing before their removal. Duty not paid by suppression of facts attracts penalty under section 11AC of Central Excise Act, 1944.

(i) M/s SAIL, Rourkela Steel Plant, in Bhubneshwar II commissionerate, engaged in manufacture of iron and steel products under chapters 72 and 73, maintained production records on estimated basis and at the end of the year carried out physical verification. Scrutiny of physical verification reports for the years 2004-05 to 2006-07 disclosed shortage of 5,751.242 MT of iron and steel products and such shortages were adjusted in production register by reducing the opening balance of such goods for the next year without assigning any reason. The duty of Rs. 2.28 crore payable on such inadmissible adjustment was not paid. The department has not demanded the duty. The assessee though applied for condonation of shortage but the same was not condoned till the date of audit.

(ii) In four other similar cases of M/s R.S. Infra Project Pvt. Ltd., M/s Ghaziabad Precision Products Pvt. Ltd., M/s Haryana Pipes Pvt. Ltd. and M/s Rashtriya Ispat Nigam Ltd., in Ghaziabad and Visakhapatnam I commissionerates, engaged in manufacture of iron and steel under chapters 72

and 73, adjusted the shortages in their books of accounts without assigning any reasons and did not pay duty of Rs. 1.65 crore. This resulted in non payment of duty of Rs. 1.65 crore along with equal amount of the penalty of Rs. 1.65 crore.

(iii) M/s IISCO Steel Plant (a unit of SAIL), in Bolpur commissionerate, engaged in manufacture of iron and steel, did not show the actual clearance of waste and scrap in excise records during the year 2004-05. By short accounting 4,329 MT of waste and scrap in excise records, the assessee evaded/avoided duty payment of Rs. 76.13 lakh.

Further, while carrying forward the closing balance of the stock at the end of the year 2006-07 as opening balance for the year 2007-08, the assessee had shown substantial shortages and discrepancies in respect of quantity, value, inventory of goods, etc. In some cases daily stock report exhibited even minus balances of major items. The assessees could neither show any records of payment of central excise duty nor reconcile the discrepancies. Exhibiting such minus balances in the statutory records violated the provisions of Rule 4(1) of Central Excise Rules, 2002 and resulted in probable evasion of duty of Rs. 5.56 crore. On this being pointed out (October 2007), the department stated (February 2008) that SCN was being issued.

1.7.9 Interest and Penalty

1.7.9.1 Interest on delayed payment of duty

Section 11AB of Central Excise Act, 1944 stipulates that where any duty of excise has been short levied or short paid, the person who is liable to pay the duty shall, in addition to the duty, be liable to pay interest from the first day of the month succeeding the month in which the duty ought to have been paid till the date of payment of such duty.

M/s Mukund Ltd., in Belgaum commissionerate, engaged in the manufacture of alloy and non alloy steel falling under chapter 72, paid duty belatedly on the differential values based on actual cost and profit calculated for the years 2000-01, 2001-02, 2003-04 and 2004-05. However, the applicable interest amounting to Rs. 1.30 crore was not paid, which should be recovered.

On this being pointed out (December 2005 and October 2007), the department admitted (February 2008) the audit observation and confirmed the demand for interest.

1.7.9.2 Non levy of interest on duty determined under section 11A (2)

Section 11 AA of Central Excise Act, 1944, prescribes that where an assessee is charged with duty determined under sub section (2) of Section 11 A and fails to pay such duty within three months from the date of such determination, the assessee shall pay in addition to duty, interest at the appropriate rate on such duty from the date immediately after the expiry of the said period of three months till the date of payment of such duty. However, if the duty is determined before 26 May 1995 (viz. the date of enactment of Finance Act, 1995) and the assessee fails to pay such duty within three months from the said date of enactment, then such assessee shall be liable to pay interest under this section from the date immediately after three months from such date till

the date of payment of such duty. Where the duty determined to be payable is reduced by the Commissioner (Appeals), Appellate Tribunal or as the case may be, the Court, the date of such determination shall be the date on which an amount of duty is first determined to be payable.

Bhubaneshwar II commissionerate confirmed one demand of Rs. 1.99 crore for the period from 1992-93 to 1996-97 on 19 December 2005 on account of duty on net excess quantity of excisable goods removed from the plant to depot and stockyard than the quantity shown in the RG- 1/RT-12/ER-I-Returns by M/s SAIL, Rourkela Steel Plant, Rourkela. A duty of Rs. 14.56 crore was originally confirmed by the Commissioner, Bhubaneshwar II on 24 December 1998. The case was remanded back by CEGAT, New Delhi and accordingly the Commissioner confirmed the demand of Rs. 1.99 crore on 19 December 2005.

The assessee paid the entire duty by 31 December 2005 but did not pay the interest of Rs. 1.42 crore for the period from 24 March 1999 to 31 December 2005 for such delayed payment till July 2007. The Department had also not taken any action.

1.7.9.3 Other cases

Similarly, during the period 2005-06 to 2007-08 (upto September 2007) in 42 other cases, the assessees did not pay the interest of Rs. 82.17 lakh, in 11 cases, penalty of Rs. 3.07 crore was not levied and in seven cases duty of Rs. 26.36 lakh was not paid. On this being pointed out, the department accepted 18 cases involving a duty of Rs. 83.39 lakh and recovered Rs. 27.16 lakh in 15 cases. In four cases, SCNs for Rs. 1.38 crore were also issued to the assessees.

1.7.10 Service Tax

1.7.10.1 Non payment of service tax by business auxiliary service provider

Business Auxiliary Service has been brought under service tax net with effect from 1 July 2003. Section 65(19) of the Finance Act, 1994 defines business auxiliary service to mean any service in relation to production or marketing or sale of goods or promotion or marketing of services or any customer care services in any manner to a client. Failure to deposit service tax attracts penalty equal to service tax not paid under section 78 of the above Act.

Test check of records of five assessees in Rohtak commissionerate and two assessees in Faridabad commissionerate, engaged in manufacture of iron and steel products under chapter 72 and 73, revealed that they purchased raw material and passed it on to downstream manufacturers and earned a profit of Rs. 70.79 crore which was in the form of commission classifiable under the 'Business Auxiliary Services'. They were, therefore, liable to pay service tax including education cess amounting to Rs. 8.69 crore approximately and penalty of an equal amount. Interest was also chargeable under section 11 AB of Central Excise Act, 1944.

1.7.10.2 Short payment of service tax by construction service provider

Section 66 of the Finance Act, 1994, as amended, provides levy of service tax at the rate of 12 per cent in place of 10 per cent with effect from 18 April 2006. Two per cent education cess on the aggregate amount of service tax was also leviable under section 95 of the above Act.

M/s Inter Arch Building Products Pvt. Ltd., in Noida commissionerate, engaged in manufacture of iron and steel products under chapter 72, earned Rs. 270.95 crore by providing construction service during the period April 2006 to March 2007 and paid service tax at the rate of 10.20 per cent (including education cess) instead of 12.24 per cent (including education cess) applicable. Thus, the assessee had paid service tax short by Rs. 5.53 crore including education cess. The assessee was, therefore, liable to pay Rs. 5.53 crore along with interest of Rs. 71.00 lakh.

1.7.10.3 Short payment of service tax by manpower recruitment agency

Test check of the records of M/s Advance Steel Tubes Ltd., in Ghaziabad commissionerate engaged in manufacture of iron and steel products under chapter 72, revealed that the assessee company received service charges, by providing manpower recruitment or supply agency service, amounting to Rs. 7.65 crore between April 2002 to March 2007 and service tax of Rs. 68 lakh was payable on this amount. However, the company paid service tax of Rs. 11.17 lakh only, short by Rs. 56.82 lakh. The assessee was also liable to pay interest Rs. 16.66 lakh and penalty of Rs. 56.82 lakh.

1.7.10.4 Non payment of service tax on Erection & Commissioning and Installation service

M/s Inter Arch Building Products Pvt. Ltd. and M/s Advance Steel Tubes Ltd., in Noida and Ghaziabad commissionerates respectively, engaged in manufacture of iron and steel and its products under chapter 72 & 73, rendered erection, commissioning and installation work of pole and structure and received Rs. 15.69 crore during the period April 2003 to March 2007 on which service tax of Rs. 1.55 crore including education cess, was payable. Both the assessees have not paid the service tax. Thus, the service tax of Rs. 1.55 crore including education cess, interest of Rs. 57 lakh and penalty equal to service tax Rs. 1.55 crore was payable by these assessees.

On this being pointed out (March 2008), the department admitted (September 2008) the observation in respect of M/s Advance Steel Tubes Ltd., Ghaziabad and reported issue of a SCN for Rs. 70.99 lakh.

1.7.10.5 Non payment of service tax on services obtained from foreign service providers

By Rule 2(d) (iv) of the Service Tax Rules, 1994, inserted with effect from 16 August 2002, a person receiving taxable services in India has been made liable for payment of service tax on services provided by a person who is a non resident or is from outside India and does not have any office in India.

(i) Consulting Engineer Services

M/s Southern Iron & Steel Company Ltd., in Salem commissionerate, paid Rs. 1.37 crore through foreign currency towards import of design and

engineering and drawings for the wire rod mill in August 2006 but the applicable service tax of Rs. 16.77 lakh under the 'consulting engineer services' was not paid. The assessee was liable to pay service tax of Rs. 16.77 lakh including education cess with interest of Rs. 2.36 lakh and penalty of Rs. 16.77 lakh including education cess, under section 78 of the Act above.

On this being pointed out (December 2007), the department accepted (January 2008) the audit observation and stated that SCN was being issued.

(ii) Underwriting service

M/s Nava Bharat Ventures Ltd., in Hyderabad III commissionerate, engaged in manufacture of ferro alloys, incurred an expenditure of Rs. 3.04 crore in foreign currency towards 'underwriting service' payment to Lehman Brother (foreigner having no office in India) for FCCB issue but did not discharge service tax liability of Rs. 37.19 lakh including education cess, as service receiver. The assessee was also liable to pay interest and penalty.

(iii) Business Auxiliary Service

M/s Tata Steel Ltd., in Jamshedpur commissionerate, engaged in manufacture of pig iron, billets etc. under chapter 72, paid Rs. 33.10 crore and Rs. 95.32 crore during the years 2005-06 and 2006-07 respectively to foreigner firms (having no office in India) towards commission and commitment charges covered under business auxiliary service but did not pay service tax including education cess of Rs. 15.05 crore. The assessee was also liable to pay interest and penalty

1.7.10.6 Non payment of service tax on 'Real Estate Agent' Service

Test check of records of M/s Shivam Iron and Steel Company Ltd., in Ranchi commissionerate, engaged in manufacture of iron and steel ingot, MS bars under chapter 72, revealed that the assessee received Rs. 4.05 crore during 2005-06 on account of profit from dealing of land. This income is covered under real estate agent service income. The assessee was liable to pay service tax of Rs. 41.31 lakh including education cess on this income which has not been paid. The assessee is, therefore, liable to pay interest of Rs. 10.74 lakh for two years and penalty of Rs. 41.31 lakh. The total amount payable was Rs. 93.36 lakh.

1.7.10.7 Non payment of service tax by contractors for temporary supply of manpower

As per section 65(68) of the Finance Act, 1994, as amended with effect from 16 June 2005, the service regarding supply of manpower temporarily or otherwise to a client falls under the category of manpower recruitment or supply of agency services and service tax is payable on such services.

During the period 1 July 2005 to 30 June 2007, M/s Mohan Steel Ltd., in Kanpur commissionerate, engaged in manufacture of iron and steel products under chapter 73, paid a sum of Rs. 2.70 crore for getting the work executed on occasional basis. The work relating to shifting, peeling, cutting CFD and processing was got executed through contractor. In terms of the provisions mentioned above, the service tax was payable by the contractors. Audit scrutiny revealed that none of the contractors had charged service tax in their bills nor they were registered with Central Excise department for service tax

purposes. Evidently the service tax was neither paid by the contractors nor by the assessee company. Thus, service tax of Rs. 33 lakh including education cess, was recoverable; besides interest of Rs. 3.32 lakh and penalty of Rs. 33 lakh was also payable.

On this being pointed out (March 2008), the department accepted (April 2008) the audit observation and stated that it is determining the service tax liability of the contractors.

1.7.10.8 Non payment of service tax due to incorrect availing of exemption

Section 65(19) of the Finance Act, 1994, defines business auxiliary service to mean, inter-alia, any service in relation to production or marketing or sale of goods or promotion or marketing of services or any customer care services in any manner to a client. As per notification No. 8/2005-ST dated 1 March 2005 exemption has been provided from service tax to a person producing goods from the inputs received from a manufacturer and sending the resultant product to the same manufacturer for further manufacture of final products, on which excise duty is payable.

M/s SAIL Rourkela Steel Plant, in Bhubaneshwar II commissionerate, engaged in manufacture of iron and steel products under chapter 72, received Rs. 7.62 crore from M/s Mishra Dhatu Nigam Ltd. during 2004-05 to 2006-07 towards conversion charges for conversion of slabs into plates against supply of slabs through challans on job work basis. The assessee cleared such plates without payment of duty/service tax. Since M/s Mishra Dhatu Nigam Ltd., Hyderabad is a defence organisation, they have not made payment of any duty on the final products manufactured out of the said plates. Hence, the assessee was liable to pay service tax of Rs. 82.35 lakh including education cess, on the conversion charges so received by them.

1.7.10.9 Non payment of service tax on Business Support Service

Business Support service was covered in service tax net from 18 April 2006 and infrastructural support services are covered under the category of business support services. Infrastructural support service includes providing office along with office utilities, lounge, reception with competent personnel to handle messages, secretarial services, internet and telecom facilities, pantry and security.

M/s Tata Metaliks Ltd., in Haldia commissionerate, engaged in manufacture of pig iron under chapter 72, entered into an agreement with M/s Inox Air Products Ltd. for oxygen enrichment facility to be installed at the premises of the assessee by M/s Inox Air Products on 'build own operate' basis. The assessee supplied a plot inside its premises along with some services to M/s Inox Air Products for installation of the facility and generation of oxygen.

Scrutiny of agreement and other records revealed that the assessee rendered infrastructural support service of Rs. 3.22 crore on which service tax of Rs. 39.65 lakh including education cess payable during the period from May 2006 to January 2008 was not paid.

1.7.10.10 Non levy of service tax on lease rent covered under banking and other financial services

M/s Tata Steel Ltd., in Jamshedpur commissionerate, engaged in manufacture of iron and steel products under chapter 72, purchased railway wagon and gave it to railway for supply of goods (own and other) and received lease rent from Railways. The assessee received lease rent of Rs. 10.35 crore from railways during the year 2003-04 to 2006-07 but did not pay applicable service tax of Rs. 97.60 lakh including education cess. Additionally, penalty equal to service tax of Rs. 97.60 lakh and interest of Rs. 30.20 lakh was also payable for the default. The total amount payable was Rs. 2.25 crore.

1.7.10.11 Non imposition of penalty for late payment of service tax

Section 76 of the Finance Act, 1994, as substituted with effect from 18 April 2006, provides for payment of interest and penalty for delayed/non-payment of service tax.

M/s Essar Steel Ltd., in Surat I commissionerate, engaged in manufacture of iron and steel products under chapter 72, availed of intellectual property services, banking and financial services and erection & commissioning services from foreigners. The assessee paid service tax of Rs. 1.80 crore but delayed by periods ranging between 26 to 427 days. The assessee was liable to pay penalty of Rs. 25.79 lakh which was not paid.

1.7.10.12 Other cases

In 99 other cases, the assessees did not pay/short paid the service tax of Rs. 15.48 crore including education cess. In 35 cases the assessees were also liable to pay interest of Rs. 93.72 lakh on short payment of service tax and in 27 cases penalty of Rs. 2.31 crore was chargeable. In 24 cases involving service tax of Rs. 1.05 crore, the department accepted the related audit observations and recovered Rs. 89.63 lakh from 19 service providers. In six cases SCNs for Rs. 1.59 crore were also issued.

Recommendation No. 7

- *In our opinion, the root cause of cases of non payment of service tax by the manufacturers was the absence of cross linked information on taxable services provided by the manufacturers in the corresponding excise returns. The Government may consider integrating the excise and service tax returns to mitigate the risk of evasion of duties/tax more so as the environment of all tax administration is becoming e-enabled.*

The Ministry was in agreement (November 2008) with the above recommendation during the exit conference.

1.7.11 Internal controls

Rule 6 of the Central Excise Rules, 2002, stipulates that the assessee is required to follow self assessment procedures. The departmental officers are, inter-alia, responsible for ensuring the correctness of the assessments made by the assessees, issuing show cause notice (SCN) in the event of non payment, short payment or erroneous refunds, adjudicating SCN within the prescribed

time limit, and enforcing recovery in case of confirmed demands. As per para 2 (Part VI-Chapter 3) of CBEC Central Excise Manual of Supplementary Instructions read with Board's circular dated 15 July 2005, the Range Superintendent/Assistant Commissioner/Deputy Commissioner/Additional Commissioner/Joint Commissioner are required to scrutinise the returns as per prescribed limit by calling for documents and records from the assessees.

Some illustrative cases of ineffective internal controls, noticed during the course of the audit review are narrated below:

1.7.11.1 Loss of revenue due to non-raising of demand

Rule 57 of the erstwhile Central Excise Rules, 1944 provides that no credit of input used in the manufacture of final products shall be allowed if the final product is exempt from the whole of the duty of excise or is chargeable to 'nil' rate of duty (amended rule 6 of Cenvat Credit Rules, 2004). The SC in the case of Madhumilan Syntax Pvt. Ltd. {1988(35) ELT 349 (SC)} held that unless a SCN was issued under section 11A of the Central Excise Act, 1944, the department was not entitled to recover any dues.

M/s Salem Steel Plant, in Salem commissionerate, engaged in manufacture of stainless steel sheets/coils of chapter 72 and coin blanks of chapter 73, cleared stainless steel coil blanks with payment of duty, during the period from 1 January 1994 to 12 October 1994 to Indian government mint as the Government of India granted adhoc exemption for the period from January 1994 to July 1995. The assessee preferred a claim for refund of duty of Rs. 3.27 crore paid by them for the period from 1 January 1994 to 12 October 1994. In the SCN issued on dated 3 April 1995, the department rejected a sum of Rs. 1.18 crore since the claim was time barred. Subsequently, a corrigendum to the order-in-original was issued in August 1995 after adjusting the credit of duty of Rs. 1.58 crore taken on the entire inputs consumed in the manufacture of coin blanks cleared (September 1995). The assessee went in appeal. CESTAT allowed the assessees' appeal (September 2004), quoting the ruling dated 28 September 2001 that confirmation of demand of duty could not traverse beyond the scope of SCN and allowed refund of Rs. 1.58 crore. The assessee also took (April 2005) re-credit of Rs. 1.58 crore in his Cenvat account. Non-raising of demand at the time of issue of SCN had resulted in loss of revenue of Rs. 1.58 crore.

1.7.11.2 Inaction of the department in cases relating to default in payment of duty

Rule 8(3) of Central Excise Rules, 2002, as applicable from April 2003, stipulates that if an assessee fails to pay the amount of duty on excisable goods cleared in a month by the due date, he shall be liable to pay the outstanding amount alongwith interest. Rule 8(3A) as existed prior to 1 June 2006 further stipulated that where any assessee defaulted in payment of duty beyond thirty days from the due date, the facility of monthly payment of duty was to be forfeited for two months starting from the date of communication of orders passed by the AC/DC or till such date on which all dues including interest thereof were paid, whichever is later and during the period, the assessee could discharge his duty liability on consignment basis without utilising cenvat credit till date of payment of outstanding amount including interest. The

provision of two months was substituted vide notification dated 1 June 2006 with condition to pay on consignment basis till date of payment of outstanding amount with interest. In the event of failure in clearance of such goods, the same would be deemed to have been cleared without payment of duty and consequences and penalties as provided in these rules would follow. In the event of failure in clearance of such goods, the same would be deemed to have been cleared without payment of duty and consequences and penalties as provided in these rules will follow. Rule 25 of the Rules above, provides that if any manufacturer removes any excisable goods in contravention of any of the provisions of those Rules or the notifications issued under these Rules, all such goods are liable to confiscation and the manufacturer is liable to a penalty not exceeding the duty payable on the excisable goods or rupees ten thousand, whichever is greater.

(i) M/s Shree Metaliks Ltd., Barbil, in Bhubaneshwar-II commissionerate, engaged in manufacture of Sponge iron, Pig iron etc. under Chapter 72, defaulted in payment of central excise duty of Rs. 3.70 crore relating to December 2005, March 2006 and April 2006 which was paid in installments between February 2006 to June 2006 after a delay of 31 days to 66 days. The orders forfeiting the facility to pay dues on installments and debarring the assessee to use cenvat credit were not issued by the department. As no such orders were issued, the assessee continued to pay duty on clearance made during the said period on monthly payment basis using cenvat credit instead of paying on consignment basis from PLA.

(ii) Similarly, M/s Shree Metaliks Ltd., Angul, in Bhubaneshwar-I commissionerate, defaulted in payment of duty of Rs. 2.74 crore for the months of November, December 2006 and June to August 2007 by more than 30 days but continued to pay duty on monthly basis. The assessee also paid less interest of Rs. 0.28 lakh for delayed payment of duty. However, the department did not take any action for forfeiture of the facility and the assessee continued to utilise the cenvat credit. As such the assessee in both cases was liable to pay penalty of Rs. 6.44 crore on this account.

On the observations being pointed out (December 2007), the department did not accept the first observation and stated (December 2007) that the rule has been amended allowing such utilisation from 1 June 2006. The reply is not relevant as the period of objection was before 1 June 2006. In the second case, the reply was awaited.

1.7.11.3 Misclassification of 'Secondary and Higher Education, (SHE)' cess

Secondary and Higher Education Cess (SHE) was introduced with effect from 1 March 2007 at the rate of one per cent of basic excise duty. The proceeds of this fund were intended to finance higher education. The Principal Chief Controller of Accounts (PCCA), CBEC vide circular dated 13 April 2007 specified that the temporary accounting code for accountal of "SHE-Receipt awaiting transfer" was 00380086. The PCCA, CBEC subsequently vide circular dated 4 October 2007 intimated operation of new minor head and issued correction slip to account code.

M/s Vikram Ispat, in Raigad commissionerate, while making payment of duty through TR challans for the period from March 2007 to September 2007 had classified SHE Cess under accounting head 00380087 other receipts instead of under correct head 00380086. This resulted in mis-classification of SHE cess of Rs. 65.70 lakh.

On this being pointed out (October 2007), the department accepted (November 2007) the observation and stated that the matter would be taken up with PAO for taking appropriate action.

1.7.11.4 Other cases

Two other assessees, in Thane II and Raigad commissionerates, had also mis-classified SHE cess amounting to Rs. 33.50 lakh during the period March 2007 to September 2007.

1.7.11.5 Non-submission of periodic returns

Rule 12(2) (a) of Central Excise Rules, 2002, stipulates that every assessee shall submit a financial information statement for the preceding financial year to which the statement relates, in the form ER-4 by 30 November of the succeeding year.

Further rule 9 A (1) of Cenvat Credit Rules, 2004, stipulates that a manufacturer of final products shall furnish annually by 30 April of each financial year, a declaration in the form ER-5 in respect of each of the excisable goods manufactured or to be manufactured by him, the principal inputs required for use in the manufacture of unit quantity of such final products.

Similarly, rule 9A(3) of the Rules above, stipulates that a manufacturer of final products shall submit, within ten days from the close of each month, a monthly return in the form ER-6 in respect of information regarding the receipt and consumption of each principal input with reference to the quantity of final products manufactured by him.

(i) Test check of records of M/s Singhal Enterprises Pvt. Ltd., in Raipur commissionerate, engaged in manufacture of iron and steel products, revealed that ER-4 returns were not submitted during 2005-06 and 2006-07, ER-5 returns were not submitted during the period 2005-06 to 2007-08 and ER-6 returns were not submitted for June 2007 to December 2007.

On this being pointed out (January 2008), the department accepted (January 2008) the observations and stated that the assessee were being advised to file the returns immediately and action proposing penalisation will also be initiated for alleged contravention of the Rules.

(ii) In nine other cases, non submission of returns (ER-4, ER-5 and ER-6) were noticed in Chennai I, II, Coimbatore, Salem, Madurai, Puducherry and Trichy commissionerates. On these being pointed out (September 2007 to February 2008), the department reported (February 2008) that in two cases returns have been filed by the assessees.

1.7.12 Other cases of interest

1.7.12.1 Mis-reporting of demand cases pending adjudication

Amended section 11A(2) of Central Excise Act, 1944 stipulates that adjudication of cases remanded back by appellate authorities for denovo adjudication are also required to be entered into the records as new cases and finalised within prescribed time as in the case of SCNs.

M/s Jotindra Steel and Tubes Ltd., in Faridabad commissionerate, engaged in manufacture of iron and steel products under chapter 72, had shown a liability of Rs. 48.02 lakh in their balance sheet for the year 2006-07 as central excise demand on account of case remanded back by CEGAT pending assessment afresh. The Central Excise Officer of Division I of Faridabad commissionerate had furnished nil information in January 2008 in respect of cases pending in unconfirmed demand register against the assessees. Thus, this case was not reflected in Monthly Technical Report also and resulted in misreporting of cases with substantial amount.

1.7.12.2 Incorrect grant of registration certificate

Rule 9 of Central Excise Rules, 2002, read with notification dated 26 January 2001 (No. 35 and 36 /2001-CE (NT)) provides that if the person has more than one premises requiring registration, separate registration certificate (RC) shall be obtained for each of such premises. However, the commissioner may provide single RC if two or more premises of the same factory (where premises are interlinked) are segregated by public road, railway line or canal, the commissioner of central excise may, subject to proper accountal of the movement of goods from one premises to other and such other conditions namely interlinked process products manufactured/produced in one premises are substantially used in other premises of the manufacture of final products common electricity supplies common labour/work force, common administration/work management etc.

Test check of records of M/s Joneja Bright Steel (P) Ltd., in Faridabad commissionerate, engaged in manufacture of bright bar and specialty wire under chapter 72, revealed that the assessee had two plants at separate plots No 239 and 244 in sector 24 of Faridabad with separate registrations. The assessee applied for single RC in August 2003 for both the plants which was granted by the department. The single registration was not applicable in this case as per provisions referred to above. The allowance of single registration by the commissioner was not correct and the clearance of manufactured goods at plot No. 239 to sister concern at plot No. 244 without payment of duty was not permissible and it was required to be cleared on payment of duty by adopting value equivalent to 110 per cent of cost of production from April 2004 to September 2007.

On this being pointed out (October 2007), the department issued (July 2007) a SCN for Rs. 1.49 crore pertaining to the period June 2007 to March 2008.

1.8 Conclusions

Audit review has revealed a few system as well as compliance weaknesses relating to the assessment and collection of duty from Iron and Steel sector. These are summarised below:

- The payment of duty through cenvat rather than by cash is excessive indicating possible misuse of cenvat credit facility. This is an area of concern, which the Ministry needs to address after investigating the reasons for such excessive cenvat credit use by these sectors and include this criterion (cenvat to PLA ratio) as a risk factor for investigation/internal audit of the assessees.
- Furthermore, while many products are cleared from stockyards (and not factory gates where duty is paid) after undergoing value addition through customization, this value addition escapes duty as 'cutting and bending' has not been declared as 'manufacture'. Accordingly, there is a need to amend the chapter notes appropriately.
- Absence of a restrictive clause on the quantity of inputs cleared 'as such' vis-à-vis procured and used in the manufacture of final products could lead to misuse of the cenvat scheme as some manufacturers could buy/procure huge quantities of inputs after availing quantity discounts, much in excess of their own requirement for manufacturing finished goods, and clear the inputs 'as such' at a premium. The Government should consider amending the Act and applicable rules to restrict the percentage clearance of inputs cleared as such which have been procured by the manufacturers. Alternatively, the duty reversal/payment should be at the enhanced sale value of the inputs cleared 'as such'.
- In a few cases, the production declared on which duty was paid was substantially lower than the declared capacities. Government should institute an internal control which should trigger audit/investigation of units which declare their production and pay duty on the declared production below a pre-defined percentage of installed capacity.
- Additionally, in the absence of standard input-output norms for the domestic industry, the risk of suppression of production has not been adequately mitigated. The Government should prescribe some indicative input-output norms for domestic industries which can act as a benchmark against which the actual production could be measured, and cases of significant variations should act as a trigger for detailed investigation/internal audit for detecting suppression of production and revenue loss.
- There is a need for the Government to amend the Act suitably to make 'Zinc dross' excisable and the process of obtaining 'Zinc dross' as manufacture in view of the value and marketability of the commodity.
- The compliance issues identified in audit related to suppression of production by showing reduced sales, undervaluation on account of incorrect determination of cost of production, incorrect availing of and use of cenvat credit and non-payment of service tax. The Government, therefore, needs to strengthen the existing internal control mechanism to

ensure that the Government dues are realised efficiently and revenue evasion, frauds, etc. are dealt with effectively.

While the total financial implication of this audit intervention is Rs. 1373.94 crore, the direct additional revenue which could come to the Government is Rs. 904.67 crore. Of these, observations with money value of Rs. 25.32 crore had been accepted (till November 2008) by the department and Rs. 6.12 crore recovered.

Seven specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. Five of these recommendations have been agreed to, by the Ministry.

SECTION 2 - SERVICE TAX

CHAPTER II
SERVICE TAX ON BUSINESS AUXILIARY SERVICES

Executive Summary

A review of the tax administration and the internal controls relating to a selected service was conducted to evaluate whether this was effective in identifying and bringing into tax net potential assessees and were efficient in ensuring regular and correct payment of service tax by registered service providers.

Audit review has revealed that the internal control mechanism existing in the department to bring unregistered service providers into tax net were ineffective and inadequate. Key performance indicators (KPIs) like minimum surveys to be conducted by a commissionerate to identify potential assessees were not prescribed, in the absence of which their performance could not be evaluated. Consequently, a large number of active unregistered service providers were escaping from the service tax net and audit could identify 1,193 of these, with actual loss of service tax of Rs. 123.87 crore and further an estimated service tax loss of Rs. 15.21 crore. (This is approximately 6.03 per cent of the total revenue collected from this service).

The Board should require the commissionerates to establish KPIs in relation to the minimum surveys to be conducted in a year to identify/register assessees and garner additional revenue. Subsequently, the Board should evaluate the performance of the commissionerates based on this criterion too. Further, the procedure for conducting survey needs to be streamlined to collect information about potential assessees from various sources including from income tax department. In all the cases identified by audit, of service providers who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by these service providers and take appropriate action. Additionally, inter-governmental and inter-departmental coordination and control mechanism to ensure that only registered assessees provide services and pay applicable tax, needs to be strengthened, which would mitigate the risk of evasion of tax by service providers to the Government sector.

Further, the Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.

Furthermore, internal controls to detect and take proactive action against 'stop filers' were ineffective and resulted in evasion of actual revenue of Rs. 170.26 crore and estimated revenue of Rs 38.08 crore. The department needs to devise an appropriate and effective mechanism to detect in time 'stop-filers' of returns and collect revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.

Additionally, the internal control mechanism to verify the correctness of returns filed was inadequate and ineffective and audit noticed several cases of short levy of service tax and evasion of service tax by suppression of value of services. The short levy worked out to Rs. 111.70 crore. To address the root cause of these irregularities, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This checking may be reinforced by detailed scrutiny. The selection of cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.

The adjudication officers are not required to finalise a demand case relating to service tax, within a prescribed time frame, which could lead to delays in finalisation of cases and recovery of service tax. The Government should prescribe a time-limit for adjudicating demand cases (SCNs) relating to service tax, through appropriate legislation. This would mitigate the risk of delay in adjudication of such cases and consequential risk to revenue.

Audit also observed incorrect and excess availing and utilisation of cenvat credit by providers of business auxiliary services. The Government should amend the ST-3 return to include relevant information regarding the receipt/provision of non taxable/exempt services to mitigate the risk of utilisation of cenvat credit in excess of the prescribed limit.

Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.

The database of registered assessees needs to be maintained exhaustively, updated continually to remove inconsistent data and improve the reliability of available data. This would assist the department to administer the service tax in an improved and more efficient manner.

While the total financial implication of this audit intervention (review) is Rs. 999.44 crore, the direct additional revenue which could come to the Government is Rs. 892.86 crore.

Twelve specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in this report. All the twelve recommendations were agreed (November 2008) to, by the Ministry.

2.1 Highlights

- **Decline in growth of revenue and assessee base from this service, during the year 2006-07 in comparison to previous year need to be investigated and mechanism put in place to ensure that the decline is not due to evasion.**

(Paragraph 2.6.1)

- **Survey is a key activity which helps to identify potential assessees and thereby augment Government revenues. However, performance indicators for this activity had not been prescribed.**

(Paragraph 2.6.2)

- **Measures undertaken by the department to bring unregistered service providers into tax net were ineffective and inadequate. Audit identified 1,193 unregistered service providers. While actual loss of revenue from 587 of this service providers was Rs. 123.87 crore, the estimated revenue loss from the remaining 606 unregistered service providers was Rs. 15.21 crore.**

(Paragraphs 2.6.2.4 and 2.6.2.5)

- **Approximately 36 per cent of returns due were not submitted by the registered service providers, for which no action was initiated by department. Service tax of Rs. 74.95 crore was evaded by 316 registered service providers during the period when they did not file returns. Interest of Rs. 20.36 crore was also leviable, besides penalty of Rs. 74.95 crore. Furthermore, audit identified 1,517 service providers who evaded an estimated service tax of Rs. 38.08 crore by not filing returns during the year 2006-07.**

(Paragraphs 2.6.3, 2.6.3.1 and 2.6.3.2)

- **Verification of returns was ineffective and policy for scrutiny of these returns ambiguous as service tax of Rs. 48.56 crore was evaded by 358 registered service providers on account of suppression of taxable value. Interest of Rs. 14.58 crore was also leviable besides penalty of Rs. 48.56 crore.**

(Paragraph 2.6.4)

- **Scrutiny of the ST-3 returns on the basis of information furnished by the assessees was not adequate as audit could detect cases where service tax of Rs. 115.76 crore was short paid.**

(Paragraph 2.7.1)

- **In 77 cases, the assessees had availed/utilised cenvat credit of Rs. 17.99 crore incorrectly.**

(Paragraph 2.7.2)

- **Correlation of income tax data with service tax data is a key factor for correct evaluation of service tax liability. However, allotment of PAN based STC numbers to enable such correlation has been slow and non-exhaustive.**

(Paragraph 2.7.4)

- **Exemption from service tax of Rs 16.96 crore was availed incorrectly in 31 cases.**

(Paragraph 2.7.5)

2.2. Introduction

Service tax on the service of Business Auxiliary Service (BAS) was levied with effect from 1 July 2003. The scope of this service has been expanded from time to time through changes/amendments in the Finance Acts. Section 65 (19) of the Finance Act, 1994, defines BAS as 'any service in relation to (i) promotion or marketing or sale of goods produced or provided by or belonging to the client; or (ii) promotion or marketing of service provided by the client; or (iii) any customer care service provided on behalf of the client; or (iv) procurement of goods or services, which are inputs for the client; or (v) production or processing of goods for, or on behalf of, the client; or (vi) provision of service on behalf of the client; or (vii) a service incidental or auxiliary to any activity specified in clauses (i) to (vii) such as billing, issue or collection or recovery of cheques, payments, maintenance of accounts and remittance, etc.' but any activity which amounts to manufacture within the meaning of section 2(f) of Central Excise Act, 1944, is not BAS.

2.3 Audit objectives

The audit review was conducted in audit to seek assurance that: -

- the mechanism to identify and bring in potential assessees in tax net for levy of service tax was effective;
- tax administration was efficient and effective in ensuring compliance with the applicable legislations and rules; and
- the internal controls were in place and effective.

2.4 Scope of audit

Records relating to this selected service, in 57 out of 71 commissionerates dealing with service tax, were test checked. Period covered under audit was from the year 2004-05 to 2006-07.

2.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in October 2008 and an exit conference was held with the Ministry officials in November 2008. The responses of the Ministry to the recommendations received in November 2008 and responses of the department, wherever received, have been incorporated appropriately.

AUDIT FINDINGS AND RECOMMENDATIONS

2.6 System issues

2.6.1 Trend of revenue

Total service tax collected during the year 2006-07 was Rs. 37,598 crore. The BAS service contributed Rs. 2,313.63 crore during 2006-07 which constituted

6.15 per cent of the total revenue collection from all the services during the year 2006-07.

Table No. 1 indicates the trends of revenue from BAS in respect of 71 commissionerates, the table No. 2 reflects the percentage growth of the assessees and the revenue (these are based on the data provided by the commissionerates): -

Table No.1: Trend of revenue from BAS

(Amount in crore of rupees)

2003-04		2004-05		2005-06		2006-07	
No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.	No. of assessees	Amt.
7,867	244.94	58,552	446.56	74,764	1,273.81	92,277	2,313.63

Table No. 2: Percentage growth of assessees and revenue from BAS

2004-05		2005-06		2006-07	
Assessees	Revenue	Assessees	Revenue	Assessees	Revenue
644.27	82.31	27.69	185.25	23.42	81.63

Audit observed that: -

- In Indore, Chennai III and Trichy commissionerates, there was decline of 19.92, 26 and 37.21 per cent in number of service providers, though revenue had increased by 171.83, 193.20 and 32.12 per cent respectively during the year 2006-07 over the year 2005-06.
- In Tirupathi commissionerate and Chandigarh division of Chandigarh commissionerate, there was decline of 2.84 & 12.21 per cent and 1.27 & 36.02 per cent in number of service providers and revenue, respectively during the year 2006-07 over the previous year 2005-06 though there was no change in limit of threshold exemption of rupees four lakh. This could be indicative of an increase in number of 'stop filers'.
- In Guntur commissionerate, there was decline of 18.76 per cent in revenue though the number of service providers had increased by 36.92 per cent during the year 2006-07 over the previous year 2005-06. There is a risk that there was suppression of value of services provided and resulting service tax from BAS in this commissionerate.

Recommendation No. 1

- *The Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.*

Agreeing to the recommendation, the Ministry stated (November 2008) that revenue monitoring is done on a regular basis by Directorate General of

Service Tax (DGST) and CBEC and decline in revenue from any service triggers off special monitoring and review efforts.

2.6.2 Inadequate and ineffective efforts to broaden the tax base

Section 69 of the Finance Act, 1994 read with rule 4 of the Service Tax Rules, 1994, provides that every person liable to pay service tax shall make an application for registration to the concerned central excise officer in form ST-1, within a period of 30 days from the date on which the service tax under section 66 of the Act above is levied. For registration of eligible service providers and ensuring payment of service tax, the Government has relied mainly on 'voluntary compliance'.

The growth of revenue is directly linked with the growth of the assessee base. With increasing reliance on voluntary compliance, it becomes important for the department to put in place an effective mechanism for collecting information from various sources in order to bring persons evading tax, into the tax net.

As part of the action plan drawn by the DGST and circulated to chief commissioners on 26 May 2003, the department was required to collect intelligence, conduct surveys and to identify unregistered service providers and get these registered. Instructions to field formations to carry out 'street to street surveys' to identify tax evaders were also issued in January 2004.

2.6.2.1 Data on surveys undertaken in 57 commissionerates during the years 2005-06 and 2006-07 and its impact on revenue was obtained and analysed.

Table No. 3

(Amount in crore of rupees)

Year	No. of surveys	No. of new registrations based on surveys		Total additional revenue realised	
		For all services	BAS	From all services	BAS
2005-06	1,491	1,700	414	6.91	1.59
2006-07	1,890	1,346	529	12.45	8.74

Audit observed that: -

- No target of surveys was fixed for any commissionerate, in the absence of which the performance of the commissionerates could not be evaluated.
- No surveys were conducted in 22 out of 57 commissionerates. In selected ranges/divisions of six exclusively service tax commissionerates, no surveys were conducted. Some of the other commissionerates where no surveys conducted were: - Hyderabad II, Hyderabad III, Hyderabad IV, Goa, Rohtak and Panchkula commissionerates.
- In Vadodara I and Jalandhar commissionerates, only one survey was conducted in each case during the year 2006-07. No survey was conducted during the year 2005-06.

Recommendation No. 2

- *The Board should require the commissionerates to establish 'Key performance indicators' in relation to the minimum surveys to be conducted by the Ranges/Divisions under their jurisdiction, which could be a criterion to evaluate the performance of the commissionerates.*

Agreeing in principle to the recommendation, the Ministry stated (November 2008) that though no separate targets are fixed for survey and search operations, but instructions are issued to commissionerates to speed up survey and intelligence gathering for identifying tax evaders for better tax compliance. The Ministry further felt that fixing of minimum survey targets may result in undue interface between tax administration and tax payers.

2.6.2.2 Non-conducting of searches and seizures

Section 82 of the Finance Act, 1994, as amended with effect from 16 August 2002, empowered the commissionerates of central excise to conduct searches in the premises of assessee and seize documents, wherever necessary. The DGST, Mumbai vide their communication dated 27 June 2003 also instructed the commissionerates to exercise these powers in an effective and meaningful manner, on selective basis considering the potential to augment revenue. Out of the 57 commissionerates test checked in audit, search was conducted by eight commissionerates only and further documents were seized in six cases by three commissionerates. Furthermore, no such searches were conducted and seizures made during 2006-07 by three out of six exclusively service tax commissionerates {Delhi (ST), Bangalore (ST) and Kolkata (ST)}. A few of the other commissionerates where no search/seizures were effected were Vadodara I, Vadodara II, Surat I, Rajkot, Chandigarh, Jalandhar, Ludhiana, Goa, Rohtak, Panchkula, Cochin, Trivadrum, Patna and Nagpur.

2.6.2.3 Unregistered service providers escaping from the tax net

The results of the efforts made by the department in terms of widening of the tax base and yielding of extra revenue were largely ineffective as mentioned in the preceding paragraph. The revenue collection in these services also showed a decline in growth rate during the year 2006-07 as per the trend analysis mentioned at the earlier paragraph 2.6.1. An attempt was, therefore, made by audit on a limited scale to gauge the extent to which the active, though unregistered, service providers escaped the tax net. For this purpose, information from various sources, such as yellow pages, newspapers, websites, income tax returns, departments of State and Central Governments, Corporations, Public Sector Undertakings and other secondary records etc., was accessed by audit, to the extent feasible and analysed further.

Preliminary findings of audit indicate that 1,193 service providers of BAS (41 commissionerates) had not registered themselves with the central excise department. The additional potential assessees identified by audit represent approximately 1.29 per cent of the registered 92,277 assessees of the service for the year 2006-07. The loss of service tax (besides interest and penalty) revenue due to these unregistered service providers could be to the order of magnitude of Rs. 139.08 crore, as pointed out in the succeeding paragraphs. This represents 6.01 per cent of the total service tax collections from this

service during the year 2006-07. Additionally, penalty of Rs. 139.08 crore and interest[2] of Rs. 23.88 crore would also be leviable in these cases.

2.6.2.4 Actual loss of service tax due to unregistered service providers identified by audit

In order to identify unregistered service providers, the income tax records and other connected secondary records, wherever possible, were cross verified. Audit was able to verify income tax records and other related records (such as annual financial statements, departmental/public sector undertaking contracts records, etc.) of 587 service providers out of 1,193 such identified unregistered services providers of BAS. The service tax evaded by these service providers was Rs. 123.87 crore. Additionally, penalty of Rs. 123.87 crore was also payable with a further interest liability of Rs. 23.88 crore.

Some illustrative cases are mentioned in the succeeding paragraphs: -

(i) M/s C E S Onyx Pvt. Ltd., in Chennai commissionerate, engaged in providing service of collection and disposal of waste (a service covered under BAS), entered into an agreement with the Corporation of Chennai (COC) for collection and disposal of municipal solid waste. The assessee received service charges of Rs. 106.31 crore from COC during the period from September 2004 to March 2007. However, neither did the assessee get registered nor did it pay the service tax. The assessee was liable to pay service tax of Rs. 11.86 crore. Additionally, it was liable to pay penalty of Rs. 11.86 crore and interest of Rs. 2.40 crore. The total amount payable was of Rs. 26.12 crore.

(ii) M/s State Trading Corporation of India Ltd (STC), in Kolkata (ST) commissionerate, were engaged in providing certain services to their clients by way of procurement of goods and for promotion of exports for their clients during the year 2005-06 and 2006-07, for which it collected Rs. 32.34 crore as charges from clients. Though these services fell under the category of BAS, the assessee did not register and did not pay any service tax which led to non-levy of service tax amounting Rs. 3.64 crore. The assessee was further liable to pay penalty of Rs. 3.64 crore and interest of Rs. 67.60 lakh.

(iii) During the period from 2004-05 to 2006-07, M/s Bangalore Metropolitan Transport Corporation (BMTC), Bangalore hired a number of vehicles from 45 private vehicle owners for providing transport service to commuters in Bangalore. On verification of records, it was noticed that BMTC has entered into agreement with the owners of private vehicles to provide new vehicles along with drivers and to bear the cost of fuel & maintenance charges. Hire charges were paid to the vehicle owners at the fixed rate (per km) as agreed upon, on the basis of certificate issued by the depot managers indicating total number of kilometers run by each vehicle during the month for making payment towards hire charges. The services provided by the service providers on behalf of a client had been covered under BAS as per Board Circular dated 17 September 2004 and accordingly the vehicle providers were liable to pay service tax of Rs. 9.37 crore on Rs. 72.06 crore received as hire charges from BMTC during the period from 2004-05 to 2006-07. These service providers were further liable to pay penalty of Rs. 9.37 crore and interest of Rs. 1.63 crore.

[2] Interest liability has been worked out up to March 2008, unless otherwise stated.

(iv) It was seen from the Annual Reports of M/s Tata Refractories Ltd., Belpahar, in Bhubaneshwar II commissionerate, that the assessee paid Rs. 5.17 crore to commission agents in foreign currency during 2004-05 to 2006-07 for procuring export orders. However, the applicable service tax of Rs. 50.39 lakh was not paid. The assessee was also liable to pay interest of Rs. 9.67 lakh along with minimum penalty of Rs. 50.39 lakh.

On this being pointed out in audit (November 2007), the department accepted (July 2008) the observation for the period 2005-06 to 2006-07 and stated that the assessee had since paid service tax of Rs. 33.72 lakh and interest of Rs. 4.93 lakh on the commission paid during the period April 2005 to September 2007.

(v) Goa Electronics Ltd. (GEL), a company owned by Government of Goa, in Goa commissionerate, engaged in production of 'Smart Cards' (Driving Licence) for the Transport Department of Government of Goa, did the activity of procuring smart cards and supplying to Transport Department. The assessee did not get itself registered with service tax department though the activity was liable for taxation under BAS. Thus, a consideration of Rs. 1.82 crore received during the period from May 2006 to March 2008 by the assessee escaped levy of service tax. This resulted in non payment of service tax of Rs. 22.36 lakh besides interest of Rs. 1.80 lakh and penalty of Rs. 22.36 lakh.

2.6.2.5 Estimated loss of service tax in respect of other unregistered service providers identified by audit

In the absence of related records, audit attempted to estimate the quantum of evasion of service tax in respect of the remaining 606 out of 1,193 number of identified unregistered service providers by applying the parameter of average revenue yield from registered assessees from same services. An estimated service tax of Rs. 15.21 crore was evaded by these unregistered service providers during the year 2006-07 alone. Penalty of Rs. 15.21 crore was also leviable.

Recommendation Nos. 3, 4 and 5

- *The procedure for conducting surveys needs to be streamlined and strengthened in the commissionerates to collect information about potential assessees from various sources including from income tax department. The surveys should be conducted in a professional manner after collection, collation and analysis of information.*
- *In all cases of service providers identified by audit, who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by not only these service providers but also by service providers in these categories not covered by audit and take appropriate action to recover the tax due together with interest and penalty.*
- *Inter-governmental and inter-departmental coordination and control mechanism needs to be strengthened to ensure that only registered assessees provide services and pay applicable tax. This would mitigate the risk of evasion of tax by service providers to the Government sector.*

Agreeing in principle to these recommendations, the Ministry stated (November 2008) that a number of steps have been taken to streamline and strengthen the procedure for conducting surveys including constitution of a committee to identify third party sources, directions to its field formations to identify and locate the unregistered service providers from internet sites, setting up of help centres and issue of modus-operandi circulars to disseminate relevant knowledge to the field formations. Inter-governmental and inter-departmental co-ordination is achieved through regular interactions with Income Tax and State Sales Tax departments through regional economic intelligence committee meetings.

2.6.3 Ineffective monitoring of service tax returns

Section 70 of the Finance Act, 1994, read with rules 7(1) and (2) of Service Tax Rules, 1994, provides that every person liable to pay service tax should itself assess the tax, furnish half yearly return in form ST-3 or ST-3A by the 25th of the month following the half year. Under the amended section 77 of the said Finance Act, a person failing to furnish the returns in due time is liable to a penalty subject to a maximum of one thousand rupees.

This return is one of the critical tools with the department for effective administration of service tax and to combat evasion of service tax by registered service providers. It is, therefore, important for the department to watch and ensure that the returns are regularly submitted by all active registered service providers.

The position of submission of returns by registered service providers of BAS, during the period from 10 September 2004 to March 2007 has been mentioned in the following table: -

Table No. 4

(Amount in crore of rupees)

No. of returns due	No. of returns received	Returns received by due date	Returns received late	No. of returns not received	Penalty levied	Penalty not levied
1,76,263	1,13,580	95,296	18,284	62,683	0.02	3.35

The above data relates to 57 commissionerates.

Audit observed that: -

- The percentage of non-receipt of returns due was 35.56.
- The percentage of returns received late was 16.10.
- 3,679 returns out of 10,742 (34.25 per cent) which were due to be received prior to 10 September 2004 were not received up to September 2007.
- Action for levy of penalty of Rs. 3.35 crore on defaulting assessees was not taken.

2.6.3.1 No mechanism to detect and take action for 'stop filers', leading to evasion

Audit assessed the number of service providers of BAS not filing returns as significantly high for want of proper watch by department over the submission of returns and inaction by department by way of imposition of penalty in cases of default. Audit, therefore, attempted to ascertain whether these registered service providers were actually rendering services and thereby evading tax during the period when they had not furnished the returns. An independent verification of income tax returns and other connected records of a few of such defaulters, on a very limited scale, indicated that 316 assessees in 26 commissionerates had continued providing services, on which no service tax was paid during the period when they had not filed the returns. The department did not take any action for non-submission of returns by these defaulters. Nor did it verify whether the defaulters were actively engaged in providing services during the period of default. This resulted in evasion of service tax to the extent of Rs. 74.95 crore. Interest of Rs. 20.36 crore and penalty of Rs. 74.95 crore was also leviable.

Some illustrative cases are mentioned in the succeeding paragraphs: -

(i) M/s Siemens Public Communication Networks Pvt. Ltd., in Gurgaon division of Delhi (ST) commissionerate, is engaged in providing telecommunication services in 'Information and Communication Network System (ICN)' and 'Information and Communication Mobile System (ICM)'. The assessee was registered under six services other than BAS and received a commission of Rs. 64.65 crore for selling and marketing activities undertaken for the products during the years 2003-04 to 2006-07. The assessee had not filed any ST-3 returns relating to the amount of commission charged which fell under BAS during the above period. Thus, the assessee evaded service tax of Rs. 6.43 crore. Additionally, penalty of Rs. 6.43 crore and interest of Rs. 2.12 crore was leviable.

(ii) According to section 65 (19) of the Finance Act, 1994, production or processing of goods for or on behalf of the client has been covered under BAS with effect from 10 September 2004. M/s Gupta Coal and Washeries Ltd., in Nagpur commissionerate, engaged in processing of goods on behalf of client and registered under BAS, provided services to Karnataka Thermal Power Station during the period from 10 September 2004 to 31 March 2005 and received an amount of Rs. 22.74 crore towards washing charges of coal. The assessee was liable to pay service tax of Rs. 2.32 crore. However, neither did the assessee file any return nor did it pay any tax for the said period. The assessee was further liable to pay interest of Rs. 85.42 lakh and penalty of Rs. 2.32 crore. The department was requested to work out the service tax payable from 1 April 2005 to 15 June 2005.

On this being pointed out (November 2007), the department stated (February 2008) that as 'production or processing of goods on behalf of client' was substituted in Finance Act, 2005 with effect from 16 June 2005, the service of processing of goods was taxable from that date only.

The reply of the department is not acceptable as 'production of goods' would include 'processing' also and only for the purpose of clarity the word 'processing' was added in the statutory provisions from June 2005.

Additionally, the interpretation of the department was applied inconsistently as similar assessees under the commissionerate were paying service tax on washing charges received from Electricity Board since 10 September 2004.

(iii) M/s Seagram India Pvt. Ltd. (SIPL), Gurgaon (a wholly owned subsidiary of M/s Pernod Ricard, France), in Gurgaon (Division III) of Delhi (ST) commissionerate, engaged in the manufacture, marketing and sale of alcoholic beverages in India with different brands of Indian made foreign liquor (IMFL) owned by M/s Pernod Ricard, France or their affiliates, provided marketing and other related services to a large number of independent distillers, for which they entered into agreements with them. As per agreements, M/s SIPL provided quality control, supervision, technical assistance and marketing assistance services to the manufacturers, marketing and sale support etc. The assessee obtained registration under BAS in October 2004 and filed returns from 9 July 2004 to September 2006. Verification of the ST-3 returns and other related records revealed that the assessee realised service charges of Rs. 134.82 crore and paid service tax of Rs. 10.97 crore for the period from 9 July 2004 to September 2006. The assessee, however, stopped filing return after September 2006 and filed a claim for refund of tax for the above period. The department had neither decided the refund case nor cancelled the registration certificate. Thus, the assessee was required to file the return regularly and pay the applicable service tax till the refund case was decided. Out of the balance billed amount of service charges of Rs. 25.12 crore that was outstanding, the assessee had subsequently recovered Rs. 12.20 crore (October and November 2006) but did not pay applicable service tax of Rs. 1.49 crore. An interest of Rs 25.88 lakh and penalty of Rs. 1.49 crore was also payable. The recoveries of the service charges effected subsequent to November 2006 (up to Rs. 12.92 crore) were not provided to audit. There is a possibility of evasion of applicable service tax of Rs. 1.56 crore on this amount. The assessee was also leviable to pay penalty of Rs. 1.56 crore and interest of Rs. 30.35 lakh.

On this being pointed out (January 2008), the department stated (September 2008) that two SCNs for Rs. 12.13 crore (Rs. 10.97 crore and Rs. 1.16 crore) have been issued in July 2008 for rejection of refund claim of the assessee.

Further, this assessee did not submit any returns during the period December 2006 to June 2007 as well although it had realised Rs. 32.98 crore on account of marketing and technical assistance fee from bottlers during this period. Leviable service tax was neither paid by the assessee nor was it demanded by the department. This resulted in evasion of service tax to the extent of Rs. 4.04 crore. Additionally, penalty of Rs. 4.04 crore and interest of Rs. 52.48 lakh was leviable.

(iv) M/s United Coal Washeries Ltd., in Nagpur commissionerate, engaged in washing of coal on behalf of Maharashtra State Power Generation Company Ltd. (MSPGCL), Nagpur, received an amount of rupees five crore during the period from 1 December 2005 to 31 March 2007 towards coal washing charges. However, the assessee did not file the return and did not pay the applicable service tax of Rs. 58.75 lakh. The assessee was also liable to pay interest of Rs. 16.84 lakh and penalty of Rs. 58.75 lakh.

On this being pointed out (December 2007), the department accepted (March 2008) the observation and informed that the assessee had since paid an amount of Rs. 60.10 lakh service tax including education cess and has further paid penalty of rupees six thousand for non filing of returns for the said period.

(v) M/s Gupta Coal Ltd. (bearing registration No AAACG4587BST002 under BAS), in Nagpur commissionerate, engaged in providing service of clearing and forwarding agent to various parties also and paying service tax accordingly, arranged transport of washed coal to Raichur (Karnataka Thermal Power Station) on behalf of M/s Gupta Coal and Washeries Ltd (a sister concern). The scrutiny of records revealed that during the period from 1 April 2005 to 31 December 2007, the assessee had received Rs. 3.77 crore towards arranging transport of washed coal on which service tax of Rs. 43.17 lakh was payable under BAS but the neither did the assessee file any return nor did it pay the applicable service tax. The assessee was also liable to pay interest of Rs. 6.51 lakh and penalty of Rs. 43.17 lakh.

On this being pointed out (January 2008), the department stated (March 2008) that the assessee had paid (March 2008) an amount of Rs. 43.17 lakh with interest of Rs. 4.75 lakh.

(vi) M/s Professional Citadel Infotel, in Ludhiana commissionerate, engaged in providing BAS had not furnished returns during the period 2003-04 and 2005-06. But from the records of the Cell Phone Company (Spice Communication Ltd., Mohali), it was observed that the assessee had rendered service during the above period for a value of Rs. 3.16 crore. This resulted in evasion of service tax of Rs. 30.68 lakh, in addition to interest liability of Rs. 11.43 lakh and penalty of Rs. 30.68 lakh.

2.6.3.2 Estimated loss of service tax in respect of registered service providers who had stopped filing returns

The Government exempted small service providers with taxable service up to rupees four lakh from payment of service tax from 1 April 2005 vide Notification No. 6/2005-ST dated 1 March 2005.

It was noticed that 1,517 service providers whose annual receipt of BAS had exceeded rupees four lakh during the year 2005-06 had submitted their returns for the year. However, the assessees did not submit the return for the year 2006-07. Despite this, the department did not take any action to ascertain if these service providers had fallen below the threshold or they had stopped filing return/tax due to evasion. In the absence of related records, audit estimated the quantum of service tax evaded by these service providers as Rs. 38.08 crore with an equal penalty liability of Rs. 38.08 crore.

Recommendation No. 6

- *The department needs to devise an appropriate and effective mechanism to detect in time 'stop filers' of returns and collect the revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.*

The Ministry agreed with the recommendation and stated (November 2008) that identification of 'stop filers' was difficult in the present manual system but an effective mechanism for its identification will be implemented through the ACES (Automation of Central Excise and Service Tax) project.

2.6.4 Taxable value suppressed

The power vested in superintendent of central excise to call for any records from the assessee for verification was withdrawn, when section 71 of the Finance Act, 1994 was omitted with effect from 10 September 2004. This power was, however, seldom exercised by the department for verification purpose even prior to 10 September 2004, as had been pointed out in the reviews on various services contained in the Audit Reports of earlier years. Since no mechanism to check the correctness of the assessment made by the service providers as a deterrent has been put in place, the risk of suppression of assessable value in ST-3 returns to evade payment of service tax remains un-mitigated.

As per amended section 78 of the Finance Act with effect from 10 September 2004, any person who suppresses or conceals the value of taxable services with an intent to evade the payment of service tax or raises the inaccurate value of taxable service shall be liable to a penalty in addition to service tax and interest, a sum which shall not be less than, but shall not exceed twice, the amount of service tax sought to be evaded. Rule 5 of the Service Tax Rules was amended and new sub-rule 4 of rule 5 was inserted with effect from 1 March 2006, empowering the departmental officers/authorities to inspect the records at the premises of the assessee.

Attempt was, therefore, made by audit to ascertain the extent of correctness of tax paid by assessees by cross verification of ST-3 returns with income tax returns and other related records of a few assessees. Audit noticed deliberate attempts by assessees to suppress the value of services and consequently evade service tax, in a few cases.

The service tax evaded by 358 assessees (in 32 commissionerates) by suppression of their assessable value was Rs. 48.56 crore during the period from July 2003 to March 2007. Additionally, interest of Rs. 14.58 crore and penalty of Rs. 48.56 crore was also leviable in these cases.

Some illustrative cases are mentioned in the succeeding paragraphs: -

(i) M/s Bharti Airtel Ltd., Ambala Cantt, in Panchkula commissionerate, engaged in providing BAS, received Rs. 257.69 crore in advance towards services provided as per their trial balance for the years 2003-04 to 2005-06. The assessee had not shown the advance receipt of Rs. 257.69 crore in the half-yearly returns submitted during the period 2003-04 to 2005-06 except a sum of Rs. 65.39 crore in the second half-yearly return for the period October 2005 to March 2006. Thus, the assessee had suppressed the assessable value of Rs. 192.30 crore on which service tax of Rs. 18.52 crore was evaded. Besides interest of Rs. 6.74 crore and penalty of Rs. 18.52 crore were also leviable.

(ii) M/s Glaxo Smith Kline Customer Health Care Ltd., Sonepat, in Rohtak commissionerate, engaged in the manufacture of Horlicks and its allied products, received commission amounting to Rs. 29.10 crore towards BAS as per their balance sheet for the period ended March 2007. The assessee did not include the amount of commission of Rs. 29.10 crore in ST-3 returns during the period 2006-07. Suppression of taxable value resulted in evasion of

service tax of Rs. 2.97 crore. Penalty of Rs. 2.97 crore and interest of Rs. 38.59 lakh was also leviable.

(iii) Cross verification of the income tax returns of M/s Ravi Metal Treatment, in Rajkot commissionerate, engaged in providing BAS revealed that the assessee had undervalued services to the extent of Rs. 6.79 crore in ST-3 returns during the year 2005-06. This resulted in short payment of service tax to the extent of Rs. 69.23 lakh besides applicable interest of Rs. 18.20 lakh and penalty of Rs. 69.23 lakh.

(iv) M/s Bihar Raffia Industries Ltd., in Jamshedpur commissionerate, engaged in manufacture of HDPE Bags under chapter 39 of Central Excise Tariff, rendered BAS by way of procuring orders on behalf of the clients and in this process earned commission/brokerage of Rs. 7.13 crore but paid service tax on suppressed value of Rs. 3.03 crore during the period 2004-05 to 2006-07. This resulted in short payment of service tax of Rs. 44.47 lakh. The assessee was also liable to pay interest of Rs. 12.69 lakh and penalty of Rs. 44.47 lakh.

Recommendation Nos. 7 and 8

- *To address the root cause of the irregularities pointed out through paragraph 2.6.4 of this report, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This checking may be reinforced by detailed scrutiny. The selection of cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.*
- *The department should investigate all cases identified by audit where suppression of taxable value was resorted to and take appropriate action including recoveries of tax due.*

The Ministry agreed with the recommendation and stated (November 2008) that the Board has approved the draft of service tax scrutiny manual, which provides for all the steps to be taken on the lines suggested by audit.

2.6.5 Time limits for adjudicating service tax cases not prescribed

Section 73 of Finance Act, 1994, relates to issue of SCN and recovery of service tax short levied. These provisions are on lines of section 11A of Central Excise Act prescribing a time limit of one/five years for issue of SCNs in normal/fraud cases. However provisions similar to the provision of section 11A prescribing time-limit of six months/one year, where it is possible to do so, for finalisation of adjudication cases relating to central excise receipts, have not been incorporated in section 73 to administer service tax cases. The adjudication officers are not obliged to finalise a demand case (SCN) relating to service tax within a prescribed time frame, which could lead to delays in finalisation of cases and recovery of service tax.

Audit observed that in the absence of such time limits having been prescribed, adjudication proceeding in 785 SCNs (68 commissionerates) relating to

service tax on BAS and involving revenue of Rs. 80.71 crore were pending (as on 30 September 2007), of which 43 SCNs involving revenue of Rs. 8.73 crore were pending for more than two years.

Recommendation No. 9

- *The Government should prescribe a time-limit for adjudicating demand cases (SCNs) relating to service tax through appropriate legislation. This would mitigate the risk of delay in adjudication of such cases and consequential risk to revenue.*

The Ministry was in agreement (November 2008) with the above recommendation, during the exit conference.

2.7 Compliance issues

2.7.1 Ineffective verification and scrutiny of returns

The scrutiny of returns filed by the service providers is the most important element of the enforcement strategy of tax administration. The overriding aim of such verification/scrutiny is to provide a credible deterrence to wilful suppression of assessable value as well as to realise appropriate revenues. The verification/scrutiny broadly would consist of checking on the basis of: (i) the information contained in the ST-3 returns; and (ii) scrutiny of other supporting records such as commercial records, income tax returns, etc. of the assessee for ascertaining the correctness of the tax paid.

Prior to 10 September 2004, section 71 of the Finance Act, 1994, provided for the verification of the correctness of the tax assessed by the assessee, on the basis of information contained in the returns filed by the assessee. This section also empowered the superintendent of central excise to call for any accounts, documents or other evidence in connection with such verification, though this power was sparingly exercised by range offices. After withdrawal of section 71 above (with effect from 10 September 2004), no departmental instructions were issued for verification/scrutiny of returns till 8 February 2007. The Board issued instructions on 8 February 2007 for scrutiny of ST-3 returns filed by large service tax payers on a selective basis.

The verification with reference to the information available in ST-3 returns has assumed greater significance because of the following factors: (i) grant of value based threshold exemption with effect from 1 April 2005; (ii) grant of specific and conditional exemption (service tax on specified percentage of gross value) to certain services; (iii) the introduction of Cenvat Credit Rules, 2004 with effect from 10 September 2004, allowing cenvat credit of excise duty paid on inputs or capital goods or cenvat credit on input service; and (iv) grant of exemption of service tax on export of service.

The succeeding paragraphs of this audit review report on the selected service (BAS) bring out that scrutiny of the returns conducted by the department has not been effective. Audit verified the status of verification/checking of ST-3 returns received in 57 commissionerates during 2006-07. It was observed that 47 per cent of the returns received (received: 60,830, verified: 32,311) were pending for verification/scrutiny.

Audit attempted to check some of the ST-3 returns including those verified/checked by department on the basis of the information furnished by the assessees. Records of ST-3 returns were not maintained properly and service-wise in the department, making it difficult for audit to obtain ST-3 returns relating to BAS. On scrutiny of some of the ST-3 returns with reference to information contained in those which audit could obtain, it was noticed that service tax of Rs. 115.76 crore besides interest of Rs. 27 crore and penalty of Rs. 116.64 crore had been short paid by 626 assessees. Of these, the department had accepted audit observations involving revenue of Rs. 65.54 crore and had recovered Rs. 10.66 crore and issued SCNs for Rs. 11.28 crore. This indicated that basic checks with reference to the available information in ST-3 return were not exercised by the department. This resulted in even mistakes apparent from records going undetected by the department.

A few illustrative cases are mentioned in the succeeding paragraphs:-

2.7.1.1 Service tax on lottery agents

The service in relation to provision of service on behalf of client became taxable under BAS from 10 September 2004. The constitution bench of the Supreme Court in the case of M/s Sunrise Industries held that paper lotteries are not goods but only actionable claims. According to the United Nations Central Products Classification[3], lottery has been classified as service under Heading No 96920 along with services such as slot machine services, lotto and casino and gambling house service. The discounts received by the sole selling agents/promoter for promotion, marketing, sale and distribution of paper lotteries are nothing but service charges for providing service on behalf of the client and are accordingly taxable under BAS. The applicability of service tax under BAS on services provided by agents/distributors in relation to promotion or marketing of lottery tickets was further confirmed by inserting an explanation under sub clause (ii) of clause 19 of section 65 of the Finance Act, 2008.

(i) M/s Sree Balaji Agencies, in Kochi commissionerate, engaged in providing services for promotion, marketing, sale and distribution of paper lottery tickets on discount basis got discounts on sale of the tickets of Royal Government of Bhutan (RGB). The amount of discount received, on the basis of sales as detailed in the sales tax returns filed by the assessee for the period from 1 April 2005 to 28 January 2007, was Rs. 170.81 crore. The assessee was liable to pay applicable service tax of Rs. 19.78 crore besides interest of Rs. 4.73 crore and penalty of Rs. 19.78 crore on such discount, which was not paid.

On this being pointed out in Audit (May 2008), the department admitted (August 2008) the observation and reported that the assessee is liable to pay

[3] The Central Product Classification (CPC) constitutes a complete product classification covering goods and services. It is intended to serve as an international standard for assembling and tabulating all kinds of data requiring product detail including industrial production, national accounts, service industries, domestic and foreign commodity trade, international trade in services, balance of payments, consumption and price statistics. Other basic aims were to provide a framework for international comparison and promote harmonization of various types of statistics dealing with goods and services.

service tax of Rs. 48.46 crore including education cess for the period July 2003 to March 2008 and SCN will be issued shortly.

(ii) In a similar case, M/s Megha Distributors, in Calicut commissionerate, engaged in promoting and marketing of paper lotteries belonging to the Royal Government of Bhutan and other governments, received discount of Rs. 196.30 crore during the years 2005-06 and 2006-07. Neither did the assessee take service tax registration nor did it pay the applicable service tax of Rs. 23.41 crore. Interest of Rs. 5.11 crore and penalty of Rs. 23.41 crore was additionally payable.

2.7.1.2 Non payment of service tax under import of service

Rule 2 (1) (d) (iv) of Service Tax Rules, 1994, stipulates that the person receiving taxable services in India is liable for payment of service tax on services provided by person who is non resident or is from outside India or is not having any office in India.

(i) M/s Motorola (India) Pvt. Ltd., in Gurgaon division of Delhi (ST) commissionerate, engaged in receiving services covered under BAS from foreign service providers, entered into agreement with foreign service providers for rendering services such as information technology, support services sales and business development, support in wireless infrastructure, global procurement etc. The assessees paid commission amounting to Rs. 151.41 crore to various foreign service providers towards rendering BAS during the period between July 2003 and March 2006. However, service tax of Rs. 15.16 crore leviable thereon was not paid by the recipient of services in India (Motorola). Additionally, an interest of Rs. 4.37 crore and penalty of Rs. 15.16 crore was also leviable.

(ii) M/s Tata Steel, in Jamshedpur commissionerate, engaged in manufacturing of steel products, received service of sale of goods, market development, and export promotion from foreign agencies and paid commission of Rs. 36.49 crore in foreign currency during the period 2003-04 to 2006-07 on which service tax was not paid. The assessee was liable to pay service tax of Rs. 3.74 crore besides interest of Rs. 1.03 crore and penalty of Rs. 3.74 crore. Total amount due was of Rs. 8.51 crore.

2.7.1.3 Service tax on providing marketing of various loans

M/s Team HR Services Ltd., in Delhi (ST) commissionerate, engaged in providing BAS to various clients, provided marketing of car loan, home loan, personal loan etc to ICICI Bank. The internal audit of the assessee (parent company) was conducted in September 2006. In reply to a query of internal audit, the assessee contended (September 2006) that the company had been marketing car loan and other retail finance products as prescribed by the client (ICICI Bank), according to which the said services were not taxable during the period under audit. It was observed that the department did not accept the contention of its parent company (M/s Solution Integrated Marketing Services Ltd.) for the year 2003-04 and 2004-05. However, no SCN was issued by the department. The assessee, however, started charging service tax from November 2006 after internal audit. As per the annual accounts, the assessee had provided service of Rs. 84.47 crore and Rs. 122.58 crore during the year 2005-2006 and 2006-2007, respectively. However, the service tax returns

furnished to the department had declared only Rs. 26.38 crore and Rs. 92.69 crore, respectively for the years 2005-06 and 2006-07. The discrepancy was also not explained as no exempt services had been provided during the period. The short declaration of the value of services resulted in short-payment of service tax of Rs. 9.72 crore. Besides, interest of Rs. 1.89 crore and penalty of Rs. 9.72 crore was also leviable.

On this being pointed out (September 2007), the department instructed (October 2007) the assessee to deposit the total amount of Rs. 21.33 crore or clarify the position. The assessee had since (November 2007 and January 2008) deposited Rs. 9.36 crore as service tax. The balance service tax of Rs. 0.36 crore, interest of Rs. 1.89 crore and penalty of Rs. 9.72 crore were yet to be recovered.

2.7.1.4 Procurement of inputs for clients

M/s MSTC Ltd., in Kolkata (ST) commissionerate, engaged in providing certain services to different clients by way of procuring goods on behalf of the clients, realised service charges of Rs. 67.42 crore in lieu of providing such services during the period 2005-06 and 2006-07, but the applicable service tax of Rs. 7.45 crore was not paid. The assessee was also not registered with the department for BAS. The assessee was also liable to pay penalty of Rs. 7.45 crore and interest of Rs. 1.49 crore.

2.7.1.5 Irregular benefit under Export of Service Rules, 2005

Under rule 3(2) of the Export of Service Rules, 2005, any taxable service shall be treated as export of service, which is exempt from the levy of service tax, when the following conditions are satisfied: -

(i) such service is provided from (delivered outside substituted from 1 March 2007) India and used outside India; and

(ii) payment for such service provided is received by the service provider in convertible foreign exchange.

M/s ATE Marketing Pvt. Ltd., in Mumbai (ST) commissionerate, engaged in receiving orders from Indian companies and passing them on to the foreign companies for supply of goods on commission basis, obtained orders from various companies in India for a foreign company. The foreign company, on receiving orders, delivered goods to the Indian companies. Service tax was leviable on the commission received by the assessee as the service had been provided in India. The assessee received an amount of Rs. 9.62 crore in 2005-06 and Rs. 14.71 crore in 2006-07 as commission but did not pay the service tax. This resulted in short levy of service tax of Rs. 98.11 lakh for 2005-06 and Rs. 1.80 crore for 2006-07. The assessee was also liable to pay penalty of Rs. 2.78 crore and interest of Rs. 36.16 lakh.

On this being pointed out (August 2007), the department stated (April 2008) that SCN for Rs. 2.78 crore was being issued.

2.7.1.6 Service of collection of bills

Section 65(19) of Finance Act, 1994, as amended in 2004, inter-alia, defines BAS to include services 'dealing with goods or services or documents of title

to such goods or services and collecting payments of sale price of such goods or services as explained under the term commission agent'.

M/s E-Seva, established as an autonomous body by the Government of Andhra Pradesh in Hyderabad II commissionerate, was engaged in providing the service of collecting utility bills and tax payments and service of processing and forwarding of certain application like passport etc. on behalf of companies owned by both the Government and private sector and charging its client certain amount as commission. Thus, the services provided by the E-Seva fell under the ambit of BAS and liable to service tax accordingly. Though the E-Seva is registered as a service provider under BAS, it did not file any return nor did it pay applicable service tax of Rs. 1.97 crore on the commission of Rs. 18.37 crore received during the period July 2004 to March 2007. The assessee was also liable to pay Rs. 1.97 crore as penalty and interest of Rs. 52.90 lakh.

Furthermore, the assessee was also issuing bus passes on behalf of Andhra Pradesh State Road Transport Corporation on a commission basis and had charged Rs. 4.29 crore during the years 2004-05 to 2006-07 on which service tax of Rs. 47.27 lakh was not paid. Additionally, penalty of Rs. 47.27 lakh and interest of Rs. 10.19 lakh was also payable.

2.7.1.7 Non/short payment of service tax

As per Rule 6 of Service Tax Rules, 1994, the service tax shall be paid to the credit of the Central Government by the 5th of the month immediately following the calendar month in which the payments are received towards the value of taxable service.

Scrutiny of returns of M/s Nair Coal Services, in Nagpur commissionerate, for the period April 2007 to October 2007 revealed that an amount of Rs. 7.31 crore was received by the assessee. However, applicable service tax of Rs. 89.88 lakh was not paid. The assessee was further liable to pay interest of Rs. 5.64 lakh and penalty of Rs. 89.88 lakh.

On this being pointed out (November 2007), the department reported (January 2008) recovery of Rs. 96.34 lakh (including interest).

2.7.1.8 Evasion of service tax

M/s Schenkar India Pvt. Ltd., in Delhi (ST) commissionerate, engaged in providing BAS, showed the receipts from this service as Rs. 71.50 lakh and Rs. 1.33 crore during 2005-06 and 2006-07 respectively in the ST-3 returns. Scrutiny of income tax TDS certificates received by the assessee revealed that the assessee had received commission/brokerage worth Rs. 2.84 crore and Rs. 6.57 crore during these two years. The assessee had concealed the receipts of service charges of Rs. 7.36 crore and evaded service tax of Rs. 85.80 lakh. The assessee was liable to pay service tax of Rs. 85.80 lakh along with interest and penalty of Rs. 13.96 lakh and Rs. 85.80 lakh respectively.

2.7.1.9 Service tax on job work relating to exempt final products

Section 65 (19) of Finance Act, 1994 as amended in 2005, BAS, inter-alia, includes production or processing of goods for or on behalf of a client. However, by Notification No.8/2005-ST dated 1 March 2005 as amended on dated 7 June 2005 such production or processing of goods not amounting to

manufacture was exempt from levy of service tax provided (i) such goods are produced using raw materials of semi finished goods supplied by the client, and (ii) goods so produced are returned to the client for use in or in relation to the manufacture of any other goods on which appropriate duty of excise is payable.

(i) M/s Ruchi Soya Industries Ltd., in Mangalore commissionerate, engaged in doing job work of processing of oils (a commodity exempt from central excise duty), provided job work services to M/s Kuldip Overseas Pvt. Ltd. and received job work charges of Rs. 7.88 crore from 2004-05 to 2005-06. However, the assessee did not pay the applicable service tax of Rs. 48.53 lakh on these charges. The assessee was also liable to pay penalty of Rs. 48.53 lakh and interest of Rs. 12.62 lakh.

(ii) M/s Oil Country Tubular Ltd. (OCTL), in Hyderabad III commissionerate, engaged in the manufacture of drilling pipes, entered into a job work agreement with M/s Indian Seamless Metal Tubes Ltd. (ISMTL), Pune, during the years 2004-05 and 2005-06 for carrying out certain processes like heat treatment and end finishing of casing pipes on the green pipes supplied by M/s ISMTL. The agreement, inter-alia, provides for payment of fixed price to the assessee for the above processes. The goods after processing were supplied to ONGC direct or through ISMTL. M/s ISMTL claimed exemption from levy of excise duty on the finished goods supplied to ONGC as 'deemed exports'. The process undertaken by the assessee did not amount to manufacture. During the period from 10 September 2004 to 31 March 2006, the assessee received a consideration of Rs. 3.47 crore as job charges but did not discharge the applicable service tax liability of Rs. 35.38 lakh. Interest of Rs. 9.20 lakh and penalty of Rs. 35.38 lakh was additionally leviable.

2.7.1.10 Hiring charges on machines supplied on behalf of the clients

M/s Bengal Beverages Pvt. Ltd., in Kolkata commissionerate, engaged in providing visicoolers[4] machines to retailers on behalf of client, received Rs. 9.82 crore towards 'hire charges' of these machines from the clients during the period July 2003 to March 2006. Such visicooler machines were provided to the retailers for safe and cool storage of aerated water and hence necessary for marketing of the goods. These visicoolers were also capitalised in the assessee's fixed assets accounts. For the said business practice of facilitating customer service/marketing of finished products etc. the assessee was liable to pay service tax under BAS which was not paid. This resulted in non payment of service tax to the order of Rs. 83.80 lakh. The assessee was also liable to pay penalty of Rs. 83.80 lakh and interest of Rs. 44.94 lakh.

On this being pointed out (August 2006), the department accepted (July 2007) the observation and stated that SCN has since been issued (June 2007).

2.7.1.11 Service tax on up-linking charges

M/s Asianet Communications Ltd., in Trivandrum commissionerate, engaged in providing services in the category 'broadcasting services' by using the transponders of Videsh Sanchar Nigam Limited (VSNL) for telecasting their programmes, up-linked the programmes of M/s Jeevan TV from its earth

[4] Machines used for safe and cold storage of aerated water.

station through the same transponders. For this, the company received service charges of Rs. 7.20 crore during the period from 1 July 2003 to 31 March 2007 at Rs. 16 lakh per month. As the service charges received by the company was for promotion of services provided by M/s Jeevan TV, it attracted service tax under BAS. No service tax was being paid by the company on the above charges collected. The assessee was liable to pay service tax of Rs. 72.14 lakh, interest of Rs. 26.15 lakh and penalty of Rs. 72.14 lakh.

2.7.1.12 Non payment of service tax on incidental services

M/s Coal Handlers Pvt. Ltd., in Kolkata (S T) commissionerate, engaged in providing incidental services (placing of orders, payment handling and other liaison work, etc. in relation to procurement of coal for their client) covered under BAS, paid service tax from 16 June 2005 onward. However, the incidental services were being provided by the assessee since 10 September 2004 but the assessee did not pay the applicable service tax on the receipts on this account. This led to non-payment of service tax of Rs. 48.47 lakh, on receipts of Rs. 4.75 crore during the period from September 2004 to June 2005 besides penalty of Rs. 48.47 lakh and interest of Rs. 12.60 lakh.

2.7.1.13 Reimbursements not included in the value of services

As per section 67 of the Finance Act 1994, the value of any taxable service shall be the gross amount charged by the service provider for the service rendered by him. This gross amount shall be reckoned as amount charged for the service rendered irrespective of the nomenclature used for the amount charged for the service rendered.

M/s Rawmet Commodities Pvt. Ltd., in Kolkata (ST) commissionerate, engaged in providing the output services on behalf of the client as a commission agent, received certain reimbursements amounting Rs. 4.11 crore during 2005-06 from its client. Such reimbursements were in the form of salary of staffs, office expenses, business promotion expenses etc. that were incurred for providing the output service on behalf of the client as a commission agent. Such charges so realised should have formed part of the value of taxable services. However, the assessee did not include this amount in the assessable value of the services thereby evading service tax of Rs. 41.11 lakh besides penalty of Rs. 41.11 lakh and interest of Rs.10.69 lakh.

2.7.1.14 Short payment of service tax on advance payment

Section 67 of Finance Act, 2004 (No.2) provides that the payment received before the provision of taxable service is treated as amount received for the taxable service and service tax is required to be paid on such amount received.

M/s I-Process Services (India) Pvt. Ltd., in Delhi (ST) commissionerate, engaged in providing office operation services to ICICI Bank, received advance payment of Rs. 27.38 crore during June 2005 to March 2006. Out of this, an amount of Rs. 4.21 crore was related to exempted service (call centre service). Thus, the balance amount of Rs. 23.17 crore was towards taxable service to be provided. But the ST-3 returns were filed for Rs. 19.54 crore as advance payment for taxable services to be provided and Rs. 0.23 crore was shown as receipt against taxable services provided. This resulted in less disclosure of the advance receipt of Rs. 3.40 crore and consequent short

payment of service tax of Rs. 34.67 lakh. The assessee was also liable to pay penalty of Rs. 34.67 lakh and interest of Rs. 9.01 lakh.

2.7.1.15 Undervaluation of taxable service due to non addition of the value of consideration

Rule 3 of the Service Tax (Determination of Values) Rules, 2006, provides that, subject to the provisions of section 67, the value of taxable service, where the consideration received is not wholly or partly consisting of money, shall be determined by the service provider in the following manner : -

(a) the value of such taxable service shall be equivalent to the gross amount charged by the service provider to provide similar service to any other person in the ordinary course of trade and the gross amount charged is the sole consideration;

(b) Where the value cannot be determined in accordance with clause (a), the service provider shall determine the equivalent money value of such consideration which shall, in no case be less than the cost of provision of such taxable service.

Rule 2 (1) (d) (vi) of Service Tax Rules, 1994 (as amended w.e.f. 1 April 2005), stipulates that an asset management company engaged in sale of mutual funds, is liable to pay service tax under BAS, for receiving the services of sale or distribution of such units.

A few illustrative cases where the value of services was determined incorrectly are discussed in the following paragraphs: -

(i) M/s Reliance Capital Asset Management Company, in Mumbai (ST) commissionerate, engaged in sale of mutual funds covered under BAS, paid commission/brokerage to the distributors for sale of mutual funds during the year 2006-2007. The assessee had also given gold coins, gift coupons etc., valuing to Rs 2.09 crore to its distributors, as incentive. However, as the amount involved in the gift of incentives was not included in the gross amount for payment of service tax, the taxable service was under assessed by such consideration. This resulted in a short payment of service tax of Rs. 24.61 lakh. The assessee was also liable to pay interest of Rs. 3.20 lakh and penalty of Rs. 24.61 lakh.

(ii) Chhattisgarh State Electricity Board (CSEB) received consideration in cash and kind (power units) from private manufactures of electricity for selling their power to clients through its transmission lines. This service comes under the definition BAS. CSEB was liable to pay service tax of rupees nine lakh on cash consideration received during the year 2003-04 to 2006-07. The actual consideration received in kind in lieu of service provided could not be worked out due to non availability of the information (free units) in CSEB's financial statements.

2.7.1.16 Service tax on sales commission

Service tax is payable on the sales commission received by the commission agents under Section 66 of the Finance Act, 1994 under BAS from 9 July 2004 (sales commission was exempt from service tax up to 8 July 2004).

The Coir Board, in Kochi commissionerate, engaged in promotion and development of coir industry in India, received commission of Rs. 2.92 crore from the coir manufacturers during the period from July 2004 to March 2007. However, the applicable service tax of Rs. 31.52 lakh was not paid by the Coir Board. Interest of Rs. 9.08 lakh and penalty of Rs. 31.52 lakh was additionally payable.

Responding to the observation, the department stated (August 2008) that the SCN demanding the tax has since been issued (April 2008), though under 'clearing and forwarding agents' services as the taxability of the 'Coir Board' under the 'business auxiliary services' was under examination.

2.7.1.17 Payment of service tax at incorrect rates

M/s MSTC Ltd., in Kolkata (ST) commissionerate, engaged in providing BAS, paid service tax of Rs. 2.17 crore on service charges of Rs. 19.84 crore during year 2006-07. However, the assessee was liable to pay service tax of Rs. 2.43 crore at the rate of 10.20 per cent including education cess up to 17 April 2006 and 12.24 per cent including education cess from 18 April 2006 onwards. This led to short-payment of service tax of Rs. 25.56 lakh. The assessee was also liable to pay interest of Rs. 3.32 lakh and penalty of Rs. 25.56 lakh.

2.7.1.18 Non payment of service tax by post offices

The Board's circular dated 23 August 2007 had clarified that the post offices were required to pay service tax on the commission received for collection of certain utility bill payments. These services had come under the BAS from 10 September 2004.

Information collected from the various post offices in audit revealed that during the period 2005-06 to 2006-07 an amount of Rs. 2.01 crore was received by six post offices, in Nagpur commissionerate, on account of commission for collection of electricity bills and BSNL bills on which service tax of Rs. 22.60 lakh was payable. However, no service tax had been paid.

On the observations being pointed out (October 2007 and November 2007), the department stated (December 2007 and January 2008) that post offices at Wardha and Paratwada are collecting service tax with effect from 18 April 2006 and the same are credited by way of book transfer. The reply regarding the remaining post offices was not provided.

The reply regarding the above said post offices is incomplete as the service tax was payable from 10 September 2004 and not from 18 April 2006.

2.7.1.19 Other cases

Five hundred and ninety nine other cases of ineffective scrutiny of returns which had led to short levy of service tax totalling of Rs. 24.74 crore were also noticed by audit. Interest of Rs. 5.79 crore and penalty of Rs. 25.94 crore was further leviable in these cases. Of these, the department had accepted audit observations involving revenue of Rs. 5.47 crore and had recovered Rs. 33.46 lakh and issued SCNs for Rs. 9.67 crore.

2.7.2 Cenvat credit

In terms of rule 4 of the Cenvat Credit Rules, 2004, credit of excise duty or service tax paid on any input or capital goods or any input service is allowed to a provider of taxable service. Credit can be utilised towards payment of service tax subject to the fulfilment of certain conditions. Section 14AA of the Central Excise Act, 1944 (made applicable on ST under Section 83 of Finance Act, 1994) stipulates that in case where the commissioner suspects excess use of cenvat credit, he/she may require an audit to be conducted by a cost accountant.

Audit observed incorrect and excess availing and utilisation of cenvat credit totalling Rs. 17.99 crore, by providers of business auxiliary services in 77 cases. Interest of Rs. 2.75 crore and penalty of Rs. 13.75 crore was further leviable in these cases. Of these, the department had accepted audit observations involving revenue of Rs. 51.75 lakh, recovered Rs. 40.51 lakh and issued SCNs for Rs. 46.95 lakh.

A few interesting cases are mentioned in the following paragraphs: -

2.7.2.1 Cenvat credit in excess of the admissible limit

Rule 6(3) (c) of the Cenvat Credit Rules, 2004, provides that where a provider of output service avails of cenvat credit in respect of any input or input services and provides output services which are chargeable to tax as well as are exempt and does not maintain separate accounts in respect of both category of services, then the provider of output service will utilise credit only to the extent of an amount not exceeding twenty per cent of the service tax payable on the output services.

(i) M/s HTMT Global Solutions Pvt. Ltd., in Bangalore commissionerate, engaged in providing services availed cenvat credit on input service/capital goods/input service distribution. The assessee provided both taxable and exempt services, however, no separate accounts were maintained for the year 2006-07. The utilisation of cenvat credit was not restricted to 20 per cent of applicable service tax on output services and this resulted in excess utilisation of cenvat credit by Rs. 3.23 crore. The assessee was also liable to pay interest of Rs. 41.93 lakh and penalty of Rs. 3.23 crore.

(ii) M/s Hewitt Associates (India) Pvt. Ltd., in Gurgaon division of Delhi (ST) commissionerate, engaged in BAS and management consultancy services, utilised cenvat credit on inputs/input services for providing taxable as well as non-taxable services (including export of services). The assessee, however, did not maintain separate accounts of inputs used in both type of services. The assessee utilised cenvat credit exceeding 20 per cent of the tax liability towards taxable output services during the period from 2005-06 to 2006-07. This resulted in excess utilisation of cenvat credit of Rs. 2.03 crore, which is required to be paid in cash. The assessee was also liable to pay interest of Rs. 34.91 lakh and penalty of Rs. 2.03 crore.

(iii) M/s Infovision Information Services Pvt. Ltd., in Delhi commissionerate, engaged in providing both taxable as well as non-taxable services availed cenvat credit on input services. The assessee had not maintained separate accounts of input services utilised in these services. The assessee paid service tax of Rs. 4.86 crore during the year 2006-07 through

cash and cenvat credit. The assessee utilised credit of Rs. 1.39 crore towards payment of service tax, notwithstanding the fact that the assessee was eligible for utilisation of cenvat credit of only Rs. 97.24 lakh (capped at 20 per cent of applicable service on output services). Accordingly, there was excess utilisation of cenvat credit of Rs. 42.16 lakh, which needs to be recovered in cash. Besides, the assessee was also liable to pay interest of Rs. 5.48 lakh and penalty of Rs. 42.16 lakh.

The root cause of the excess utilisation of cenvat credit in the cases discussed above has been the lack of disclosure of information relating to exempt services provided/received (including its value) in the prescribed form of ST-3 for filing service tax returns. In audit's opinion this is an important internal control through which the risk of excess utilisation of cenvat credit could be mitigated.

Recommendation No 10

- *Government should amend the ST-3 return to include relevant information regarding the receipt/provision of non taxable/exempt services to mitigate the risk utilisation of cenvat credit in excess of the prescribed limit.*

The Ministry was in agreement (November 2008) with the above recommendation during the exit conference.

2.7.2.2 Cenvat credit on the input service used for providing exempted output service

Rule 6(1) read with rule 6(6) of the Cenvat Credit Rules, 2004, stipulates that cenvat credit is not available on input services used to provide output services which are exempt from service tax. Services which are exported are exempt from levy of service tax. The incorrect availing of cenvat credit attracts interest under Rule 14 of the Rules.

M/s Sutherland Global Services Ltd., in Chennai commissionerate, engaged in providing call centre service, availed cenvat credit of Rs. 4.04 crore during June 2005 to March 2007 on the input service used in export of call centre service. This resulted in incorrect availing of cenvat credit of Rs. 4.04 crore. The assessee is also liable to pay interest of Rs. 94.46 lakh in addition to the requirement of reversal/payment of credit of Rs. 4.04 crore.

On this being pointed out (April 2008), the department stated (July 2008) that though the assessee had availed cenvat credit on the input service used for providing exempted output service, assessee's claim of refund of credit of Rs. 1.50 crore relating to the period June 2005 to February 2006 has been disallowed. The status regarding balance credit and recovery of interest has not been intimated.

2.7.2.3 Incorrect availing of suo-moto credit

Section 11B of the Central Excise Act, 1944, provides for claiming refund of the excise duty by making an application for refund before the expiry of a year from the relevant date. There is, however, no provision in the Central Excise Act/Rules under which suo moto credit of the excise duty/cenvat credit can be taken. The Board clarified on 13 October 1997 that there is no provision in the Finance Act to adjust service tax due against what has been already paid.

Therefore, the assessee has to file a refund claim if necessary under section 11B (as made applicable to service tax). The Tribunal in the case of M/s Comfit Sanitary Napkins (I) Pvt. Ltd. {(2004) 174 ELT 220)} also held that the assessee cannot take suo moto refund but has to follow the procedure laid down under section 11B of the said Act.

M/s Bharti Airtel Ltd., Ambala Cantt., in Panchkula commissionerate, irregularly adjusted the excess deposit of service tax amounting to Rs. 1.59 crore between October 2004 and March 2005, without claiming refund under Section 11B. While this was in violation of the existing procedure, the correctness of the refunds was also in doubt, not having been examined by the department as no claim was filed, examined and appropriate amount sanctioned subsequently. Additionally, the assessees benefited by way of immediate credit which became available to them for further use. This resulted in irregular availing of suo moto credit amounting to Rs. 1.59 crore which should be recovered in cash. Interest of Rs. 53.55 lakh and penalty of Rs. 1.59 crore was also recoverable.

2.7.2.4 Cenvat credit paid on behalf of foreign service providers

Rule 2(l) of the Cenvat Credit Rules, 2004, stipulates that inputs service means any service, (i) used by a provider of taxable service for providing an output service; or (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products, up to the place of removal and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage up to the place of removal, procurement of inputs, activities relating to business. Further, rule 2(p) of the rules, stipulate output service as any taxable service provided by the provider of taxable service to a customer, client, subscriber or any other person, and expression provider and provided will be construed accordingly.

Explanation below rule 2(p) further clarifies that if a person is liable to pay service tax does not provide any taxable service or does not manufacture final product, the service for which he is liable to pay the service tax shall be deemed to be the output service. The Cenvat Credit Rules allow credit of service tax paid on input services for utilisation against service tax payable on output services.

M/s Goldman Sachs Services Ltd. (STP unit), in Bangalore (ST) commissionerates, engaged in providing back office services covered under BAS to their group of companies situated outside India, availed Cenvat credit of service tax paid on behalf of foreign services providers to the extent of Rs. 1.01 crore between April 2006 to September 2007. As the service tax had been paid on behalf of foreign service providers, it cannot be considered as an output service, the availing of credit was not in order. The assessee was also liable to pay interest of Rs. 6.59 lakh and penalty of Rs. 1.01 crore.

2.7.2.5 Cenvat credit on capital goods

Cenvat credit availed of under the Cenvat Credit Rules can be utilised for payment of central excise duty on finished goods or for service tax leviable on output service. Wrong utilisation of cenvat credit is recoverable with interest.

Clause (vi) of Section 65 (19) of Finance Act, 1994, stipulates that BAS includes provision of service on behalf of the client but it does not cover service to the client.

M/s TV Sundaram Iyengar & Sons, in Madurai commissionerate, engaged in providing various services including BAS to various units, availed cenvat credit of countervailing duty of Rs. 95.52 lakh on imported forklift truck during 2006-07. The nature of service provided by the assessee was material handling, movement of material for production and after production within the factory of its sister concerns namely M/s Wheels India, M/s TVS Logistics Service Ltd., Pune, etc. The assessee discharged the service tax liability by utilising the cenvat credit availed on capital goods. The service provided by the assessee was not provision of service on behalf of the client but it was provision of direct service to the client which was not covered under BAS. Since no output service was provided, the assessee was not eligible to avail any input credit on capital goods. The incorrect availing of cenvat credit of Rs. 95.52 lakh was required to be reversed. The assessee was further liable to pay interest of Rs. 14.93 lakh.

2.7.2.6 Fraudulent availing of cenvat credit

As per Rule 14 and 15 of Cenvat Credit Rules, 2004, where cenvat credit in respect of input services has been taken or utilised wrongly on account of fraud, collusion, wilful misstatement or suppression of facts or contravention of any of the provisions of the Finance Act or Rules, the amount equivalent to the credit availed shall be recovered along with penalty equal to the amount of such credit. The rules further provide that the assessee shall be liable to pay interest from the first day of the month succeeding the month in which the credit was wrongly taken till the date of payment of such amount.

M/s Motorola (India) Pvt. Ltd., in Gurgaon division of Delhi (ST) commissionerate, engaged in providing taxable services took service tax credit amounting to Rs. 42.38 lakh twice in seventy one cases i.e. first time in July 2006 and second time on the same invoices between September 2006 and March 2007. Since the credit of duty was taken fraudulently, the assessee was liable to pay service tax of Rs 42.38 lakh besides penalty of Rs. 42.38 lakh and interest of Rs. 5.28 lakh.

On this being pointed out (November 2007), the assessee deposited service tax of Rs. 31.83 lakh and interest of Rs. 3.76 lakh in November 2007. Report on recovery of the balance amount had not been received.

2.7.3 Service tax collected but not remitted to the Government

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

Cross verification of service tax payments made by M/s. Tata Steel (TISCO), Jamshedpur to M/s Tata Ryerson Ltd and M/s B.M.W. Jamshedpur, in Jamshedpur commissionerate, engaged in providing processing services revealed that during the period 2005-06 and 2006-07, these external

processing agents had collected a sum of Rs. 8.74 crore towards service tax but these service providers deposited only Rs. 5.08 crore. This resulted in short deposit of service tax totalling Rs. 3.65 crore. These assessees were further liable to pay interest of Rs. 48.49 lakh and penalty of Rs. 3.65 crore.

In another case, M/s PCM Cement Concrete Pvt. Ltd. in Siliguri commissionerate, collected service tax of Rs. 62.53 lakh but did not remit this amount into the Government account.

On this being pointed out (October 2007 and November 2007), the department accepted (December 2007) the observations and issued SCN for Rs. 62.53 lakh.

2.7.4 Allocation of permanent account number (PAN) based Service tax code (STC)

The Board in their letter dated 27 August 2001 issued instructions for allotment of service tax code (STC) numbers based on PAN allotted by Income Tax department to all service providers. The work was to be completed latest by 15 November 2001. The progress was to be monitored by the DGST on a weekly basis. The Board, vide circular dated 21 February 2002, had issued further instructions for allotment of PAN based service tax code numbers. As a part of electronic tax administration programme, the department has also developed allotment of service tax payer code number programme. The DGST in its 'Performance Report' for the year 2004-05 had stated that the scheme of allotment of PAN based registration numbers and allotment of STC codes had been properly implemented in most of the commissionerates all over India. Audit, however, found that the progress made in this regard was not encouraging and above instructions were not followed by the department as was observed from the statistical information/data furnished. It was indicative of lack of monitoring and appropriate corrective action by the department.

Position of allotment of PAN based service tax code number as on 31 March 2007 in 71 commissionerates relating to BAS is given in the following table: -

Table No. 5

No. of service providers	No. of service tax providers not allotted STC Numbers	Percentage
88,177	8,792	10

Audit observed that:-

- The work of allotment of service tax code numbers, which is crucial from the point of view of cross verification of value of services, was yet to be completed even after a lapse of more than seven years.
- In Nasik commissionerate, none of the 1669 registered service providers in respect of BAS service had been allotted STC number based on PAN.
- Six commissionerates did not furnish the information relating to PAN based STC allocation.

- In Indore commissionerate, STC number based on PAN has not been allotted to 69.69 per cent service providers.

Recommendation No. 11

- *Correlation of income tax data with service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of the scheme has been slow and non-exhaustive, which needs to be corrected.*

The Ministry noted (November 2008) the above recommendation for further necessary action.

2.7.5 Exemptions

Audit observed 31 cases where exemptions from service tax totalling Rs. 16.96 crore were incorrectly availed. An additional liability of penalty totalling Rs. 11.83 crore and interest totalling Rs. 4.82 crore was applicable in these cases. Of these, the department had accepted the audit observations involving revenue of Rs. 5.58 lakh, recovered Rs. 2.32 lakh and had issued SCNs involving Rs. 4.08 crore.

A few cases are discussed below: -

2.7.5.1 Under notification No. 6/99-ST dated 9 April 1999, taxable service specified in clause 90 of section 65 of the Finance Act, 1994, was exempted from service tax, in respect of which payment was received in India in convertible foreign exchange. However, this notification was rescinded by notification No. 2/2003 dated 1 March 2003. The Central Government vide notification No. 21/2003 dated 19 November 2003 again exempted taxable services from service tax in respect of which payment is received in India in convertible foreign exchange. Thus, there was no exemption from service tax in such cases for the intervening period i.e. from 1 March to 20 November 2003.

M/s Microsoft Corporation (India) Pvt. Ltd., in Gurgaon division of Delhi (ST) commissionerate, engaged in providing marketing services under BAS to different clients outside India, received Rs. 152.68 crore in convertible foreign exchange for providing services during the year 2003-04. The proportionate value of service charges in convertible foreign exchange for the period 1 July 2003 to 20 November 2003 worked out to Rs. 59.40 crore. However, the assessee incorrectly availed the exemption from payment of service tax on Rs. 59.40 crore. This resulted in non-payment of service tax of Rs. 4.75 crore besides interest of Rs. 2.68 crore and penalty of Rs. 4.75 crore.

2.7.5.2 Section 65 (19) of the Finance Act, 1994 defines BAS as any service in relation to promotion or marketing of service provided by the client or any service incidental or auxiliary to any activity such as billing; issue or collection or recovery of cheques, payments, maintenance of accounts and remittance, evaluation or development of prospective customer, public relation services etc, including services as commission agent. The services of commission agent who causes sale or purchase of goods were exempt from the

payment of service tax from 1 July 2003 to 8 July 2004 as per Notification No. 13/2003-ST dated 20 June 2003. Thus, commission agent who rendered services not relating to sale or purchase of goods were required to pay service tax during the above period under BAS.

M/s Voltas Ltd., in Coimbatore commissionerate, entered into an agreement with M/s Lakshmi Machine Works Ltd. to provide services like booking of orders, collection of payments, clerical support, tracking of delivery schedules, operational assistance, customer service etc. Scrutiny of their annual report for the years 2003-04 and 2004-05 revealed that the assessee received commission of Rs. 15.52 crore for providing such services. As the services did not involve sale or purchase of goods, the commission received was not exempt from service tax under BAS. However, the assessee did not discharge the service tax liability of Rs. 1.24 crore for the period 1 July 2003 to 8 July 2004. Interest of Rs. 46.38 lakh and penalty of Rs. 1.24 crore was further recoverable.

2.7.5.3 Board's circular dated 5 November 2003 provides that the commission received by distributors on mutual fund distribution is liable to service tax under BAS. Further, the exemption under Notification No. 13/2003-ST, dated 20 June 2003 is applicable only to commission agents dealing in goods.

M/s Integrated Enterprises (I) Ltd., in Chennai (ST) commissionerate, Chennai, engaged in providing services as a retail financial intermediary facilitating various financial instruments like fixed deposits, bonds, debentures and mutual funds of various corporate, started paying service tax under BAS from 1 May 2005. Scrutiny of 'Annual Reports' for the years 2003-04, 2004-05 and 2005-06 disclosed that the assessee had received brokerage (distribution income) of Rs. 20.06 crore during 1 July 2003 to 30 April 2005. However, the assessee did not pay the applicable service tax of Rs. 1.79 crore on the above receipts under BAS. The assessee was also liable to pay interest of Rs. 83.40 lakh and penalty of Rs. 1.79 crore.

2.7.5.4 Notification dated 3 March 2005 stipulates that the taxable service shall be treated as export of service provided (i) such service must be to a recipient located outside India, (ii) such service is delivered outside India and used outside India (prior to 1 March 2007) or such service is provided from India and used out side India (from 1 March 2007), (iii) payment for such service is received by the service provider in convertible foreign exchange. Thus, export of service delivered outside India or provided from India but used outside India is exempt from the purview of service tax.

M/s Gmmco Ltd., in Chennai (ST) commissionerate, engaged in providing of various services to M/s Caterpillar India Ltd., entered into sales and service agreement with M/s Caterpillar Overseas Company, Singapore in connection with promotion or marketing or sale of goods provided by the foreign company, by procuring purchase orders from the local customers, and received commission, fees and service charges in foreign exchange of Rs. 11.70 crore and Rs. 14.29 crore during the years 2005-06 and 2006-07 respectively. However, the assessee did not discharge the service tax liability under BAS by claiming exemption under export of service even though the assessee had rendered the service in India. This resulted in non payment of service tax of Rs. 2.94 crore besides interest of Rs. 53.77 lakh and penalty of Rs. 2.94 crore.

2.7.6 Internal Controls and monitoring

2.7.6.1 Non-maintenance of registers/computerized database of service providers

ST-3 return registers are required to be maintained by the divisions. These registers have important information like name of the service provider, amount of services provided, service tax payable, date of receipt of return, etc.

During test check of records maintained in service tax divisions, audit noticed that: -

- In nine divisions of Mumbai (ST), Pune I, Pune II, Nasik and Aurangabad commissionerates and all the ranges/divisions of Kolkata (ST), Bolpur, Siliguri, Haldia and Bangalore commissionerates, the prescribed ST-3 return registers were either not maintained or were incomplete.

2.7.6.2 Incomplete database of assessees in STREMS

A new package 'Service Tax Revenue Monitoring System (STREMS)' was developed to monitor the revenue collected through service tax. STREMS captures the information from the ST-3 returns filed by the service tax payees and generates various reports to help the department for accounting and control purpose.

Audit observed that: -

- Database in respect of all the 5,119 service providers under BAS was not created in the Chennai (ST) commissionerate,
- Chennai III, Coimbatore, Madurai and Tiruchirapalli commissionerates did not furnish the information on creation of database for service providers of BAS.
- The database was not updated by Bhubaneshwar I & II, Ranchi and Jamshedpur commissionerates.

2.7.6.3 Inconsistent and unreliable data

On the basis of figures available from the Kolkata (ST) commissionerate, it was noticed in audit that the total number of registered assessees under BAS during the year 2005-06 was 2,898. However, the division-wise break up of this figure shows that the number of assessees registered under this service was only 1,388 in the commissionerate.

Further, during the same year, it was noticed that the revenue collection under BAS was Rs. 68.80 crore for the whole of Kolkata (ST) commissionerate while the division wise break-up of the revenues were Rs. 10.56 crore, Rs. 3.19 crore and Rs. 15.38 crore respectively, which added up to Rs. 29.13 crore only for the commissionerate leaving a difference of Rs. 39.67 crore between the two sets of figures.

2.7.6.4 Creation of special cells

As per DGST's instructions dated 26 May 2003, the creation of special cells for building up complete database in respect of potential assessees was a mandatory task. Audit observed that: -

(i) The department did not set up 'special cells' in 29 commissionerates. Some of these were:- Delhi (ST), Ahmedabad III, Rajkot, Bhavnagar, Vadodara I, Surat II, Vapi, Daman, Chandigarh, Ludhiana Bangalore (ST), Belgaum, Mysore and Mangalore commissionerates.

(ii) Five commissionerates had not furnished the information about creation of special cells.

(iii) Out of the 80,226 registered service providers of BAS in 66 commissionerates, database has not been created in respect of 16,400 service providers.

In the absence of complete and updated information/database regarding the registered service providers and the returns being filed by them, in our opinion, the department was not in a position to exercise an effective monitoring of the returns.

Recommendation No. 12

- *The database of registered assessees needs to be maintained exhaustively, updated continually to remove inconsistent data and improve the reliability of available data. This would assist the department to administer the service tax in an improved and more efficient manner.*

The Ministry accepted the above recommendation (November 2008) and intimated that the cleaning up and updating of assessee registration database will be accomplished through the 'Automation in Central Excise and Service Tax (ACES)' project.

2.7.6.5 List of accounts not filed

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

Audit observed that during the period from July 2003 to March 2007 in 61 commissionerates, 18,638 ST-3 returns of the 30,093 returns those were filed for the first time, did not have the list of accounts appended with the returns. Audit noted that: -

- Sixty two per cent of service providers had not given the details of books of accounts maintained by them.
- During the period from July 2003 (date of inception of BAS) to March 2007, no assessee of Ahmedabad (ST), Vadodara I, Vadodara II, Shillong, Dibrugarh, Chandigarh, Jalandhar, Ludhiana, Ghaziabad, Kanpur and Puducherry commissionerates had submitted the list of books of accounts at the time of filing of ST 3 return for the first time.
- Ten commissionerates, including exclusive service tax commissionerates at Delhi, Bangalore, Kolkata and Chennai did not provide the data relating to accounts details being filed with the first ST return.

The percentage of service providers who gave the list of books of accounts at the time of filing of their first return in a few (Goa, Jamshedpur, Mysore and

Salem) commissionerates was only one to ten per cent. The department had not monitored the receipt of these and had not taken any corrective action.

2.7.7 Conclusions

Audit review of administration of service tax related to business auxiliary services has revealed the following system and compliance deficiencies:-

- The internal control mechanism existing in the department to bring unregistered service providers into tax net was ineffective and inadequate. Key performance indicators (KPIs) like minimum surveys to be conducted by a commissionerate to identify potential assessees were not prescribed, in the absence of which their performance could not be evaluated. Consequently, a large number of active unregistered service providers were escaping from the service tax net and audit could identify 1,193 of these, with actual loss of service tax of Rs. 123.87 crore and further an estimated service tax loss of Rs. 15.21 crore. The Board should require the commissionerates to establish 'Key performance indicators' in relation to the minimum surveys to be conducted in a year to identify/register assessees and garner additional revenue. Subsequently, the Board should evaluate the performance of the commissionerates based on this criterion too.
- The procedure for conducting survey needs to be streamlined to collect information about potential assessees from various sources including from income tax department. In all the cases identified by audit, of service providers who had escaped the tax net by not registering and not paying the applicable service tax, the department should do a detailed scrutiny/investigation of the service tax evaded by these service providers and take appropriate action. Additionally, inter-governmental and inter-departmental coordination and control mechanism to ensure that only registered assessees provide services and pay applicable tax, needs to be strengthened, which would mitigate the risk of evasion of tax by service providers to the Government sector.
- The Government needs to continually monitor the data on assessee base and revenues collected and investigate the reasons for decline in revenue from a particular service despite increase in the registered tax base, to ensure that the decline is not due to evasion.
- Internal controls to detect and take proactive action against 'stop filers' were ineffective and resulted in evasion of actual revenue of Rs. 170.26 crore and estimated revenue of Rs 38.08 crore. The department needs to devise an appropriate and effective mechanism to detect in time 'stop filers' of returns and collect revenue wherever due, by effective monitoring of the receipt of returns from registered service providers.
- The internal control mechanism to verify the correctness of returns filed was inadequate and ineffective and audit noticed several cases of short levy of service tax and evasion of service tax by suppression of value of services. The short levy worked out to Rs. 111.70 crore. To address the root cause of these irregularities, the Board may consider putting in place a mechanism for checking/verification of returns on regular basis. This

checking may be reinforced by detailed scrutiny. The selection of cases for detailed scrutiny may be made on a scientific basis after appropriate risk analysis and sample size determination. The detailed scrutiny should entail correlation with other available records/returns like IT, commercial records etc.

- The adjudication officers are not required to finalise a demand case relating to service tax, within a prescribed time frame, which could lead to delays in finalisation of cases and recovery of service tax. The Government should prescribe a time-limit for adjudicating demand cases (SCNs) relating to service tax, through appropriate legislation. This would mitigate the risk of delay in adjudication of such cases and consequential risk to revenue.
- Audit also observed incorrect and excess availing and utilisation of cenvat credit by providers of business auxiliary services. The Government should amend the ST-3 return to include relevant information regarding the receipt/provision of non taxable/exempt services to mitigate the risk of utilisation of cenvat credit in excess of the prescribed limit.
- Correlation of income tax data and service tax data is a key factor for correct evaluation of service tax liability. Allotment of PAN based STC numbers is a step in right direction. However, this aspect of implementation of this scheme has been slow and non-exhaustive, which needs to be corrected.
- The database of registered assessees needs to be maintained exhaustively, updated continually to remove inconsistent data and improve the reliability of available data. This would assist the department to administer the service tax in an improved and more efficient manner.

While the total financial implication of this audit intervention (review) is Rs. 999.44 crore, the direct additional revenue which could come to the Government is Rs. 892.86 crore.

Twelve specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in this report. All the twelve recommendations were agreed to, by the Ministry.

SECTION 3 - CUSTOMS

CHAPTER III
INDIAN CUSTOMS ELECTRONIC DATA INTERCHANGE SYSTEM (ICES)

Executive Summary

The Indian Customs Electronic Data Interchange System (ICES) envisages acceptance of customs documents electronically and exchange of information electronically in centralised/structured formats, integrating customs with other agencies and was developed to implement the various provisions of the Customs Act 1962, Customs Tariff Act 1975 (CTA) and Central Excise Tariff Act 1985 (CETA). The system was designed to exchange/transact customs clearance electronically using Electronic Data Interchange (EDI).

A review of the ICES was conducted in audit with the objective to verify that the IT system had mapped the processes and provisions of the Customs Act effectively and to (i) evaluate the software in relation to fulfilment of the business requirements set down in the Customs Act, (ii) ascertain the extent of utilisation of data in the system, (iii) evaluate whether the system has adequate inbuilt controls to ensure accuracy and completeness of assessments etc., (iv) evaluate whether the modifications in the programme were properly authorised, tested, documented and implemented and (v) evaluate whether the system had adequate security controls .

The audit review has revealed deficiencies in design, application and validation controls of the system. Broadly these relate to (i) deficiencies in the system design leading to incomplete capture of data leading to manual interventions and incorrect levy of customs duty, (ii) incorrect mapping of the business rules leading to excess sanctions of drawback, 'duty entitlement passbook (DEPB)' credits and short levy of 'countervailing duty (CVD)', (iii) absence of appropriate input controls leading to entry of incorrect and invalid entries for freight/insurance resulting in undervaluation and incorrect assessment of duty forgone, (iv) absence of validation between 'customs tariff heading (CTH)' and the serial number of the notification to check for ensuring the eligibility for the benefit of exemptions, (v) absence of validation between licences and scheme codes which enabled multiple debiting of schemes such as 'DEPB', 'Duty free replenishment certificate (DFRC)' and 'Target plus scheme (TPS)' in the licences, (vi) inadequate change management control which had resulted in non-matching/duplication of 'CTH' and 'central excise tariff heading (CETH)', non-levy of 'national calamity contingencies duty (NCCD)', non-updating of notification master tables and incorrect updating of 'drawback schedule' and (vii) wastage of resources as the data available in the system was not utilised and manual processes were resorted instead. The short levy, non-levy etc. of the customs duty due to these system deficiencies noticed in cases test checked was Rs. 220.50 crore, of these, observations with money value of Rs. 76.44 crore have been accepted (till December 2008) by the department.

Five specific recommendations designed to address the system deficiencies and mitigate the risk of occurrence of similar irregularities in future have been

included in the report. All of these recommendations were acceptable to the Ministry.

3.1 Highlights

- **Deficiencies in the system design led to incomplete capture of data leading to manual interventions and consequently incorrect levy of customs duty.**

(Paragraph 3.11.3)

- **Incorrect mapping of the business rules enabled excess sanction of drawback, DEPB credits and short levy of CVD.**

(Paragraphs 3.12.1 to 3.12.3)

- **Incorrect and invalid entries for freight/insurance became possible as input controls were insufficient. This had led to undervaluation and incorrect assessment of duty forgone.**

(Paragraph 3.13.1.1)

- **Validation check between CTH and the serial number of the notification did not exist and as a result it was not possible to ensure that the benefit of exemptions was taken by only in legitimate cases.**

(Paragraph 3.13.1.2)

- **Absence of validation controls between licences and scheme codes led to debiting of licences in multiple schemes like DEPB, DFRC and TPS.**

(Paragraph 3.13.1.3)

- **Inadequate change management control led to non-matching of CTH and CETH which resulted in duplication of tariff heads and also non-levy of NCCD.**

(Paragraph 3.14.1)

- **Inadequate change management led to non-updating of notification master tables and incorrect updating of 'drawback schedule'.**

(Paragraphs 3.14.2 and 3.14.3)

- **Resources were wasted as manual process was resorted to despite the requisite data residing in the system.**

(Paragraph 3.16)

3.2 Introduction

The ICES envisages acceptance of customs documents electronically and exchange of information electronically in centralised/structured formats, integrating customs with other agencies such as Reserve Bank of India (RBI), Director General of Foreign Trade (DGFT) etc. and was developed to implement the various provisions of the Customs Act 1962, CTA and CETA. The system was designed to exchange/transact customs clearance electronically using EDI.

The main objectives of ICES were (i) respond more quickly to the need of the trade, (ii) computerisation of customs related functions including import/export, general manifest control, ex-bond clearance of warehoused goods, goods imported against export promotion schemes, monitoring of export promotion schemes, (iii) reduce interaction of the trade with the Government agencies, (iv) provide retrieval of information from other custom location to have uniformity in assessment and valuation, (v) provide management information system for policy making and its effective revenue and pendency monitoring and (vi) provide quick and correct information on import/export statistics to the 'Director General of Commercial Intelligence and Statistics (DGCIS)'.

The ICES was made operational as a Pilot project at Air Cargo, Delhi in 1995 and the same was introduced in the other customs houses in a phased manner from 1997.

As a part of envisioned move from customs control to trade facilitation the following measures have been adopted for streamlining the customs procedure under the ICES:

(i) Elimination of divergent practices in the application of customs law and procedure at different customs locations by effective monitoring and analysis of computerised database.

(ii) Minimised physical examination of goods by effectively using risk management system (RMS).

(iii)The drawback payment system has been re-engineered to provide for direct disbursement of the amount into the exporter's bank account after the goods have been exported.

A system review on ICES of the Customs department was included in the Report of the Comptroller and Auditor General of India – Indirect Taxes – Customs for the year ended March 2001. That review had focused on the initial stages of computerisation viz. procurement and software development. The present audit was conducted with the major objective of verifying that the IT system had mapped the processes and provisions of the Customs Act effectively and to evaluate the software in relation to fulfilment of the business requirements set down in the Customs Act.

3.3 The system

The ICES software was developed with Oracle as the back-end database and Forms and Reports of Oracle as the front-end. The system is presently under the administrative control of the Directorate General of Systems and Data Management (DGS&DM), department of customs, New Delhi and is assisted by the National Informatics Centre (NIC). All the customs houses are connected with the DGS&DM through leased lines.

E-filing services to the trade and cargo carriers and other clients of customs and central excise (trading partners) are being provided through a portal ICEGATE (Indian Customs and Central Excise Electronic Commerce/Electronic Data interchange (EC/EDI) Gateway). ICEGATE relies

on a high-speed network called ICENET or the Indian Customs and Central Excise Network.

3.4 Master files in the system

The master tables (directory) such as the exchange rate, tariff heading, notifications etc., except anti-dumping duty (ADD), for the purpose of calculation of duty are centrally updated by the DGS&DM at New Delhi and then followed by similar process of updating in the local servers through snapshots[5].

3.5 Filing of bill of entry (BE)/shipping bill (SB)

All importers/exporters have to declare the details of import/export in the prescribed format. Declaration forms can be submitted by the importers/exporters to the 'Service Centre' in the customs house for making data entry into the system or the same can be filed through ICEGATE[6] which is connected to the customs server through leased lines. The system allots the BE/SB number after the importer/exporter verifies the data entered through a checklist generated in the service centre. The practice of manual submission of BE/SB has almost been dispensed with. The assessment of BE/SB and sanction of incentives like drawback are done through the system.

3.6 Processing of data

After the BE/SB number are generated by the system, the bills are subject to further processing including registration, examination, verification of goods, assessment and sanction of drawback by the departmental officers. Prior to the introduction of 'RMS'[7] during January 2006 to May 2007 in respect of the selected states, the system allocated the BE to the Apprising Officer (AO) for assessment and then for further checks by the Internal Audit Department (IAD) before clearance of the goods. However, after the introduction of RMS, the system selects the bills randomly based on the parameters set by the 'System Manager' for post compliance audit in place of internal audit. As regards exports, drawback amounts are sanctioned through the system at the appropriate levels.

[5]A snapshot is a replica of a target master table from a single point-in-time. Whereas in multi master, replication tables are continuously being updated by other master sites, snapshots are updated by one or more master tables via individual batch updates, known as a refresh, from a single master site.

[6]Indian Customs Gate way (ICEGATE) for filing BEs/SBs online using Remote EDI system (RES) package available in CBEC website.

[7]RMS is to enable the department for selective screening of only high risk cargo for customs examination. Under the RMS, BEs filed by importers in the ICES will be processed for risk and a larger number of consignments will be allowed clearance based on the importer's self assessment without examination.

3.7 Output of the system

After assessment, print outs of BEs/SBs, challans for payment of duty by the importers are produced by the system and credits of drawback are effected directly into the exporter's bank account through scrolls.

3.8 Audit objective

The ICES system had been modified from time to time in accordance with the changes in the Customs Act/Rules. The system has been in operation for more than a decade. The present review was conducted to verify that the IT system had mapped the processes and provisions of the Customs Act effectively and further to (i) evaluate software in relation to fulfilment of the business requirements set down in the Customs Act, (ii) ascertain the extent of utilisation of data in the system, (iii) evaluate whether the system had adequate inbuilt controls to ensure accuracy and completeness of assessments etc., (iv) evaluate whether the modification in the system were properly authorised, tested, documented and implemented and (v) evaluate whether the system had adequate security controls.

3.9 Scope of audit and methodology

The review was conducted in 18 customs stations under the control of 14 commissionerates of customs in six states (Andhra Pradesh, Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal). The import and export data for the years 2005-2006 and 2006-2007 was analysed using Oracle SQL queries (except in Delhi where export data was not furnished). The results of the queries were verified with the manual records. A sample size of two percent, subject to maximum of 200 records, was selected for cross verification of each query result with the corresponding manual record. Only 350 out of 21,450 manual records requisitioned were produced to audit in Tamil Nadu, Andhra Pradesh, Gujarat, Maharashtra and Delhi. The responses to the audit observations, wherever received, have been appropriately incorporated in this report.

3.10 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the necessary information and records for audit. The draft review was forwarded to the Ministry in October 2008 and an exit conference was conducted with the Ministry officials in November 2008. The written responses to the draft review were received from the Ministry in December 2008 and have been incorporated appropriately in this report.

AUDIT FINDINGS AND RECOMMENDATIONS

3.11 System design

System design is the process of defining the architecture, components, modules, interfaces, and data for a system to satisfy the specified

requirements. It was observed that the system did not have built in provisions to capture all relevant data and further to carry out some of the calculations for the assessment of the customs and other duties.

3.11.1 Lack of provision to calculate/classify export duty

Prior to March 2007, export duty was leviable on 'hides, skin and leather tanned or un-tanned excluding manufactures of leathers' falling under heading 14 of second schedule of CTA. The ICES did not have any provision to calculate the applicable export duty. The department had accepted the shortcoming in January 2007.

Similarly, iron ore and chromium ore were liable to levy of export duty under headings 11 and 12 of second schedule to the CTA respectively. While the system did calculate export duty on iron ore and chromium ore alongwith applicable cess, the challan generated by the system for the total amount payable did not indicate the amounts for export duty and cess, separately. Accordingly, in the monthly details of payment generated by the system, total amount collected was shown as cess and the same was adopted for compilation of accounts by PAO. To this extent the collections under the export duty were understated and collections under the cess overstated.

The Ministry, while accepting (December 2008) the observations and related recommendation of separate accountal of cess and export duty, stated that the software could be modified to differentiate these.

3.11.2 Non-availability of collections of extra duty deposit (EDD)

The system calculates the aggregate of customs duty, interest, penalty, fine etc. on assessment of each BE. Audit observed that the system did not have a provision to capture details of the collections of EDD due to which these duties were collected manually alongwith the collection of the amount of basic customs duty (BCD), CVD etc.

The Ministry, while agreeing with the observation that ICES does not have provision for calculation of EDD, informed (December 2008) that this duty is calculated manually as calculation of EDD is not a routine assessment feature.

3.11.3 Incomplete capture of the parameters and manual intervention leading to short levy of BCD

In terms of the first schedule to the CTA, textiles being imported are required to be declared in units of 'm^2or kgs' and the applicable customs duty is to be calculated at the specified rates per 'm^2 or kgs' or at ad-valorem rate, whichever is higher. However, in the common trade practice, the quantities indicated in the invoices are in terms of meter or yard and the width is indicated in inches or centimetres or with the weight in grams per square meter (GSM), which require conversion of these units into 'm^2 or kgs' for the assessment and calculation of BCD. It was observed that these detailed parameters were captured in the system in text format in a single field thus making it unusable by the system for calculation of applicable duties. In fact

the system did not even have a provision for such calculation. This necessitated that the conversion was carried out manually and the quantity with appropriate units of measurement was entered into the system. No verification of such entries was additionally done to ensure the correctness of these quantities. In the absence of the above enabling provisions in the system, it was observed in audit through data analysis that:-

a) the quantities under unit of measurement were incorrect as the importers did not apply correct conversion formulae while entering the data. This was observed in 380 items in Tamil Nadu, 116 items in Maharashtra and 29 items in Delhi. This errors resulted in short calculation of BCD of Rs. 13.93 crore (Rs. 8.35 crore in Tamil Nadu, Rs. 5.40 crore in Maharashtra and Rs. 18.02 lakh in Delhi).

b) in respect of 1,661 items, the quantity was shown as 'ZERO' or 'NULL' indicating deficient input and validation controls.

The system has a provision to edit and amend the data with respect to the quantity at the assessing officer's level. However, it was observed that, due to a design deficiency, the duty on specific rate continued to be worked out by the system based on the pre-amended data and the amended data was not utilised to arrive at the duty. This resulted in short calculation of BCD in 91 cases totalling Rs. 1.81 crore in Andhra Pradesh, Delhi, Maharashtra, Tamil Nadu and West Bengal.

While explaining (December 2008) the fact of different units of measurement being adopted in the BEs, as per trade practice and the difficulty to control these through the system, the Ministry informed that the design deficiency pointed out by audit regarding system using pre-amended data has been rectified, post audit, through a software patch.

3.11.4 Data regarding country of origin

The country of origin is used to arrive at the ADD. As per the declaration form for data entry at the service centres, the country of origin was to be captured at two sources on the form depending on the necessity. One, when the country of origin for all items was same at BE level and when the country of origin for the items was different, the country of origin was to be captured separately for all the items, individually at item level. Audit observed that system allowed capture of the country of origin in both sources even in cases where the country of origin for individual items was different. This led to presence of two different countries of origin for the same item (at BE and at item levels) in respect of 9,38,294 items mentioned in 2,06,057 BEs in Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal. This posed the risk of non-levy of anti-dumping duty as the same is levied based on various factors including the country of origin and declaration on the part of importer as to whether the imported goods were liable for such duty.

The Ministry informed (December 2008) that the system has been properly designed by capturing 'country of origin' at two places and using the value at the 'item' level for levy of ADD. Accordingly, any short levy pointed out by audit could be on account of assessment lapse.

3.11.5 SBs not matched with export general manifest (EGM) on DEPB items

Section 41 of the Customs Act, 1962 envisages filing of EGM by the shipping agent before the departure of the conveyance. Every EGM contains the details of goods being exported as in the corresponding SB. The department issues an export promotion (EP) copy based on the details in the SB for availing of duty credit under the DEPB scheme. The EP copy should not be issued in case of any incongruence of details as mentioned in the EGM and the SB. Further, the department has to verify the DEPB licence issued by the DGFT to ensure that the export had actually taken place, for which the system had a provision.

Audit observed that EP copies for claiming benefit on exports from the DGFT under DEPB scheme were issued to the exporters after verification of licences (2,968) in 11,195 SBs (Andhra Pradesh, Gujarat, Maharashtra, Tamil Nadu and West Bengal) with DEPB value of Rs. 84.13 crore even though the details of the SB did not match with the corresponding details of the EGM (shown by the system itself as "EGM Dtls. Mismatch" in the current status of the SB). This indicates that there was a risk of loss of revenue, in case the DEPB benefit had been extended incorrectly.

The Ministry informed (December 2008) that even after correcting the EGM error, the current status of the SB continued to be shown as mismatched in the system, which was subsequently rectified by NIC.

3.11.6 Currency of packing charges

The exporter/custom house agent (CHA) has to specify the invoice value, rate of commission, discount availed and other deductions etc. alongwith the currency code in the declaration form. These details contained in the declaration form are entered in the system. As per the drawback procedure, packing charges incurred is to be included for the purpose of calculation of freight on board (FOB) value of the goods. However, the provision to enter the currency code for packing charges was absent in the system. As such, by default, the currency code of invoice was taken by the system as the currency code for packing charges and the FOB value of the goods exported was calculated for the purpose of drawback mentioned in the SB.

The Ministry agreed (December 2008) to make a provision in the system for capturing packing charges in Indian rupees.

3.11.7 Items imported against licences not checked with revised Indian trade classification code (RITC)

For the levy of duty, the goods are identified through the tariff heads for customs and central excise as per the respective acts, separately. In the ICES, these were captured for different items of the BE/SB. With effect from March 2005, the CETH and the CTH have been aligned as RITC.

Licences issued by the licencing authority under various export promotion schemes like DEEC, EOU, DFRC, EPCG etc., contain details of items of goods to be imported, quantity, value and the RITC. Though the licence

contains RITC, it was not being captured at the time of registration at the port of import. Capturing the RITC, as per the licence, can enable the system to validate the items imported under the licence by comparing it with the RITC contained in the BE. In the absence of such validation of RITC, possibility of import of goods not covered under the licence could not be ruled out.

The Ministry informed (December 2008) that while there is a provision in the ICES system to capture ITC (HS)/RITC, these were not necessarily reflected in the licences issued by the DGFT. Presently, however, mention of ITC (HS) code has been made mandatory in the EDI licence messages received from the DGFT. It further informed that as the verification of the correctness of the ITC (HS) code is not done at the DGFT end and in case of such incorrect data, the CTH in the BE is corrected by the appraising officer. Accordingly, the validation through the system is not under consideration presently, as that would lead to unnecessary hardship to the trade as correction in the BE would then require correction in the ITC (HS) in the licence issued by the DGFT.

3.11.8 Interest on goods cleared from the warehouse

Under section 61 (2) (ii) of the Customs Act, 1962, Board had clarified (February 2005) that interest is to be levied for delayed clearance of goods from the warehouse, in respect of goods cleared under DEPB licence, if the goods are not cleared from the warehouse within 90 days. Similarly, interest was to be levied in respect of goods cleared from the warehouse by debiting the licences under the TPS.

Audit observed that in 2,129 BEs relating to the schemes such as DEPB, TPS etc., interest of Rs. 4.22 crore (Gujarat Rs. 0.30 lakh in 16 BEs, Maharashtra Rs. 2.74 crore in 343 BEs, Tamil Nadu Rs. 1.48 crore in 1,760 BEs and West Bengal Rs. 0.02 lakh in ten BEs) for delayed clearance of goods from the warehouse was not levied in respect of goods cleared from the warehouse beyond 90 days, as the provision for the same was not built into the system.

The Ministry agreed (December 2008) with the audit observations that provision for calculation of interest for clearance from warehouse beyond 90 days has not been built in the ICES which is calculated manually by the assessing officer and short levy pointed out by audit on this account could be due to assessment lapse.

3.12 Incomplete mapping of business rules

The deficiency in customising various business rules in the system, absence of certain provisions as per the rules/Acts in force were observed relating to the following business requirements:

3.12.1 Agency commission

The drawback rules provide that the agency commission, if any, paid to foreign agency shall be included for the purpose of allowing drawback. Further, the agency commission paid shall be restricted to 12.5 per cent of the value of goods exported. The declaration form furnished by the exporter/CHA

did not contain the details whether the commission was paid to the foreign agency or not.

The system, by default, treated the commission paid as foreign agency commission and the FOB value was calculated accordingly. The amount of commission paid was also not restricted to 12.5 per cent of the value of goods. Due to non- restriction of the commission amount paid in foreign currency to 12.5 per cent of the value of goods, there was an excess sanction of drawback of Rs. 1.53 crore and DEPB amount of Rs. 6.17 crore, as detailed below:

Table no. 1
Excess sanction of drawback and DEPB

(Amount in lakh of rupees)

State	No. of invoices	Excess drawback	No. of items	Excess DEPB
Andhra Pradesh	52	0.61	3,350	32.73
Gujarat	267	2.14	3,483	47.85
Maharashtra	4,978	65.08	30,259	479.60
Tamil Nadu	7,579	79.80	10,043	49.84
West Bengal	475	5.20	4,058	7.37
Total	**13,351**	**152.85**	**51,193**	**617.39**

The Ministry agreed (December 2008) to these audit observations and informed that the ICES application has been modified, post audit, to restrict the agency commission to 12.5 per cent.

3.12.2 Sanction of drawback

As per rule 8 of the Drawback Rules,1995, no amount of drawback shall be allowed, if the amount or rate of drawback is less than one per cent of the FOB value, except where the amount of drawback per shipment exceeds Rupees five hundred.

Audit observed that in 287 cases (seven cases in Andhra Pradesh, 15 cases in Gujarat, 42 cases in Maharashtra, 169 cases in Tamil Nadu and 54 cases in West Bengal), the drawback amount of less than Rupees five hundred were sanctioned, even though the drawback amount was less than one percent of the FOB value.

The Ministry assured (December 2008), that the necessary corrections in the logic built in the system will be done.

3.12.3 Abatement of CVD in respect of imported footwear

In terms of central excise notification dated 1 March 2006, for assessment of CVD on footwear falling under heading 6401 to 6405 of CETA on the basis of maximum retail price (MRP), an abatement of 37 per cent was to be allowed in respect of footwear of retail sale price (RSP) exceeding Rs. 250 and not exceeding Rs. 750 per pair and for other, abatement at the rate of 40 per cent

on the MRP is admissible. Audit observed that the provisions have not been mapped correctly in the system.

Data analysis revealed that in 57 cases of footwear in the price range of Rs. 250-750 per pair were allowed 40 per cent abatement instead of 37 per cent, resulting in short levy of CVD and in 11,830 cases (Delhi – 5,843 items, Andhra Pradesh - 11 items, West Bengal - 808 items and Maharashtra – 5,168 items) CVD was levied in excess by allowing incorrect abatement of 37 per cent instead of 40 per cent on footwear falling in the price range other than Rs. 250 – 750 per pair.

On the deficiency in the system design being pointed out, the Ministry informed (December 2008) that the system is designed to capture only a unique abatement rate against a CETH and the provision for multiple abatement rates is handled through manual assessment only.

Recommendation Nos. 1 and 2

- *Review of the business rules mapped in the system may be carried out.*
- *Any changes built into the system should be documented and conformity of the changes to the business rules ensured. The changes should be authorised by an appropriate authority. An audit trail of the changes made to the system and the data should be maintained. For centralised applications, a centralised change management system should be in place.*

While agreeing (December 2008) to the recommendations, the Ministry informed that (i) business rules are mapped into the system on the basis of statutory provisions and circulars of the Board, (ii) deficiencies in mapping pointed out are rectified, (iii) any changes to the system are done after instructions from the DGS&DM, and (iv) audit trail of these changes are trapped in the e-mail system of the directorate. It further assured that in centralised application, 'Information Technology Infrastructure Library (ITIL)' would be put in place.

3.13 Application controls

Every system should have input, processing, validation and output controls to ensure that the data entered in the system, processing of data and output generated are correct, complete and protect the business interest of the department. Data analysis revealed the following deficiencies in various controls.

3.13.1 Input control and validation check

Input controls ensure that data entered into the system are authorised, complete and correct and validation checks ensure that the data conforms to the business rules. Audit observed that the system lacked both input controls as well as validation checks to ensure complete and correct capture of the primary data in its database.

3.13.1.1 Incorrect computation of assessable value

The assessable value of the goods imported is to be determined under section 14 of the Customs Act, 1962. Rule 9(2) of the Customs Valuation Rules, 1988, provides that if the cost of transportation (freight) is not ascertainable, such cost shall be taken as 20 per cent of FOB value of the goods and if the cost of insurance is not ascertainable, it shall be taken as 1.125 per cent of the FOB value, provided further that in the case of goods imported by Air, the cost of freight shall not exceed 20 per cent of the FOB value of goods. The cost of insurance and freight ascertained or computed in accordance with the above rule shall be added to the FOB value of goods to arrive at the cost, insurance and freight (CIF) value of goods. The system has provision to capture the amount as well as the percentage of the freight and insurance.

As per Board's instruction on 'procedure for clearance of imported and exported goods', the importer is required to furnish the documents such as invoice, packing list, import licence, country of origin certificate, bill of lading, delivery order and insurance document (insurance memo/policy). Under the EDI system, the original documents are not required to be furnished at the service centre but the same should be furnished at the time of examination /clearance of goods. Data analysis in audit has revealed the following deficiencies.

i) Acceptance of zero or null values in respect of freight/insurance

The value or percentage rate is essential in respect of the freight or insurance components for computation of assessable value in respect of FOB based imports. However, the system allowed 'null' or 'zero' values against the freight /insurance values and the respective percentage rates in 380 invoices. This showed absence of input controls and validation checks in system leaving the data unreliable and posed the risk of undervaluation and consequent short calculation/payment of duty.

The Ministry, while agreeing with the observation, informed (December 2008) that the defect has since been rectified by implementation of a software patch.

ii) Acceptance of lesser percentage values against freight /insurance

In the absence of input regarding actual value of insurance and freight, system accepted the percentage of freight and insurance. However, it was noticed that system accepted lesser percentages than the specified rates of 20/1.125 per cent in 1,67,010 cases which were assessed based on FOB value. This resulted in undervaluation of goods and proportionate short levy of duty and incorrect assessment of duty foregone to the tune of Rs. 50.97 crore.

Chennai commissionerate confirmed (January 2007) the undervaluation and further stated that the system did not display the percentage rate on the screen. However, the Tuticorin commissionerate stated (November 2007) that the audit finding was in the cases of assessable value arrived at on the declared freight and insurance when the importer produced the documentary evidence. Visakhapatnam commissionerate stated (January 2008) that actual insurance and freight cost were ascertainable as importers submitted the related documents at the time of import.

However, on a test check of 25 cases in Tamil Nadu and Andhra Pradesh, the documentary evidence for payment of insurance at less than 1.125 per cent was not available in 13 cases in Tamil Nadu, and in 12 cases in Andhra Pradesh, the importer had taken comprehensive insurance.

This showed that there was no system to verify the correctness of data entered, since the system did not display data of freight/insurance entered in percentage rate on the screen. Further, the system did not have any provision to check the value covered under the comprehensive insurance policy, since the comprehensive insurance would cover the prescribed period and the same could be utilised in any port in India.

The Ministry stated (December 2008), that there was no bar in accepting lesser percentage of freight/insurance, if documentary evidence to that effect exists and these documents are subject to verification by the customs officers.

3.13.1.2 Benefit of notifications

The importer/CHA has to declare the notification and its serial number for each item of import for availing exemption of duty. The CTH in turn is linked to the serial number of the notification. The EDI system did not have a validation check to ensure whether the item was eligible for the benefit of exemption under the relevant notification.

In terms of customs notifications dated 1 March 2005 and 1 March 2006, the rates of duty non-agricultural items of chapter 25 and onward of the CTA were reduced to 15 per cent and 12.5 per cent respectively. These notifications were fed into the system with serial number as well as with CTH separately.

Data analysis in audit has revealed absence of linkage of the CTH to the serial number of the notification due to which following irregularities occurred: -

(i) Benefits of exemption under these notifications were incorrectly extended to agricultural items (chapter 1 to 24), though these chapters were not covered under the said notifications. This resulted in short levy of BCD of Rs. 18.03 lakh in Tamil Nadu, Delhi and West Bengal.

(ii) In respect of other than agricultural items that were not covered under the said notification, the benefit of reduction in duty was allowed to 181 cases in Tamil Nadu and Maharashtra resulting in short levy of BCD amounting to Rs. 75.89 lakh.

(iii) Lack of validation between the CTH and the serial number of the notification led to incorrect allowance of the exemption benefits. In the case of customs house, Chennai for the CTH 51111130, the exemption could be extended under serial number 29 (with duty of 15 per cent or Rs. 135 per m^2 which ever was higher). However, the benefit of the notification was allowed under serial number 31(with duty of 15 per cent or Rs. 80 per m^2 which ever was higher). As a result the BCD was incorrectly assessed by the system to the tune of Rs. 34.30 lakh.

The Ministry explained (December 2008), that the CETH/CTH is captured in the notification directory of ICES only in cases of unconditional application.

3.13.1.3 Debiting of licences under multiple schemes

Export promotion scheme licences are issued by the DGFT for schemes like DEPB, DFRC and TPS specifying the quantity, CIF value for which imports can be made by the licence holder, value of duty and validity of the licence period. Each licence issued by the licensing authority was to be registered in the ICES and a registration number was assigned. At the time of clearance of goods, the importer has to furnish the registration number and the scheme code in the declaration form and the duty/value/quantity is debited by the system against the licence.

Audit observed that due to absence of linkage between the licences/ registration numbers and scheme codes, against which the licences have been issued, debit of duty/value/quantity was made in more than one scheme by the system in respect of 6,408 items of import pertaining to the 528 licences in the states of Andhra Pradesh, Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal. Thus, possibility of undue benefit of advance credit of duty by way of duty foregone could not be ruled out in the case of pre-export benefit schemes.

The Ministry informed (December 2008) that post audit, the validation is now done of scheme code instead of scheme codes groupings by implementation of a software patch.

3.13.1.4 Grant of exemption of special CVD

Special CVD of customs at the rate of four per cent to countervail state taxes was introduced from 1 March 2006 vide custom notification No.19/06 dated 1 March 2006. Vide custom notification No. 20/2006, the special CVD is exempted provided both the BCD and CVD are exempted.

Scrutiny revealed that in 7,505 cases in the selected states, the system allowed exemption of the special CVD without validating/ensuring that both the applicable BCD and CVD were 'zero'. This resulted in incorrect grant of exemption for levy of special CVD of Rs. 123.84 crore.

The Ministry stated (December 2008) that instances of allowing the benefits wrongly are due to assessment lapses and to aid these assessments, necessary checks have been incorporated in the ICES post audit through a software patch.

3.13.1.5 CVD based on RSP

In the Conference of chief commissioners of customs, held on 25 and 26 September 2003 at Visakappattinam, it was held that duty is to be levied on the basis of the transaction value ignoring the RSP, wherever there is evidence that RSP has been deliberately mis-declared. Thus, in cases where the assessable value based on the RSP was less than the normal assessable value, the normal assessable value should be taken for the purpose of calculation of CVD.

Scrutiny revealed that in 41,039 cases in the selected states, the assessable value of goods based on RSP was less than the normal assessable value (assessable value for customs purpose plus customs duty). This had resulted in a probable short levy of CVD of Rs. 6.05 crore by the system.

The Ministry stated (December 2008) that CVD can be levied on the basis of transaction value only when there is evidence of deliberate mis-declaration of the RSP and such cases can be investigated/handled only manually and not through the system.

Recommendation No. 3

- *Input controls and validation checks should be reviewed and built into the system, wherever required.*

The Ministry informed (December 2008) that input controls and validation checks have already been incorporated in the system, wherever feasible.

3.14 Change management control

Change management controls are necessary to ensure that standardised methods, processes and procedures are used for all changes, facilitate efficient and prompt handling of all changes and maintain the proper balance between the need for change and the potential detrimental impact of changes. Audit observed lacunae in the change management processes that resulted in the following deficiencies:

3.14.1 Non-matching of the CTH and CETH

Import duty is levied on the goods imported, for which, the goods are classified under CTH. For the purpose of levy of the CVD and NCCD, the goods are classified under the CETH. As far as the goods of 'Work of art and antiques' and goods imported under 'Project import', the goods are to be classified under chapters 97 and 98 of CTA. As there are no corresponding chapters 97 and 98 under CETA, the goods are to be rightly classified under the appropriate chapter heading between 1 and 96 of CETA. From the March 2005, the CTH and CETH have been aligned. Hence, the CTH and CETH of the goods imported are one and same, except for goods imported under chapter 97 and 98 of CTA.

In the absence of the input control to prevent two different codes under CTH and CETH for the same goods imported (excluding project import), the system allowed to enter different codes.

Data analysis in all the selected states revealed that there were different codes in 2,52,897 items involving assessable value of Rs. 3,608.07 crore. Furthermore, the deficiency mentioned above resulted in non-levy of NCCD amounting to Rs. 4.43 lakh in respect of 35 items in Tamil Nadu and Rs. 0.42 lakh in respect of one item in Delhi.

The Ministry stated (December 2008) that validation between CETH and CTH is not done in the ICES.

3.14.2 Non-updating of notification master tables

As per the Handbook for customs officers, all the notifications issued at the time of Budget were updated centrally and the notifications issued

subsequently were to be updated by the System Manager of the respective customs houses. However, it was observed that 14 notifications relating to levy of ADD issued during years 2005 to 2007, were not fed into the database of Chennai commissionerate. This shows that the notification directory (master tables) was not updated/corrected at appropriate time in the local offices.

While agreeing to the observation, the Ministry stated (December 2008) that instructions would be issued to the customs houses to constantly upgrade/correct notification master tables including those belonging to ADD.

3.14.3 Incorrect updating of drawback schedule

The drawback schedule is being updated centrally at New Delhi and the ICES system at each location is being updated through snapshots. Further, the System Manager has been authorised to update the directory, in case, the updating through snapshot was not feasible. The data in the drawback table is used for calculating the drawback.

Audit observed that (i) the rate of drawback on specific rate was incorrect resulting in incorrect apportionment of the drawback between customs and central excise and (ii) the unit of measurement and the rate were incorrect resulting in incorrect sanction of drawback. The above showed inadequacies in the updating of the master data for calculation of duty.

The Ministry agreed (December 2008) that due to the large number of the entries in the drawback schedule some discrepancies may creep in during updation and these discrepancies are rectified on such discrepancies being reported.

3.15 Other points of interest

3.15.1 Difference between the assessment and collection files

Duty calculated by the system and fine, penalty and interest thereon, if any, is collected through designated banks. The relevant data is also made available to the bank by the system. The challan for payment is generated through the system. After collection of duty through the bank, the goods are allowed to be cleared.

Data analysis revealed that the duty amount stated to be collected through various banks (Rs. 19.89 crore) as stored in the system were found to be less by Rs. 9.56 crore than the amount of duty as (excluding fine, penalty and interest) shown in the system as assessed (Rs. 29.45 crore) in respect of 598 BEs in Tamil Nadu, Gujarat, Maharashtra, West Bengal and Delhi for the period April 2005 to March 2007. The reasons for such difference could not be ascertained from the department.

Chennai and Tuticorin commissionerates stated (January and November 2007) that the reasons for the difference could not be identified and the issue has been taken up with the DGS&DM, New Delhi.

The Ministry stated (December 2008) that it was possible that the amount collected was less (upto rupees nine) than the duty assessed, as the system accepts duty payment, if the amount paid is matching upto 'tens' level. It further stated that duty can be recalculated for BEs taken up for post clearance audit, etc. However, the inconsistency is not due to any design deficiency.

3.15.2 Interest for delayed payment of duty

Under section 47 (2) of the Customs Act, 1962, in respect of goods entered for home consumption, when the importer fails to pay duty within five working days from the date on which the BE is returned to him for payment of duty, he shall pay interest on the amount of duty till the date of payment of the duty.

Audit observed that the interest was not levied by the system in respect of ex-bond BE for home consumption though it was levied in certain cases during the year 2005 and there was no consistency in levying interest in all cases.

Data analysis revealed that in 18,294 ex-bond BE, the interest for delayed payment of duty of Rs. 10.65 crore was not calculated by the system in the selected states (Andhra Pradesh - Rs. 3.69 lakh in 98 BEs, Delhi - Rs. 4.42 lakh in 192 BEs, Gujarat - Rs. 2.08 crore in 2,792 BEs, Maharashtra - Rs. 4.94 crore in 9,599 BEs and Tamil Nadu - Rs. 3.55 crore in 5,613 BEs).

3.15.3 Calculation of duty foregone

The system calculates the amount of duty to be levied and amount of duty foregone based on the rates in the customs tariff, notifications and the scheme under which the import takes place. The amount of duty foregone is the difference between the duty to be levied as per the tariff and the effective duty to be levied after allowing the exemptions under various notifications. By definition, the duty foregone cannot be a negative figure.

Audit observed from the data in Delhi, Gujarat, Maharashtra, Tamil Nadu and West Bengal that the item-wise duty foregone was negative (BCD amount in 30,403 items, CVD amount in 20,093 items and other amount in 2,597 items) indicating inconsistencies in the duty to be levied as per tariff and effective duty to be levied after allowing exemptions. This posed the risk of short calculation of duty to be collected for non-fulfilment of export obligations, while redemption of licences, as the duty foregone was reduced.

The Chennai and Tuticorin commissionerates replied (January 2007 and November 2007) that the reason could be furnished by NIC and the issue has been brought to the notice of the DGS&DM, New Delhi.

3.16 Database not utilised to its potential

The ICES has been developed to implement the provisions of the Customs Act, 1962 and various other laws that impose levy of duties and give effect to exemptions from payment of duties and export promotion incentives. It was noticed that even after lapse of more than ten years, the data was not used for the following functions which were continued to be executed manually: -

(i) Maintenance of bond register

Bonds/bank guarantees were executed by the importer for the amount of duty foregone as envisaged in the customs notification.

The data such as value of the bond, expiry date, enforcement date are fed into the system at the time of registration. As the required data are available in the system, the data can be used for generating notices before expiry of the validity date of the bonds and bank guarantees to avoid loss of revenue to the Government. But it was observed that the bond registers continued to be maintained manually, without using the database in the system.

The Ministry agreed with the observation and stated (December 2008) that the audit recommendation will be considered for implementation.

(ii) Levy of bond interest for delayed clearance of goods

All the required data for calculation of bond interest under section 61 of the Customs Act, 1962, for delayed clearance of goods from warehouse, viz. date of bonding, date of assessment and date of payment of duty were available in the system. Yet, the same was calculated and collected manually.

The Ministry agreed with the observation and stated (December 2008) that the audit recommendation will be considered for implementation.

(iii) Finalisation of the provisional assessment

With the additional details obtained from the importer and the data already available in the system, it could be used for finalisation of the provisional assessments. However, these assessments were being finalised manually.

The Ministry agreed (December 2008) that the module for final assessment of provisional assessment cases is yet to be developed in the system.

Recommendation No. 4

- *The system should be modified to use the available data fully so that all business processes are done through the system instead of resorting to manual procedures.*

The Ministry stated (December 2008) that the audit recommendation will be considered for implementation.

3.17 Documentation

The system manual was not available with the department. 'Handbook for customs officers', published in August 2004, was distributed among the officers in the department as user manual. The same was not updated thereafter, even though there were substantial changes in the structure of the database and duty structure.

The Ministry informed (December 2008) that it was in the process of migrating from a distributed system to a centralised system and that the NIC has been asked to provide the system manual of the centralised version of the ICES.

3.18 Business continuity planning

There was no standby/backup server in the department as a measure of business continuity planning. Backup assignments were allotted to NIC as per the MOU with the DGS&DM, New Delhi, and the same was taken daily by the NIC. The data at customs house, Chennai was backed up daily and kept in fireproof cabinet in the same complex and not at a different location at Chennai. At ACC, Mumbai it was kept in the server room itself. The backups were never retrieved or tested. Thus, even though department took backups, the reliability of the same was never tested and ensured.

Recommendation No. 5

- *A periodical review of the performance of the system may be put in place to ensure continued efficiency and effectiveness of the system towards the desired/dynamic business objectives.*

The Ministry stated (December 2008) that instructions for safe keeping of back up tapes/cartridges to field formations would be reiterated. It further informed that a data centre at Delhi and disaster recovery centre at Chennai have been set up and gradually the existing ICES locations will migrate to the data centre.

3.19 Conclusions

The ICES has been in place for over ten years. However, the results of audit of the system have shown that the system was yet to incorporate important business rules and built-in provisions to capture all the relevant data. It was also seen that the system had deficiencies in the input control and the validation checks including a deficient control on the data being entered by the third party. The changes in the system were not documented and archived. Further, the changes in the notification etc. were not mapped/captured in the system which led the system liable to yield incorrect results. Even after ten years of implementation, the system did not have provisions for maintenance of bond register, levy of bond interest for delayed clearance of goods, finalisation of the provisional assessment etc., leading to the resorting to manual systems, even though the data for the same was available in the system.

CHAPTER IV
PROJECT IMPORTS

Executive Summary

The 'Project Imports' scheme was introduced in the year 1965, whereby imports of various items of machinery, equipments, raw materials, components etc. required for the initial setting up or for substantial expansion of a project were made leviable to at a uniform rate of duty subject to certain procedural requirements to be complied with, by the importers. All the imports in such cases were made classifiable under a special customs tariff heading 98.01 created for this purpose. The project import rate is generally a concessional rate vis-a-vis the varying rates which are otherwise applicable to different items of plants and machineries, components etc.

A review of the 'Project Imports' was conducted in audit with a view to ascertain that (i) the cases under the project imports had complied with the applicable rules, regulations and procedures framed under the Customs Act, 1962, Project Imports Regulations, 1986 (PIR) and instructions issued by Board from time to time, (ii) project imports cases had been finalised without undue delay and without causing loss of revenue and (iii) the internal control and monitoring mechanism governing project imports were adequate and effective in ensuring that the scheme was not put to misuse.

The audit review has revealed some systemic as well as compliance weaknesses relating to grant of project imports benefits and finalisation of project imports cases. Broadly these relate to (i) a need for developing an appropriate accounting and monitoring modules integrated with the EDI system to facilitate effective monitoring of cases relating to project imports, (ii) the need of fixation of a realistic time frame for finalisation of assessments relating to project contracts after receipt of the reconciliation statements as substantial delays were noticed, (iii) absence of penal provisions for non-submission/delay in submission of reconciliation statements and other requisite documents which had facilitated delays in cases relating to finalisation of project imports cases and (iv) inappropriate splitting up of items under project imports to get benefit of lower merit rate assessment. The compliance issues noticed in audit related to incorrect availing of project imports concession, import of spares and consumables in excess of ten per cent of value of goods specified in the contract, incorrect grant of duty concession to excluded categories of machinery, discrepancies between the details of goods permitted to be imported and actually imported, incorrect grant of duty concessions due to clearance/import of goods before registration of contract, incorrect grant of project imports concessions due to non-submission of required documents, finalisation of project contracts without installation certificate and plant site verification and non-submission of requisite bond and cash security etc. These resulted from a weak and ineffective internal control mechanism relating to the administration of project imports. In the light of various shortcomings pointed out in this report, the Board should undertake a comprehensive review of the working of the scheme

including the internal control and monitoring mechanism in vogue which govern the project imports and strengthen these.

The total financial implication of this audit intervention is Rs. 644.46 crore. Five specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. While four of these have been accepted (November 2008) by the Ministry, the remaining recommendation was reported to be under its consideration.

4.1 Highlights

- **One thousand and sixty eight cases of project imports were not finalised even after one to 296 months of receipt of reconciliation statements. There is a need for the Government to fix a time frame for finalisation of assessment post submission of the requisite documents.**

(Paragraph 4.6.2)

- **Requisite documents for reconciliation were either not submitted by the importers (even after lapse of seven to 165 months) or submitted with a delay of three to 105 months, in 2,289 cases. Additionally, 19 cases were finalised without receiving the requisite documents for reconciliation. The Government may consider introducing penal provisions for non-submission/delayed submission of documents to act as an internal control.**

(Paragraphs 4.6.3.1 and 4.6.3.2)

- **In three cases, project concessions were wrongly availed as goods were not imported for initial set up or for substantial expansion, objectives underlying the project imports scheme. Customs duty of Rs. 33.97 crore was recoverable in these cases alongwith an interest of Rs. 44.96 crore.**

(Paragraph 4.7.1)

- **In 28 cases, spares and consumables etc. were imported in excess of prescribed ceiling under the scheme. Customs duty of Rs. 8.86 crore alongwith an interest of Rs. 7.21 crore was recoverable in these cases.**

(Paragraph 4.7.2.1)

- **Duty concession of Rs. 7.13 crore alongwith an interest of Rs. 1.16 crore was recoverable in 25 cases under the project imports as these related to machineries those were excluded under the scheme.**

(Paragraph 4.7.2.2)

- **Customs duty of Rs. 4.37 crore alongwith an interest of Rs. 2.83 crore was recoverable in 66 cases as goods were imported in excess of registered contract value.**

(Paragraph 4.7.2.3)

- **Project imports concessions of Rs. 33.48 crore were granted in 141 cases even in the absence of necessary documents being furnished by the importers.**

(Paragraph 4.7.3)

- **Project imports concessions amounting to Rs. 11.75 crore was granted in 23 cases incorrectly without verification of the claimed substantial expansion of the installed capacities.**

(Paragraph 4.7.5)

- **Bonds submitted were short by Rs. 15.81 crore in nine cases. Further, in 143 cases, cash securities were submitted short by Rs. 3.30 crore. Additionally, 224 bank guarantees (BGs) valued at Rs. 289.09 crore had expired between November 1987 and January 2008 as these were not renewed by the department.**

(Paragraph 4.7.8)

4.2 Introduction

Project Imports required for the setting up of a plant/project/unit or for its substantial expansion for increasing the installed capacity are classifiable under the heading 98.01 of the Customs Tariff Act (CTA) and are subject to levy of customs duty at the concessional rate. For importing various items of machinery, equipments, raw material etc., at a uniform rate of duty, required for setting up or for substantial expansion of a project, PIR came into effect from 3 April 1986 in supersession of the PIR, 1965. The objective of Project imports scheme is to simplify the assessment in relation to import of capital goods and all the related items required for setting up of a project by levy of a flat rate of duty in respect of such goods.

Goods imported in one or more consignments against one or more specific contracts should be registered with the customs house through which the importers want to import major portions of its requirements under the project imports. For availing the project imports concession, the importer has to submit an application to the customs house, which should, inter-alia, contain the following:

(a) location of the project;

(b) the description of the articles to be manufactured; and

(c) the installed or designed capacity of the plant or project and in the case of substantial expansion of existing plant or project, the installed capacity and the proposed addition thereto.

The application should be accompanied by the original deed of contract together with a true copy thereof, the import trade control licence, wherever required, and an approved list of items from the concerned sponsoring authority and any other particulars or documents, as may be required. The proper officer, on being satisfied that the application is in order, registers the contract by entering the particulars thereof in a book kept for the purpose and assigns a number in token of the registration. Importers have to submit bond equal to the cost, insurance and freight (CIF) value of the contract sought to be

registered alongwith cash security deposit equivalent to two per cent of CIF value of contract subject to maximum of Rs. 50 lakh and the balance amount by BG backed by an undertaking to renew it, till the finalisation of the contract. On every bill of entry (BE) filed for clearance of goods under the Project Imports, the importer is required to indicate the project contract number allotted to it. After noting, the BE is sent to the project group, which is required to check the description, value and quantity of the goods imported vis-à-vis the description, value and quantity registered. In case these particulars are found in order, the BE is assessed provisionally under section 18 of Customs Act, 1962. A period of three months from the date of clearance of last consignment of goods covered by each contract has been prescribed, within which the importer has to produce a reconciliation statement indicating the details of the goods imported together with necessary documents as proof regarding value and quantity of the goods so imported and any other document that may be required for finalisation of the contract. Once the reconciliation is over, the bond is discharged and all liabilities of the importer get extinguished.

4.3 Audit objectives

Audit findings from an earlier review on Project Imports were reported through the Audit Report No. 4 of 1991. Public Accounts Committee (PAC) in their 23rd and 77th reports (tenth Lok Sabha) had emphasised the need for expeditious finalisation of project contracts under the scheme and preventing cases of unauthorised imports, illegal diversion of goods and other malpractices. The present review is conducted through test check of records in the offices of 18 customs commissionerates to ascertain that:-

1. The cases under the project imports had been complied with the applicable rules, regulations and procedures framed under the Customs Act, 1962, Project Import Regulations (PIR) and instructions issued by the Board from time to time,
2. Project imports cases had been finalised without undue delay and without causing loss of revenue and
3. The internal control and monitoring mechanism governing project imports were adequate and effective in ensuring that the scheme was not put to misuse.

4.4 Scope of audit and methodology

In 18 commissionerates, 6,007 project contracts were registered between 2002-03 to 2007-08. Of these, 1,994 contracts had been finalised till March 2008. Audit reviewed, on a test check basis (between August 2007 and May 2008) 1,823 project contracts of which 915 were finalised contracts and the remaining were yet to be finalised.

4.5 Acknowledgement

The Indian Audit and Accounts Department acknowledges the cooperation extended by the Ministry of Finance and its field formations in providing the

necessary information and records for audit. The draft review was forwarded to the Ministry in October 2008 and an exit conference was conducted with the Ministry officials in November 2008. During the exit conference, the Ministry agreed with four of the five recommendations included in the review and stated that the remaining recommendation was under consideration. While written responses to the draft review from the Ministry are awaited, responses of the department, wherever received and decisions agreed to, during the exit conference, have been incorporated, appropriately in the report.

AUDIT FINDINGS AND RECOMMENDATIONS

4.6 System issues

4.6.1 Need for keeping proper records/database for project imports

4.6.1.1 Availability of data

Regulation 5 of PIR read with provisions contained in Appraising Manual (Volume -1), envisages maintenance of contract register in prescribed form by the contract cell. Each contract is assigned a number in this register. Details of a project contract, as well as description and value of goods imported against a contract are noted in this register. Any amendment made in the contract is also noted in this register.

Further, as per Board's instructions dated 12 March 1992, value and quantity of a BE is to be debited, at the time of clearance, from value and quantity registered, to ensure that value and quantity of goods imported do not exceed the registered value and quantity. Moreover, as per Board's instructions dated 14 June 1991, senior officers including commissioners should monitor in detail the pendency position of these cases at monthly intervals.

(i) Details of number of project contracts cases registered during 2002-03 to 2007-08, their values, custom duty collected and duty foregone are given below: -

Table no. 1
Project contracts registered

(Amount in crore of rupees)

Year	No. of cases	Contract value	Duty collected	Duty foregone
2002-03	1,400	16,555.88	5.60	173.72
2003-04	106	670.40	245.88	223.43
2004-05	3,959	2,633.90	64.59	32.56
2005-06	255	2,879.70	172.61	123.79
2006-07	243	1,443.51	1,650.84	1,017.89
2007-08	44	5,184.84	139.60	57.64
Total	**6,007**	**29,368.23**	**2,279.12**	**1,629.03**

Analysis of the data obtained from the commissionerates revealed the following deficiencies:

- Few commissionerates (Delhi NCH, Mumbai NCH, JNCH, Chennai Sea, Chennai ACC, Trichy and Tuticorin) could not provide the contract value for projects registered.

- Few commissionerates (NCH Delhi, NCH Mumbai, JNCH, Chennai Sea, ACC Chennai, Trichy and Tuticorin) could not provide the number of projects registered alongwith their contract value.
- Few commissionerates (NCH Delhi and Tughlakabad, Kolkata Port, NCH Mumbai, JNCH, Chennai Sea, ACC Chennai, Trichy and Tuticorin) could not provide data for duty collected and that because foregone on registered projects.

(ii) The number of cases finalised during the period from 2002-03 to 2007-08 are detailed below: -

Table no. 2
Project contracts finalised
(Amount in crore of rupees)

Year	No. of cases finalised	Cases where	
		extra duty collected	duty refunded on finalisation
2002-03	488	nil	nil
2003-04	33	0.12	nil
2004-05	73	nil	nil
2005-06	752	0.09	nil
2006-07	589	9.63	2.42
2007-08	59	0.01	nil
Total	**1,994**	**9.85**	**2.42**

Analysis of the data obtained from the commissionerates revealed the following deficiencies: -

- Only 33 per cent of the cases registered were finalised upto March 2008.
- Amongst the larger commissionerates, JNCH, Kolkata (Port) and NCH, Mumbai were having very high percentage pendencies of cases and these ranged between 71 to 96 per cent. The delay in finalisation of project imports cases were mainly due to (i) non- submission of the reconciliation statements and required documents within the prescribed period of three months and (ii) delay in finalisation of project imports cases even after receipt of reconciliation statements.
- Few commissionerates (NCH Delhi, Kolkata Port, NCH Mumbai, JNCH, Chennai Sea, ACC Chennai, Trichy and Tuticorin) could not provide complete information regarding number of cases finalised, extra duty collected and duty refunded on finalisation.
- The contract registers were not maintained in prescribed format and wherever maintained, most of the columns were kept blank, important details remained unrecorded and these registers were not being submitted to higher officials at monthly intervals.

Further, the consolidated information/data on project imports registered during 2002-03 to 2007-08, the corresponding contract values, the duty collected and duty foregone which was requested (June 2008) from the Board was also not provided to audit.

Furthermore, registration and finalisation details of project contract cases were also not available in the EDI system.

4.6.1.2 Reports to the Board

Performance of commissionerates relating to disposal of work during a month is compiled and sent every month through 'Monthly Technical Report (MTR)' to chief commissioner of customs for onward transmission to Director General of Inspection, CBEC.

In their 77th Report (tenth Lok Sabha), the PAC had concluded that there was hardly any monitoring either at the commissionerate or the Board level regarding the progress of finalisation of the project contracts. Ministry, in turn, assured that customs houses were now regularly sending the monthly report on disposal and pendency position of the project contracts and Board was also closely monitoring the position.

Scrutiny of project imports cases in ten commissionerates, out of 18 commissionerates audited, revealed that in spite of the assurances to the PAC, monthly disposal and pending position of project imports cases had not been included in the MTR. For instance, in Chennai (Sea) commissionerate, 21 SCNs issued for violations of PIR were not entered in the MTR.

The above deficiencies indicate that records relating to project imports are not being maintained consistently at the field level and in the absence of similar information being available at the Board level, in our opinion, the monitoring of these project imports to ensure compliance to applicable rules and collect duty due, is weak.

Recommendation No. 1

- *The Board should develop appropriate accounting and monitoring modules and integrate these with the EDI system to facilitate effective monitoring of cases relating to project imports.*

The Ministry, during the exit conference, agreed to the recommendation.

4.6.2 Need for fixation of a realistic time frame for finalisation of assessments relating to project contracts

The PAC in their 77th report (tenth Lok Sabha) had observed that there is no provision either in the Customs Act, 1962 or in the PIR regarding time limit within which the provisional assessments are to be finalised after the receipt of reconciliation statements in relation to project imports/contracts.

The committee had recommended laying down a suitable time limit for finalisation of provisional assessments after receipt of reconciliation statement, to which the Ministry responded by stating that the objective of expeditious finalisation can be achieved by close monitoring of the cases administratively.

Test check of records of project contracts cases in nine out of 18 commissionerates audited revealed that in 1,068 cases, pertaining to the years 1983 to 2007, the assessments were not finalised even after delays ranging between one month and 296 months after the receipt of the reconciliation statements.

A few illustrative cases of inordinate delays relating to finalisation of assessments are discussed in the succeeding paragraphs:-

(i) 21 project contract cases under the Chennai (Sea) commissionerate, registered during 1999-2000 to 2006-2007 were not finalised even after submission of the documents. A total duty concession of Rs. 75.24 crore was availed in these cases under the project imports scheme.

(ii) Similarly, 85 project contracts under the Kolkata (Port) commissionerate, registered during 1998 to 2007, were not finalised even after a lapse of upto 103 months after submission of the reconciliation statements by the importers. A total duty concession of Rs. 67.88 crore was availed in such cases under project imports.

(iii) A project contract was registered by M/s Pepsico India Holdings Pvt. Ltd. on 8 June 2005 at customs house, Kandla for substantial expansion of potato chip manufacturing plant at Pune. The total CIF value of the project was Rs. 25.49 crore and a duty of Rs. 1.45 crore was foregone on this project. The last consignment was cleared on 15 December 2005. The importer submitted the reconciliation statement on 20 February 2006 alongwith copies of BEs, invoices, etc., duly certified by Chartered Engineer. However, the project was still pending finalisation of the assessment as of 31 March 2008.

Recommendation No. 2

- *The Government should fix a realistic time frame for finalisation of project contract after submission of the requisite documents by the importers to avoid delay in finalisation of project contract cases and to mitigate the risk of loss of revenue.*

The Ministry, during the exit conference, agreed to address this concern by fixing a realistic time frame for finalisation of project imports cases after submission of documents by the importers.

4.6.3 Absence of penal provisions for non-submission/delay in submission of reconciliation statements and other requisite documents had facilitated delays

In terms of the Regulation 7 of PIR read with the Boards instructions dated 11 September 2001, an importer is required to submit, within three months from the date of clearance of last consignment, a reconciliation statement showing the description, quantity and value of the goods alongwith installation certificate from registered Chartered Engineer, copies of BE, invoices, final payment certificate and other documents required for finalisation of the contract. After the submission of the required documents by the importer, the provisional assessments are to be finalised by the department. The PAC in its 77th Report (tenth Lok Sabha) had recommended that Board should keep a close watch to ensure timely submission of reconciliation statements and where the importers fail to furnish the statements within the prescribed time, the bond submitted by importers should be invoked. Pursuant to PAC recommendation, the Board vide circular dated 14 June 1991 had stipulated that on completion of the prescribed period after the last importation, bond

enforcement notices should invariably be issued to those importers who have failed to submit the reconciliation statements.

4.6.3.1 Cases finalised even in absence of reconciliation statements and other documents

Scrutiny of 19 project contract cases under Chennai (Sea) and NCH, Delhi commissionerates revealed that these cases were finalised in the absence of reconciliation statement, BE and other required documents. Customs duty of Rs. 45.77 crore was foregone in these cases. In the absence of these documents, audit was not in a position to say whether any differential duty was required to be paid by the importers.

A few illustrative cases are discussed in the succeeding paragraphs:-

(i) M/s Neyveli Ceramics and Refectories Ltd., under the jurisdiction of Chennai (Sea) commissionerate, had registered (1986) a project contract to set up a unit for manufacture of ceramic tiles. The overall CIF value of goods registered for the project was Rs. 6.11 crore. Scrutiny of the case revealed that the firm had made imports of Rs. 7.96 crore with last import being made in February 1990. Inspite of reminders from the department, the firm took nearly 14 years to submit (July 2004) a certificate from the Chartered Engineer regarding installation and commission of the imported machineries in the year 1986-87. Further scrutiny in audit revealed that there was no amendment in the contract regarding enhancement of CIF value and reconciliation statement alongwith copy of BEs was not produced by the firm. The project was, however, finalised by the department in September 2004 without the above requisite documents and plant site verification.

This resulted in improper finalisation of the project contract having a duty concession of Rs. 23.87 crore.

(ii) M/s Amrit Bottlers Pvt. Ltd., under the jurisdiction of NCH Delhi commissionerate, had registered (February 2004) a project contract for substantial expansion of an aerated water plant at Faizabad, U.P. Goods worth Rs. 1.79 crore were imported under the project contract. Audit scrutiny revealed that the project was finalised and bond was cancelled (April 2007) only on the basis of an application submitted by the importer for finalisation of the project contract. No other documents, like reconciliation statement and certificate from Chartered Engineer regarding installation of goods imported, were submitted by the importer. In the absence of these documents, finalisation of the case was against the provisions of PIR. Duty concession of Rs. 21.02 lakh was availed in this project contract.

4.6.3.2 Non-submission/delay in submission of reconciliation statement and other documents

Scrutiny of records of project contract cases in ten commissionerates revealed that in 2,083 cases, importers failed to submit reconciliation statements and other requisite documents even after seven to 165 months from the date of last consignment.

Further, in 206 cases in 11 out of 18 commissionerates audited, reconciliation statements were submitted with delay of three to 105 months after the date of last consignment.

A few illustrative cases are discussed in the following paragraphs:-

(i) In five project contracts, registered during 1999-2000 to 2005-06, under the jurisdiction of Vishakhapatnam customs commissionerate (one case) and Vishakhapatnam-II (CE & Cus) commissionerate (four cases), importers had delayed the submission of reconciliation statements and other documents by five to 22 months after clearance of last consignment. The duty foregone in these five cases amounted to Rs. 132.07 crore.

(ii) In the commissionerates of NCH, Delhi and Tughlakabad, Delhi, 41 project contracts (26 in NCH and 15 in Tughlakabad) registered during the period 1994 to 2007, were pending finalisation for want of reconciliation statements. The combined CIF value of the contracts of these cases was Rs. 202.23 crore and total duty concession of Rs. 14.92 crore was availed on these projects. In all these cases, neither did the importers apply for any extension of time limit nor did the department grant any extension for submission of reconciliation statement. Moreover, no bond enforcement notices had been sent to these importers by the department.

(iii) M/s ABB Ltd., Bangalore had registered a project contract at ICD, Bangalore for import of goods valued at Rs. 3.75 crore, required for Panipat refinery expansion project. Goods valuing Rs. 1.58 crore in four consignments were imported under the project contract. The last import, as per the project contract register was on 24 January 2005 and thereafter there were no entries and the importer had not submitted the required reconciliation statement and other documents for finalisation.

Recommendation No. 3

- *In order to improve compliance, penal provisions such as invoking of bonds etc. should be incorporated in the PIR for delay in submission of reconciliation statements and other requisite documents. This would act as an internal control mechanism and will reduce delay in finalisation of project contract cases.*

The Ministry, during the exit conference, informed that incorporation of penal measures in the PIR for delay in submission of reconciliation statements would be considered.

4.6.4 Inappropriate splitting up of items under project imports to get benefit of lower merit rate assessment

In terms of Regulation 4 of PIR, assessment under customs tariff heading 98.01 is available only to those goods which are imported under one or more than one consignments against one or more specific contracts, which had been registered with the appropriate customs house. However, the PIR is silent about assessment of part of project imports goods under project imports rate and the other part at merit rate under different exemption notifications. In audit opinion an importer claiming project imports concessions does not have the option for assessment of goods on merits at rates other than those applicable to project imports and cannot claim benefits under any other scheme. Once a contract for a project imports is registered, deregistration of some or part thereof should not be allowed. Any differential rate of duty

prescribed by exemption notification on individual goods should not be invoked for assessment of goods under the project imports scheme.

Scrutiny of records of project imports, in six out of 18 commissionerates audited revealed that in eight cases, imported goods were assessed partly under project imports rate and partly under merit under other notifications. Customs duty of Rs. 3.63 crore was foregone in these cases which are recoverable alongwith interest of Rs. 1.76 crore.

A few illustrative cases are discussed the succeeding paragraphs:-

(i) The Supreme Court, in the case of Tamil Nadu Newsprint & Papers Ltd. (2000-116-ELT-3), had opined that exemption under different tariff headings could not be claimed when items were imported under project imports heading. In Chennai (Sea) commissionerate, a project contract for Rs. 7.30 crore was registered by M/s Visteon Automotive Systems India Pvt. Ltd. in the year 2004 for import of six machines. Scrutiny of records revealed that only two machines were imported under project contract at the request of the importer and remaining four machines were assessed on merit at a lower rate under an exemption notification which was beneficial to the importer. The short levy of duty worked out to Rs. 2.58 crore with interest of Rs. 1.36 crore on goods of assessable value of Rs. 6.40 crore which were assessed/cleared incorrectly under merit /concessional rate.

(ii) M/s Grasim Industries Ltd. submitted an application (June 2006) at customs house, Kandla for registration of a project contract for import of machineries and equipments for their captive thermal power plant at Neemuch, M.P. The application was submitted alongwith a list of items duly sponsored by the sponsoring authority, department of energy, Government of Madhya Pradesh. Accordingly, a project contract was registered (August 2006) for import of above goods under the PIR with a total CIF value of US $3,20,75,756.

Scrutiny, however, revealed that one of the listed items, 'Rebar' (item No. 3.11.7 of the approved list) was subsequently imported (September 2006) under CTH 72149990 and assessed under merit rate instead of project imports rate to avail the lower rate of duty under the merit rate for this particular item. Other imports made by the importer were, however, assessed under the project imports (CTH 98.01). This resulted in incorrect availing of duty concession of Rs. 28.93 lakh on the assessable value of Rs. 4.69 crore due to irregular split up of imports.

Recommendation No. 4

- *The Government should consider amending the applicable regulations so that duality of assessments (under concessional rate for project imports and under merit rate) for items under project imports could be avoided.*

The Ministry, during the exit conference, agreed to the recommendation and informed that amendment of applicable regulations to prevent duality of assessments was under consideration.

4.7 Compliance issues

4.7.1 Incorrect availing of project imports concessions

Assessment of imported goods under customs tariff heading 98.01 is applicable to initial set up or substantial expansion of an existing unit. Further, in terms of Regulation 3 of PIR, substantial expansion should increase the installed capacity by not less than 25 per cent.

In three cases under Chennai (Sea) and NCH Delhi commissionerates, project concession was wrongly availed as goods were imported neither for the initial set up nor for substantial expansion of a plant or project. Customs duty of Rs. 33.97 crore was foregone in these cases which is recoverable alongwith interest of Rs. 44.96 crore.

An illustrative case is discussed below:-

M/s Chennai Petroleum Corporation Ltd. (formerly M/s Madras Refinery Ltd.) applied (April and June 1998) for registration of a project contract at customs house, Chennai to set up a diesel hydro desulphurisation (DHDS) plant at its refinery. The project contract was registered (August 1998) and goods to the tune of Rs. 78.52 crore were imported under the project imports scheme. The project contract was finalised (December 2003) on the basis of a clarification (December 1998) from Ministry of Finance that this project would get the benefit of PIR under 'initial setting up' of a project and no substantial capacity was required to be added.

Scrutiny revealed that as the project was set up to reduce sulphur level in high sulphur diesel (HSD) produced by two existing refineries, the department rejected (July 1998) the application of the importer for registration of the project contact under PIR. However, subsequently, the Ministry allowed (December 1998) the benefit of project imports under the clause 'initial setting up'. As the HSD and the resultant low sulphur diesel (LSD) are functionally same and are being manufactured within the existing unit, the DHDS project neither comes under initial setting up of an industrial unit nor comes under substantial expansion of an existing unit.

This resulted in incorrect availing of project imports duty concession of Rs. 32.66 crore, which needs to be recovered alongwith interest of Rs. 43.28 crore.

4.7.2 Irregular importation under project imports

4.7.2.1 Import of spares and consumable in excess of prescribed ceiling

Besides the machinery, equipment etc., for initial setting up or substantial expansion of a project, raw material, spares and consumable stores upto ten per cent of value of goods specified in the registered contract are also allowed to be imported under the concessional assessment of tariff heading 98.01, provided these are essential for maintenance of the plant or project.

Scrutiny revealed that in 28 cases in four out of 18 commissionerates audited, spares, consumables etc. were imported under concessional assessment in excess of the ten percent ceiling prescribed. Customs duty of Rs. 8.86 crore was foregone on import of these goods which is recoverable alongwith interest of Rs. 7.21 crore.

An illustrative case is discussed below:-

M/s Steel Authority of India Ltd., Salem, under the Chennai (Sea) commissionerate, registered (1994) a project contract for initial setting up of a plant for manufacture of hot rolled stainless steel coils. The total CIF value of machinery allowed to be imported was Rs. 104.72 crore. However, as per the reconciliation statement submitted by the importer, value of machineries actually imported was Rs. 91.84 crore and value of spares imported was Rs. 14.79 crore. Thus, spares having an assessable value of Rs. 5.61 crore were imported in excess of ten per cent limit. Incorrect concessional duty availed worked out to Rs. 2.47 crore and interest of Rs. 4.75 crore thereon.

4.7.2.2 Incorrect grant of duty concession to excluded categories of machinery

As per Regulation 3 of PIR, 'industrial plant' under CTH 98.01 is an industrial system designed to be employed directly in the performance of any process or series of processes necessary for manufacture, production or extraction of a commodity, but does not include establishments designed to offer services of any description, such as hotels, hospitals, photographic studios, photographic film processing laboratories etc. and a single or a composite machine.

Scrutiny of records of 25 project contract cases, in five out of 18 commissionerates audited, revealed incorrect grant of project imports concession of Rs. 7.13 crore to the excluded categories of machinery. The duty foregone of Rs. 7.13 crore alongwith interest of Rs. 1.16 crore needs to be recovered from these importers.

An illustrative case is discussed below:-

M/s National Hydroelectric Power Corporation Ltd. had registered (April 1988) a project contract in NCH, Mumbai commissionerate to construct a dam for generation of power. Goods imported under the contract were 'detonators' with CIF value of Rs. 1.11 crore. 'Detonators', being neither industrial machinery nor parts of machinery as defined in PIR, were not eligible for the project imports concession. This led to irregular grant of duty concession of Rs. 85.64 lakh.

4.7.2.3 Discrepancies between goods permitted to be imported and actually imported

As per Regulation 5 of PIR, read with the Board's instructions dated 11 September 2001, the application for registration of the project contract is to be accompanied by an approved list of items showing description, quantity, specification, quality, dimension of each item, from the concerned sponsoring authority. The details of the description of the goods and the quantity actually imported should be in accordance with approved list of items. Furthermore, the imports affected in one project contract should not exceed the contract value registered for that contract.

Scrutiny of 66 project contracts cases, in nine out of 18 commissionerates audited, revealed excess imports of Rs. 50.85 crore when compared with the contract values registered. Customs duty of Rs. 4.37 crore was foregone on import of these goods which needs to be recovered alongwith interest of Rs. 2.83 crore.

A few illustrative cases are discussed in the following paragraphs:-

(i) M/s Steel Industries Kerala Ltd., under the jurisdiction of Cochin commissionerate, registered a project contract in July 2001 for a CIF value of Rs. 2.01 crore. The project was for initial setting up of Malankara hydro electric power plant. Goods valued at Rs. 7.02 crore were, however, imported against this contract without any amendment to the contract. This resulted in excess duty concession of Rs. 1.98 crore on the differential value of Rs. 5.01 crore, which was recoverable alongwith interest of Rs. 1.29 crore.

(ii) Scrutiny of four project contract cases, registered during the period 1991 to 2005, in the commissionerate of NCH, Mumbai revealed that goods of CIF value of Rs. 1.84 crore were imported in excess of the registered CIF value. Differential duty of Rs. 94.46 lakh was recoverable in these cases.

4.7.2.4 Incorrect grant of duty concession due to clearance/import of goods before registration of contract

As per Regulation 4 of PIR, the assessment under project imports is available only to those goods which are imported against a specific contract, which has been registered with the appropriate customs house before any order for clearance of the goods for home consumption. Further, in terms of Regulation 5 of PIR, importer has to apply, in writing for registration of the contract, to the customs officer at the port where the goods are to be imported on or before their importation. Further, as per the CEGAT judgement in the case of M/s Modipon Ltd. (2000-123-ELT-614), the benefit of project imports would not be available if no contract is registered when the BE was filed.

Scrutiny of records of 24 project imports cases, in five out of 18 commissionerates audited, revealed incorrect grant of duty concession of Rs. 5.32 crore due to clearance/importation of goods before registration of the contract.

A few illustrative cases are discussed in the succeeding paragraphs:-

(i) M/s Cochin International Airport Ltd. imported and warehoused three air crash fire tenders, one air rescue tender with accessories with assessable value of Rs. 5.55 crore falling under CTH 87.05 on 31 December 1998.

Scrutiny revealed that a project contract was registered on 17 March 1999 at customs house, Cochin by M/s Cochin International Airport Ltd. for import of baggage inspection system, air crash fire tender and aerobridges. The goods imported and warehoused on 31 December 1998 were cleared against the contract registered on 30 March 1999. As the goods were imported prior to registration of the contract, their clearance at concessional rate of duty under 'Project Imports' was irregular. The duty foregone was Rs. 1.10 crore.

(ii) In customs house, Kandla, a project contract was registered (30 November 2004) on an application (4 November 2004) from M/s Ajanta Manufacturing Ltd. Audit scrutiny revealed that goods in three consignments with total value of Rs. 65.71 lakh were imported on 17 November 2004 and 29 November 2004 against the above project contract before registration. A total project imports duty concession of Rs. 15.38 lakh was availed in these three cases. This resulted in incorrect duty concession of Rs. 15.38 lakh due to importation of goods prior to the registration of project contract.

4.7.2.5 Other irregularities on importation

Irregularities like application of incorrect duty rate and incorrect determination of assessable value were noticed in three cases under the jurisdiction of Kolkata (Port) and Cochin commissionerates, which involved short levy of customs duty amounting to Rs. 4.67 crore.

An illustrative case is discussed below:-

In terms of customs notification dated 28 February 1999 {Sr. No. 288 (iii)}, goods of CTH 98.01, required for captive power plant of capacity 5MW or more, attract BCD and additional duty at 25 and 16 percent respectively. Further, special additional duty (SAD) of customs, in lieu of sales tax and other local taxes, at the rate of four per cent was leviable on imported goods vide notification No. 22/99-cus dated 28 February 1999. M/s Oswal Chemicals & Fertilizers Ltd. registered (1998) a project contract at customs house, Kolkata for initial setting up of a fertilizers plant at Paradeep, Orissa and imported (April 1999) two turbines with spares for a CIF value of Rs. 13.29 crore. The goods were assessed to BCD and additional duty at five and ten per cent respectively, applicable for goods of fertilizers project.

Audit scrutiny revealed that the project included installation of a 64 MW captive power plant for which the turbines and spare were imported. Therefore, the importer was liable to pay BCD and additional duty at 25 per cent and 16 per cent, respectively apart from SAD of four per cent. This resulted in short levy of customs duty of Rs. 4.62 crore.

4.7.2.6 Incorrect grant of project concession to generating sets imported separately as standby generators

According to Regulation 3 of PIR, 'industrial plant' means an industrial system designed to be employed directly in the performance of any process or series of processes necessary for manufacture, production or extraction of a commodity. Therefore, any machinery or power generator used for standby purpose would not be covered under the project imports as such, because machine or power generator is not directly employed in the manufacturing process. Further, in the tariff conference held in April, 1985, the question of extending the project imports concession for import of diesel generating sets for standby generation of power was discussed and it was decided that benefit on concessional assessment would not be given when generating sets are imported separately as standby generators.

Scrutiny of the records of five project contract files, in Kolkata (Port) and Chennai (Sea) commissionerates, revealed that project imports concession of Rs. 83.12 lakh was granted incorrectly to generators imported separately for standby use. The duty concession needs to be recovered alongwith interest of Rs. 25.22 lakh.

A few illustrative cases are discussed in the succeeding paragraphs:-

(i) M/s Toyota Techno Park India Pvt. Ltd. had registered a project contract in the year 2004 at Chennai (Sea) commissionerate for import of two diesel engine generators valued at Rs. 3.59 crore with a capacity of 1000 KVA each, under the category of substantial expansion. The import was in addition to existing two generators of 1000 KVA each. Audit observed that the

importer was to provide infrastructure support services to M/s Toyota Kiroloskar Motor Pvt. Ltd., which manufactured passenger cars and multi-utility vehicles. Further scrutiny revealed that diesel generators were imported to create standby power generating capacity to meet the demand of their tenant companies. Concessional assessment of the standby diesel generates was, thus, not in order.

(ii) A project contract was registered (May 2005) at customs house, Kolkata by M/s Dharampal Premchand Ltd. for import of four natural gas based generator sets valued at Rs. 4.35 crore with a capacity of 900 KWH each for initial setting up of a power unit to implement coil/sheet plant of iron and steel.

The goods were imported to provide alternate power source for uninterrupted operation of the plant apart from power drawn from existing power grid of the State Electricity Board. Thus, the power generating sets were intended for standby operation and therefore, the import of such goods alone for standby use under concessional assessment applicable for project imports was not in order. This resulted in duty being levied short by Rs. 26.09 lakh.

4.7.3 Incorrect grant of project imports concession due to non-submission of requisite documents

As per Regulation 5 of PIR, read with the Board's instructions dated 11 September 2001, an importer claiming assessment under CTH 98.01, has to submit an application, alongwith original deed of contract, industrial licence, letter of intent, SSI certificate granted by the appropriate authority, original import licence, if any, with a list of items attested by the licensing authority, recommendatory letter for duty concession from concerned sponsoring authority, showing the description, quantity, specification, quality, dimension of each item, installed capacity and proposed addition thereto and any other documents as may be considered necessary for assessment.

Scrutiny of records of 141 project imports cases, in six out of 18 commissionerates audited, revealed that project imports concession of Rs. 33.48 crore was allowed in cases where the necessary documents had not been submitted.

A few illustrative cases are discussed in the following paragraphs:-

(i) M/s Paraxair India Pvt. Ltd. and another importer, under the jurisdiction of Kolkata (Port) commissionerate, registered 104 project contracts during the years 2001 to 2007 without submission of deed of contract. Customs duty of Rs. 9.05 crore was foregone on total import of Rs. 61.56 crore in these cases.

(ii) Under the jurisdiction of Kolkata (Port) commissionerate, M/s Paharpur Cooling Tower Ltd. and two other importers registered (1998 to 2003) 18 project contracts without recommendation letter from the sponsoring authority. Customs duty of Rs. 22.51 lakh was foregone on total import of goods to the tune of Rs. 69.11 lakh in these cases.

4.7.4 Finalisation of project contracts without installation certificate and plant site verification

According to Regulation 7 of PIR, read with the Board's instructions dated 11 September 2001, for finalisation of project imports cases, an importer has to submit a certificate from registered Chartered Engineer certifying the installation of each imported item of machinery alongwith the reconciliation statement within three months from the date of clearance of last consignment. Further, to ensure that the imported goods have actually been used for the project for which goods have been imported; plant site verification should be done in cases where value of project contract exceeds rupees one crore and in other cases, plant site verification should be done, selectively.

Scrutiny of records of eight project contracts, in two out of 18 commissionerates audited, revealed that installation certificate for goods valued at Rs. 226.93 crore was not received though project contracts were finalised. Duty foregone in these cases was Rs. 78.30 crore. Furthermore, in 33 cases under seven commissionerates, plant site verification was not conducted though value of project contract exceeded Rupees one crore. Customs duty of Rs. 31.46 crore was foregone in these cases, which would be recoverable alongwith interest of Rs. 9.02 crore, if the goods had been used for purposes other than the intended project.

A few illustrative cases are discussed in the following paragraphs:-

(i) In customs house, Kandla, four project contracts were registered in 2004 with a combined CIF value of Rs. 27.99 crore. The value of each of the individual projects exceeded rupees one crore. The department finalised these projects on 27 June 2005 without plant site verification. Duty concessions of Rs. 2.92 crore were availed in these projects.

(ii) M/s Vyline Glass Works Ltd. registered (1989) a project contract at Chennai (Sea) commissionerate in the year 1989 for manufacture of laboratory glassware. Goods worth Rs. 1.10 crore were imported during 1989-90. The importer on 25 March 1992, after 33 months from date of last import, submitted reconciliation statement, copies of BEs, invoices etc. for finalisation of the project contract. The project commissioning certificate was, however, produced in January 2004 stating that project has been commissioned. The project contract was finalised in June 2004 by the department. Audit scrutiny revealed that department undertook plant site verification in June 2004, after a delay of 12 years from submission of documents and it was found that equipment imported under project imports were not being used in the production and were lying as scrap. The importer stated (June 2004) that machineries were used in the initial two years. Due to belated plant site verification, department had to accept this reply given by the importer. The duty foregone worked out to Rs. 54.82 lakh and interest involved was Rs. 1.51 crore.

4.7.5 Incorrect grant of project concession due to non-verification of substantial expansion

As per Regulation 3 (c) of PIR, 'substantial expansion' means an expansion which would increase the existing installed capacity by not less than 25 per

cent. Scrutiny of records of 23 project contract cases, in six out of 18 commissionerates audited, revealed that there was less expansion of installed capacity or non-submission of requisite documents by the importer or contracts were finalised without verifying the expanded capacity by the department. These resulted in incorrect grant of duty concession of Rs. 11.75 crore.

An illustrative case is discussed below:-

M/s Bharat Heavy Electricals Ltd. registered a project contract at Chennai (Sea) commissionerate for substantial expansion of a thermal power station of Rajasthan Vidyut Utpadan Nigam Ltd. at Kota, Rajasthan in the year 2007.. It was proposed to increase the existing capacity of 1045 MW to 1240 MW. Goods worth Rs. 18.18 crore were imported during April 2007 to July 2007. As the increase in capacity was only 18.66 per cent, which was less than the minimum requirement of 25 per cent, the project was not eligible for duty concession. However, concessional benefit to the tune of Rs. 2.03 crore was allowed, which was irregular.

4.7.6 Violation of conditions stipulated at the time of registration of contract

All items of machinery including components, required for initial set up of a unit or substantial expansion of an existing unit of a specified industrial plant, irrigation project, power project, mining project, exploration project and other projects notified by the Central Government for economic development are classifiable under CTH 98.01. Further, in terms of Regulation 5 of PIR, application for assessment under project imports should specify description of the articles to be manufactured, installed capacity and enclose other specified documents.

In three cases under Chennai (Sea) commissionerate, conditions stipulated at the time of registration of contract were not fulfilled. Duty of Rs. 87.34 crore was foregone in these cases which need to be recovered alongwith interest of Rs. 205.30 crore.

In another case of a contract (Kolkata Port) involving CIF value of Rupees one crore, the department did not verify fulfilment of the specified conditions by the importer.

4.7.7 Non-levy of service tax on services received by importers

As per the Finance Act, 1994, amended from time to time, service tax is levied on the value of taxable services rendered. Further, in terms of rule 2(1)(d)(iv) of the Service Tax Rules, 1994, inserted with effect from 16 August 2002, a person receiving taxable services in India has been made liable for payment of service tax on services provided by a person who is a non-resident or is from outside India and does not have any office in India.

Scrutiny of records of four project contract cases, under Cochin commissionerate, revealed that service tax of Rs. 1.10 crore was not paid by four service receivers/importers on services valuing Rs. 10.84 crore obtained (during 1999 to 2005) from foreign service providers.

4.7.8 Non-submission of requisite bond and cash security

In terms of Regulation 5 of PIR, read with the Board's instructions dated 11 September 2001, an importer has to submit continuity bond equal to the CIF value of the contract sought to be registered alongwith cash security deposit equivalent to two per cent of CIF value of contract subject to maximum of Rs. 50 lakh and the balance amount by BG backed by an undertaking to renew it, till the finalisation of the contract.

Scrutiny of records of 149 project imports cases, under seven out of 18 commissionerates audited, revealed that bonds were submitted short by Rs. 15.81 crore in nine cases and cash securities were submitted short by Rs. 3.30 crore in 143 cases, resulting in inadequate safeguard of the Government revenue. Further scrutiny revealed that two bonds and 224 BGs executed by importers in two commissionerates for Rs. 59.53 lakh and Rs. 289.09 crore respectively had already expired between November 1987 and January 2008 and these were not renewed. Non-initiation of action to revalidate bonds and BGs defeated their purpose of safeguarding the differential duty.

A few illustrative cases are discussed in the following paragraphs:-

(i) According to customs notification Nos. 90/94 and 91/94 dated 1 March 1994, fertilizer projects were exempted from levy of basic customs duty and additional customs duty. Further, in terms of the Board's circular dated 9 August 1995, a nominal cash security not exceeding 0.5 per cent of duty foregone at project imports rate, subject to a maximum of Rs. 20 lakh, was required to be obtained in respect of fertilizer projects, because these projects were liable to zero rate of duty. However, duty exemptions granted to the fertilizer projects were withdrawn vide customs notification No. 20/99 dated 28 February 1999 and BCD of five per cent and additional customs duty of ten per cent were imposed. At present, fertilizer projects are subject to levy of BCD at the rate of five per cent and additional customs duty at the rate of 14 per cent. Therefore, as fertilizer projects were not henceforth duty free, cash security at normal rate of two per cent of CIF value of goods sought to be imported was required to be obtained.

M/s Oswal Chemical and Fertilizer Ltd. registered (July 1999 to April 2001) 22 project contracts at customs house, Kolkata with a total CIF value of Rs. 20.96 crore, for initial setting up of a fertilizer plant at Paradeep. Scrutiny revealed that the importer did not submit any cash security stating (January 1999) that they had registered (January 1998) another project contract for a CIF value of Rs. 108.23 crore, for which they had deposited the ceiling amount of Rs. 20 lakh required for fertilizer project and therefore, no additional cash security deposit was required. As the fertilizer projects were no longer duty free, full cash security at two per cent of CIF value was required to be obtained. Omission to do so resulted in non-collection of cash security to the extent of Rs. 41.91 lakh.

(ii) M/s Akash Ceramics Pvt. Ltd. registered (July 2005) a project contract at customs house, Kandla for import of plant and machinery for setting up of an industrial project to manufacture vitrified ceramic tiles. The CIF value initially registered for the contract was Rs. 7.10 crore, which was subsequently amended (December 2005) to Rs. 8.13 crore.

Scrutiny revealed that though the importer was required to submit continuity bond of Rs. 8.13 crore and cash security of Rs. 16.26 lakh, the importer furnished continuity bond of Rs. 48.24 lakh and cash security of Rs. 0.97 lakh. This resulted in insufficient coverage of continuity bond of Rs. 7.65 crore and cash security of Rs. 15.29 lakh.

On this being pointed out, the department reported (February 2008) that continuity bond of Rs. 7.65 crore and cash security of Rs. 15.29 lakh has since been obtained from the importer.

4.7.9 Delay in adjudication of SCN issued

According to section 28(2A) of Customs Act 1962, the adjudication order, where it is possible to do so, should be passed by the adjudicating authority within six months in normal course and within one year in case of collusion, wilful misstatement, suppression of facts, fraud etc. from the date of issue of SCN/demand notice.

Scrutiny of project imports cases, in four out of 18 commissionerates audited, revealed that adjudication process has not been completed in 229 cases even after delay ranging between one to 20 years. In these cases, revenue of Rs. 511.46 crore, as quantified in SCNs, was locked up. Furthermore, in 68 cases under three commissionerates, adjudication proceedings were completed after delay of five to eight years.

A few illustrative cases are discussed in the succeeding paragraphs:-

(i) Scrutiny of project imports cases under Kolkata (Port) commissionerate revealed that 19 SCNs were issued to 16 importers between 28 September 1987 and 26 March 1999, demanding duty of Rs. 2.31 crore. The SCNs were not adjudicated even upto twenty years post their issuance. The non-adjudication of these demands led to blockage of the Government revenue to the extent of Rs. 2.31 crore.

(ii) Forty one SCNs demanding duty of Rs. 102.11 crore were issued in project imports cases under Chennai (Sea) commissionerate during the period 17 February 1997 and 24 November 1998. These SCNs have not been adjudicated even after a lapse of nine to ten years after issuance.

(iii) M/s Kunal Engineering Company Ltd. had registered (April 1986) a project contract at Chennai (Sea) commissionerate for initial setting up of a factory manufacturing high impact resistant plastic tubes and heavy duty resin impregnated conical spinning yarn carriers. The registered contract was for availing project rate of customs duty of 25 per cent under CTH 98.01 with 'nil' CVD. The importer on importing moulds, claimed the concessional rate under customs notification dated 11 October 1985 which was applicable to goods under chapter 84 and not for CTH 98.01. Accordingly a SCN was issued in August 1987 denying the benefit of above notification and the SCN was confirmed in November 1987.

A writ petition was filed at Chennai High Court by the importer and the High Court in their order dated 10 February 1997 directed the department to adjudicate the matter as per rules and merit of the case.

Scrutiny revealed that a fresh SCN was issued on 9 November 2004 after a delay of more than seven years which was returned undelivered. The SCN was adjudicated on 2 December 2004 demanding duty of Rs. 1.54 crore alongwith interest. However, as the importer did not pay the duty, a detention notice was issued on 27 December 2004 under section 142 of Customs Act 1962 for recovery of the amount and detention of goods, if any, lying under the jurisdiction of customs commissionerates. Thereafter, responding to an advertisement by official liquidator of Chennai High Court on 27 January 2005, department filed an affidavit of proof of debt (February 2005) in the High Court. However, the duty amount of Rs. 1.54 crore alongwith interest of Rs. 4.69 crore remained unrecovered. The delayed action after receipt of court order resulted in non-realisation of revenue of Rs. 6.23 crore, the recovery of which is pending with the official liquidator.

4.7.10 Non-recovery of confirmed demands

Section 28(AA) of Customs Act, 1962 provides for recovery of duty determined under section 28(2) within three months, failing which in addition to duty, interest on duty also becomes payable after expiry of three months, till the date of payment of such duty.

Scrutiny of project imports records in six commissionerates, out of 18 commissionerates audited, revealed that in 207 cases, confirmed demands of Rs. 93.55 crore, were not recovered despite the demands having been confirmed up to 14 years earlier.

Recommendation No. 5

In our opinion the root cause of irregularities pointed out through this report has been the weak and ineffective internal control and monitoring mechanism relating to imports under the project imports scheme. Accordingly, the Board should undertake a comprehensive review of the working of the scheme including the internal control and monitoring mechanism in vogue which govern the project imports and strengthen these to mitigate the risk of irregularities.

The Ministry, during the exit conference, agreed to the recommendation and informed that a comprehensive review of the working of the scheme would be undertaken.

4.8 Conclusions

The audit review has revealed some systemic as well as compliance weaknesses relating to grant of project imports benefits and finalisation of project imports cases. Broadly these relate to:

- The need for developing an appropriate accounting and monitoring modules integrated with the EDI system to facilitate effective monitoring of cases relating to project imports.
- The need of fixation of a realistic time frame for finalisation of assessments relating to project contracts after receipt of the reconciliation statements as substantial delays were noticed.

- Absence of penal provisions for non-submission/delay in submission of reconciliation statements and other requisite documents which had facilitated delays in cases relating to finalisation of project imports cases.
- Inappropriate splitting up of items under project imports to get benefit of lower merit rate assessment.

The compliance issues noticed in audit related to incorrect availing of project imports concessions, import of spares and consumable in excess of ten per cent of value of goods specified in the contract, incorrect grant of duty concession to excluded categories of machinery, discrepancies between the details of goods permitted to be imported and actually imported, incorrect grant of duty concessions due to clearance/import of goods before registration of contract, incorrect grant of project imports concessions due to non-submission of required documents, finalisation of project contracts without installation certificate and plant site verification and non-submission of requisite bond and cash security etc. These resulted from a weak and ineffective internal control mechanism relating to the administration of project imports. In the light of various shortcomings pointed out in this report, the Board should undertake a comprehensive review of the working of the scheme including the internal control and monitoring mechanism in vogue which govern the project imports and strengthen these.

The total financial implication of this audit intervention is Rs. 644.46 crore. Five specific recommendations designed to address the system deficiencies and mitigate the risk of similar irregularities in future, have been included in the report. While four of these have been accepted (November 2008) by the Ministry, the remaining recommendation was reported to be under its consideration.

Jayanti Prasad

New Delhi
Dated : 6 MAY 2009

(JAYANTI PRASAD)
Principal Director (Indirect Taxes)

Countersigned

Vinod Rai

New Delhi
Dated : 6 MAY 2009

(VINOD RAI)
Comptroller and Auditor General of India