

Chapter III

Levy and collection of Central Excise duty on Tobacco products

3.1 Introduction

Indian tobacco, introduced by the Portuguese in 17th century, is appreciated worldwide for its rich, aromatic flavour and smoothness. India is the second largest tobacco producer in the world with an annual production of about 80 crore kilograms and cultivation area of about 4.3 lakh hectares. Of the total amount of tobacco produced in the country, around 48 per cent is consumed in the form of chewing tobacco, 38 per cent as beedis, and 14 per cent as cigarettes.

3.1.1 Why we chose this topic

Tobacco is the second highest revenue yielding commodity under Central Excise after petroleum products. Table 3.1 depicts growth of revenue from tobacco products as compared to total Central Excise revenue for the period 2013-14 to 2015-16.

Table 3.1: Share of revenue from Tobacco in total Central Excise revenue

(₹ in crore)

S.No.	Year	CE revenue	Revenue from Tobacco products	Tobacco products revenue as % of CE revenue
1	2013-14	1,69,455	16,050	9.47
2	2014-15	1,89,038	16,676	8.82
3	2015-16	2,87,149	21,463	7.47

Source: Figures furnished by the Ministry

Tobacco and manufactured tobacco substitutes are classifiable under chapter 24 of Central Excise Tariff Act 1985 and Manual of Departmental instructions on excisable manufactured products on cigarette. Tobacco products are classified into two types, (i) Smoking (cigarettes and beedis) and (ii) Non-smoking, commonly known as chewing tobacco. The duty on cigarettes is levied per thousand on varying lengths and on beedis per thousand including beedi cess.

So far as chewing tobacco, the duty is levied on 'deemed production' under Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 and Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010.

The rate of duty on cigarettes has been increased year on year in the Finance Acts, as Tobacco products are considered sin products and hazardous to health. The duty levied is also at the highest rates for this reason. The duty on chewing tobacco, levied on 'deemed production', is revised periodically through issuance of notifications by the Central Board of Excise and Customs. As far as beedis, the rate of duty is lower in comparison to cigarettes and chewing tobacco on the premise that the consumption is mainly among rural folks and its affordability has to be considered.

Tobacco sector is a large employer, employing nearly 3 crore people in tobacco farming and manufacturing sectors. It is estimated that beedi manufacturing alone provides employment to more than 44 lakh workers.

In view of assessment, levy and collection of duty on tobacco products under specific provisions of the Act/Rules/Notifications, and considering the high rate levied on them treating them as hazardous/sin products, the topic was selected for audit.

3.2 Audit objectives

The subject specific compliance audit sought to assess the adequacy of the rules, regulations, notifications, circulars/instructions/trade notices etc., issued from time to time and their compliance, including internal controls, in relation to levy, assessment and collection of excise duty relating to tobacco sector and monitoring thereof.

3.3 Scope and Audit coverage

Audit collected revenue data related to tobacco and tobacco substitutes for the period from 2013-14 to 2015-16 from Automation of Central Excise and Service Tax (ACES) data provided by the Board and sample units were selected from this data for the said period based on parameters including total revenue collection, number of cases of non/short payment of duty in the unit, use of CENVAT credit etc. Accordingly, Audit selected 28 Commissionerates out of a total of 119 Commissionerates dealing with Central Excise and 35 Divisions and 61 Ranges under these Commissionerates. Selected sample of Commissionerates¹⁶ comprised of about 48 per cent, 51 per cent and 67 per cent of the total revenue from tobacco products during the years 2013-14, 2014-15 and 2015-16. Audit selected 264 assesseees falling within the jurisdiction of these selected

¹⁶ This comprised revenue from 25 Commissionerates as 3 Commissionerates Kanpur, Patna and Jalandhar did not provide the data.

Commissionerates based on parameters including detailed scrutiny due but not done/scrutiny done, internal audit due but not done/internal audit done, non/short payment of duty by the assessee etc. The period covered in this SSCA was 2013-14 (FY14) to 2015-16 (FY16).

3.4 Audit findings

3.4.1 Non/delayed filing of returns

Rule 12(1) of Central Excise Rules, 2002 stipulates that a monthly return (Form ER-1) is to be submitted by every assessee (other than SSI unit) indicating, inter alia, details of production and removal of goods by the 10th of the next month following the month for which such return is due. Though no specific penalty is prescribed for non/late filing of returns, Rule 27 of said Rules prescribes a general penalty of up to a maximum of ₹ 5000 for violating any rule, which is applicable to non/delayed filing of return.

Details of ER-1 returns submitted by manufacturers of tobacco products obtained from 61 Ranges revealed that there were 3,838 cases of non-filing in 13 Ranges and 1,480 cases of late-filing of ER-1 returns in 30 Ranges. However, the Department levied penalty in only 579 cases (39.12 per cent) in 24 Ranges for an amount of ₹ 4.59 lakh for late filing of returns and ₹ 0.05 lakh in 16 cases for non-filing of returns. The Department had neither taken any action nor imposed any penalty in the 3,822 (99.58 per cent) cases of non-filing and 901 (60.88 per cent) cases of late-filing of returns. Five Ranges where more than 100 cases were pending for action during the period 2013-14 to 2015-16 are listed below:

Table 3.2: Non/delayed filing of returns pending for action

Sl. No.	Commissionerate	Division	Range	No. of cases of non/delayed filing of returns pending for action			
				2013-14	2014-15	2015-16	Total
1	Hyderabad-II	Kothur	Mahaboob Nagar -I	504	552	561	1617
2	Jabalpur	Jabalpur	Range I	353	360	321	1034
3	Jabalpur	Jabalpur	Range III	260	300	421	981
4	Bengaluru IV	Davangere	Chitradurga	172	139	154	465
5	Bolpur	Berhampore	Dhulian-I	31	79	50	160

Number of cases of non/delayed filing of returns in Ranges Mahaboob Nagar-I under Hyderabad-II Commissionerate and Range III under Jabalpur Commissionerate had an increasing trend during the three years.

Non-initiation of action on non/delayed filing of returns indicates slackness of monitoring mechanism which can also act as a deterrent for erring assessees.

When we pointed this out (October 2016 and December 2016), the Ministry stated (October 2017) as follows:

- In 2,577 cases, the Ministry admitted audit observations, out of these, in 285 cases late fee of ₹ 2.04 lakh was recovered, in 2,175 cases SCNs were/are being issued and in 117 cases action was being initiated.
- In 1,681 cases, it was stated that non-filers are tiny beedi manufacturing units located at remote places, and run by uneducated villagers who do not know the legal provisions. All efforts were made to reach them and to advise to cancel their registrations due to closure of beedi manufacturing activity. The Ministry added that there were no arrears pending against these assessees.
- In 465 cases, it was stated that all efforts were made to pursue the beedi units to sensitize about e-filing, and all the beedi units had started e-filing the returns.

3.4.2 Preliminary Scrutiny of returns - pendency of Review and Correction (R&C) cases

After the introduction of ACES, preliminary scrutiny of returns is being done by the system itself. The purpose of preliminary scrutiny of returns is to ensure completeness of information, timely submission of returns, payment of duty, arithmetical accuracy of amount computed and identification of non-filers/stop-filers. Where discrepancy is found by the ACES system, all such returns are marked for Review & Correction (R&C)¹⁷. The returns marked for R&C by ACES should be validated in consultation with the assessee and re-entered into the system. The preliminary scrutiny of all the returns is to be conducted within three months from the date of receipt of the returns.

Audit obtained data from the selected 61 Ranges in respect of preliminary scrutiny related to tobacco sector. Audit observed that out of 46,767 returns marked for R&C by ACES, the Department could correct only 36,696 (78.47 per cent) returns within the stipulated time of three months. Thus, 10,071 returns were pending for R&C. Six Ranges¹⁸ did not provide data for the years

¹⁷ The process of resolving discrepancies in respect of marked returns is called R&C.

¹⁸ Ranges ITC under Pune-IV Commissionerate, Gondia-II under Nagpur-II Commissionerate, Tellichery under Calicut Commissionerate, Damoh-II under Bhopal Commissionerate, Jabalpur-I under Jabalpur Commissionerate and Udaipur-III under Udaipur Commissionerate

2013-14 to 2015-16. Thus, Audit was not able to comment on the performance of these Commissionerates. Ranges where maximum returns were pending for R&C are listed below:

Table 3.3: Preliminary scrutiny – High pendency of R & C Cases

Sl. No.	Commissionerate	Division	Range	No. of returns where R&C was pending			
				2013-14	2014-15	2015-16	Total
1	Tirunelveli	Tirunelveli	Palayamkottai	979	1,279	1,567	3,825
2	Tirunelveli	Tirunelveli	Tenkasi	1,232	1,207	1,234	3,673
3	Kolkata III	Kalyani	Range III	369	430	792	1,591
4	Chennai III	Vellore	Gudiyatham	0	0	408	408
5	Lucknow	Division I	Aishbagh	96	94	59	249
6	Sonepat	Kundli II	Kundli V	0	66	137	203

Pendency of R&C cases in Range Palayamkottai under Tirunelveli Commissionerate and Range III under Kolkata Commissionerate had an increasing trend during the three years.

When we pointed this out (between October 2016 and December 2016), the Ministry stated (October 2017) as follows:

- In 9,814 cases, the Ministry admitted the pendency of R&C. Out of these, in 7,498 cases the Range officers were instructed to clear the pendency expeditiously, in 1,591 cases the R&C were carried out, in 408 cases all returns marked for R&C had been done subsequently, in 249 cases the pendency has been brought down to 31 cases from 249 cases.
- In 257 cases under Sonepat Commissionerate, it was stated that the reply would follow.

The delay in carrying out R&C is not only indicative of poor monitoring of scrutiny of returns but may also lead to possible revenue escapement as pendency of R&C may result in time barring of the cases and consequent loss of revenue.

3.4.3 Inadequacy in selection of returns for detailed scrutiny

Board Circular No. 818/15/2005-CX dated 15 July 2005 had laid down detailed guidelines for manner of scrutiny of ER-1 and ER-3 returns.

The purpose of detailed scrutiny is to establish the validity of information furnished in the tax return and to ensure the correctness of valuation, availing of CENVAT credit, classification and effective rate of tax applied after taking into consideration the admissibility of exemption notification availed etc. Unlike preliminary scrutiny, detailed scrutiny is to cover only certain selected returns, identified on the basis of risk parameters developed from the information furnished in the returns submitted by the taxpayers.

Para 4B read with para 4.1A of Manual for the Scrutiny of Central Excise Returns, 2008 provides for selection of up to five per cent of total returns received for a detailed scrutiny of assessment based on risk parameters. CBEC issued revised guidelines for scrutiny of Central Excise returns in Circular No.1004/11/2015-CX dated 21 July 2015 prescribing a range of 2 to 5 per cent of total returns filed for conducting detailed scrutiny.

Audit obtained data in respect of returns received and returns subjected to detailed scrutiny from the selected 61 Ranges. Out of 61 Ranges, 8 Ranges deal only with cigarette manufacturers which are mandatory units for Internal Audit and hence not subject to detailed scrutiny. Other 14 Ranges provided incorrect/incomplete data for the three years. Out of the remaining 39 Ranges which provided data for the three years, it was observed that no returns were selected for detailed scrutiny in 34, 33 and 23 Ranges during 2013-14, 2014-15 and 2015-16 respectively despite the fact that there were a number of returns received as detailed below.

Table 3.4: Returns filed in the Ranges for the years 2013-14 to 2015-16

Number of returns ranged between	Number of ranges		
	2013-14	2014-15	2015-16
Up to 500	15	17	13
501 - 1000	12	09	07
Above 1000	07	07	03
Total	34	33	23

Ranges where number of returns received were 1000 and above, where no returns were selected in all the three years selected in audit for detailed scrutiny as detailed below:

Table 3.5: Ranges with high returns and no returns selected for detailed scrutiny

Sl. No.	Commissionerate	Division	Range	No. of returns received			
				2013-14	2014-15	2015-16	Total
1	Kolkata-III	Kalyani	Range-V	2,160	2,268	2,352	6,780
2	Kolkata-III	Kalyani	Range-III	1,640	1,606	1,651	4,897
3	Bolpur	Berhampore	Dhulian-I	1,182	1,313	1,498	3,993

It was also observed that out of 76,138 returns received in these 39 Ranges, only 308 (0.40 per cent) returns were selected for detailed scrutiny which was much less than the required 2 to 5 per cent. Further, out of these 308 returns, 191 pertained to tobacco sector and Ranges conducted scrutiny of 178 returns. From these 178 returns, the Department was able to detect lapses only in 2 cases with revenue implication of ₹ 1.86 lakh.

Hence, there was shortfall in the selection of detailed scrutiny. Low range of detection of lapses during detailed scrutiny suggests deficiency in selection criteria namely CENVAT utilisation, percentage of duty paid through PLA over last year.

When we pointed this out (between October 2016 and December 2016), the Ministry stated (October 2017) in respect of incorrect/incomplete (14 Ranges) data for the years 2013-14 to 2015-16 as follows:

- In one Range, the Ministry regretted for furnishing incorrect data.
- In ten Ranges, it was stated that the units are mandatorily covered under the risk parameters of Internal Audit/ detailed scrutiny have been done/action initiated.
- In two Ranges, it was stated the Reply would follow.
- In one Range, it was stated that returns selected for detailed scrutiny were 2 to 5 per cent.

The reply is not tenable, the Ministry arrived at the said percentage by adding the number of returns of different ranges under different Commissionerates. However, the percentage has to be ensured for selection of returns within the same Range and Commissionerate.

The Ministry stated (October 2017) in respect of shortfall in selection of detailed scrutiny (39 Ranges) for the years 2013-14 to 2015-16 as follows:

- In fifteen Ranges, it was stated that the units are being audited by Internal Audit regularly. Further, in respect of tobacco units none of

the units are falling under the prescribed risk parameters for selection of detailed scrutiny.

- In thirteen Ranges, it was stated that action for detailed scrutiny of returns had been taken/initiated.
- In seven Ranges, it was stated that reply would follow.
- In four Ranges, as seen from the reply it was noticed that the Ministry furnished reply pertaining to excess production of pouches in respect of M/s New Kamath Tobacco Limited i.e. Para 3.6.3 of this report which is not relevant to the shortfall in selection of detailed scrutiny.

Detailed scrutiny being the first line of compliance verification, shortfall in selection of returns for detailed scrutiny during the respective years by the above Commissionerates indicates weakness in compliance verification mechanism.

3.5 Internal Audit

Internal audit is an additional mechanism available with the Department for ensuring correctness of assessment of duty paid and records maintained by the assesseees. This is ensured through a scientific selection of assesseees based on risk analysis by emphasising on pre-preparation; by scrutinising of business records against statutory records and by monitoring of audit points. As per Central Excise Audit Manual 2008, the selection of units was based on the duty payment norms and units paying more than ₹ 3 crore were to be audited annually mandatorily. Consequent upon the formation of separate Audit Commissionerate (October 2014), the norms have been revised (27 February 2015), prescribing that Audit Commissionerate would release an Annual Plan by 31st May of every year indicating the name of assesseees that are proposed to be audited during the course of the year.

3.5.1 Non-conducting of Internal Audit resulted in non-detection of lapses

Audit examined the records of 22 assesseees which were due for audit as per the extant norms, but not covered by internal audit of the Department. We noticed lapses in 11 cases pertaining to 7 assesseees involving misclassification of goods, non/short payment of Service Tax, irregular availing of CENVAT credit etc. amounting to ₹ 9.40 lakh. These cases could have been detected if these units were subjected to audit. Two illustrative cases are given below:

3.5.1.1 Non-payment of Service Tax under Goods Transport Agency (GTA)

Rule 2(1)(d)(i)(B) of the Service Tax Rules, 1994 stipulates that the recipient of Goods Transport Agency (GTA) service is liable to pay service tax, if the

recipient of services is a factory, a company, a corporation, a co-operative society, a partnership firm etc.

Audit observed that M/s Vani Navashakthi Beedi Company, Kamareddy in Hyderabad I Commissionerate incurred an expenditure of ₹ 51.29 lakh towards transportation charges during 2015-16. The assessee had not discharged the Service Tax liability on the expenditure incurred. This resulted in non-payment of Service Tax of ₹ 2.23 lakh which was required to be recovered from the assessee along with interest.

We pointed this out (December 2016), the Ministry replied (March 2017) that the assessee had paid ₹ 4.58 lakh along with interest of ₹ 0.49 lakh for the period from April 2015 to November 2016.

3.5.1.2 Irregular availing of CENVAT credit

As per Rule 2(l) of CCR 2004, "input service" *inter alia* includes any service, used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products.

Audit observed that M/s Habeebur Rahman & Sons under Chennai-III Commissionerate availed CENVAT credit of ₹ 0.51 lakh as input service on service tax paid on 'Renting of Immovable Property' service during August 2014 to March 2015. It was seen that the rent amounting to ₹ 4.20 lakh was paid in respect of godown for stocking 'Tea' being traded by the assessee. As the Service Tax paid in respect of the service of 'Renting of Immovable Property' was not related to the manufacture of 'beedis', the availment of CENVAT credit of ₹ 0.51 lakh was not in order and required to be reversed along with appropriate interest.

We pointed this out (November 2016), the Ministry replied (October 2017) that the assessee reversed the CENVAT credit along with interest of ₹ 0.19 lakh.

In remaining nine cases, reply of the Ministry was as follows:

- In eight cases, the Ministry admitted the observations. Out of this, in three cases an amount of ₹ 1.87 lakh was recovered, in two cases, action for recovery of ₹ 5.12 lakh was being initiated, in two cases, filing of quarterly return in Appendix G of Cigarette Excise Manual was being examined and in one case, it was stated that the matter has been finalised.
- In one case, it was stated that the Principal Bench of Honourable CESTAT, Delhi in the case of CCE, Ludhiana vs. M/s Naghia Enterprises (P) Limited 2015 (317) ELT 475 held that there is no provision under

Central Excise Rules 2002 of maintaining prescribed records as per Cigarette Excise Manual.

Reply is not tenable as the Cigarette Excise Manual is specifically prescribed for the assessee who is into the business of cigarette manufacturing. The entire manufacturing / production cycle is captured in the Appendices A to G of the said Manual which is vital and mandatory information for levy and collection of duty which is being maintained by all other cigarette assessee.

3.5.2 Lapses remained undetected despite conducting of Internal Audit

Audit examined the records of 28 assessee which were covered by Internal Audit of the Department and noticed lapses in 5 cases of 5 assessee involving amount of ₹ 13.67 lakh. Thus, despite internal audit being conducted, these lapses were not detected. Two illustrative cases are given below:

3.5.2.1 Non-detection of non-payment of Service Tax

Truck hire charges were classifiable and taxable under the category of 'Supply of Tangible Goods service' as defined under section 65(105)(zzzzj) of Finance Act, 1994. Even after introduction of negative list with effect from 01 July 2012, the service was neither granted exemption by including it in the negative list of Service Tax nor by incorporating it in the Service Tax notification No. 26/2012-ST.

Scrutiny of records of M/s Borsad Tobacco Co Pvt. Ltd. under Anand Commissionerate revealed that the assessee had received ₹ 37.06 lakh as "Truck hire charges" during the period 2013-14. However, the assessee had not paid Service Tax on the same. The Service Tax payable on the income received was worked out as ₹ 4.58 lakh, which was recoverable along with interest of ₹ 2.80 lakh under section 75 of the Finance Act, 1994.

When we pointed this out (December 2016), the Ministry stated (October 2017) that SCN has been issued (April 2017) demanding Service Tax of ₹ 12.19 lakh along with interest and penalty for the period from 2011-12 to 2016-17.

3.5.2.2 Non-detection of short payment of duty

Audit observed from the records of M/s Maruti Tobacco Products Pvt. Ltd. (Unit-III) under Anand Commissionerate that during the period 2014-15 and 2015-16, the assessee while paying duty had adopted the duty rate of 'chewing tobacco' (₹ 24.15 lakh per month) instead of 'scented tobacco' (₹ 27.05 lakh per month) actually manufactured by the assessee which resulted in short payment of duty amounting to ₹ 2.62 lakh.

When we pointed this out (December 2016), the Ministry stated (October 2017) that duty of ₹ 2.62 lakh and interest of ₹ 0.79 lakh has been recovered.

In remaining three cases, the Ministry replied (October 2017) as follows:

- In two cases, Ministry admitted the observations. Out of this, in one case, demand of ₹ 0.01 lakh had been recovered, and in one case, SCN was issued.
- In one case, it was stated that the difference in sales and manufacturing figures noticed in audit has been reconciled and certified by the Chartered Accountant.

Though the internal audit was carried out by the Department, the lapse remained undetected until pointed out by the audit.

3.6 Other deficiencies noticed in the audit of departmental units

Audit observed non-compliance by the Department in respect of adjudication of Show Cause Notices (SCNs), inspection of subordinate departmental units and other deficiencies as detailed below:

3.6.1 Non-adjudication/Delay in adjudication of SCNs

Sub-section 10 of section 11A of Central Excise Act, SCN is to be finalised within six months or within one year from date of notice as the case may be. Audit observed 3 cases of non-adjudication and 48 cases of delayed adjudication of SCNs as detailed below:

3.6.1.1 Audit observed that M/s AVL Fragrance Private Limited in Kanpur Commissionerate filed application for surrender of its registration certificate in August 2015 but no action was taken by the Department. On ascertaining the reason of not taking any action on surrender application, it was noticed that an SCN dated 19 May 2015 involving duty of ₹ 23.23 lakh was pending for adjudication for more than 6 months. Thus, the Department failed to adjudicate the SCN in time and to take action on surrender application.

We pointed this out (February 2017), the Ministry stated (October 2017) that the SCN has been dropped by the adjudicating authority. The application for surrender of registration is under process subject to verification of records.

The reply is not tenable, as the Department failed to adjudicate the SCN within the stipulated time.

3.6.1.2 Audit observed that in respect of M/s Ashoka Flavours Private Limited in Kanpur Commissionerate, three SCNs involving duty of ₹ 56.36 crore were pending adjudication for more than a year. It was also noticed

that Assistant Commissioner had sealed 25 machines lying in the premises, out of which 20 machines were sold out by the assessee in September 2014 with the permission of the Department pending adjudication of SCNs. Meanwhile, the assessee applied for surrender of registration in December 2014. Despite pending adjudication of SCN, the Department allowed the assessee to sell the idle machines which made the possibility of recovery of arrears remote.

When we pointed this out (February 2017), the Ministry stated (October 2017) that all the three SCNs have been transferred to Call Book as these are pending in High Court. Further, it was stated that Pan Masala Packing Machine Rules do not restrain sale of machines where confirmed demands are pending for adjudication.

The reply is not tenable, as Rule 18 and Rule 19 of Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 and Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010 all provisions of the Act and Central Excise Rules, 2002 shall apply *mutatis mutandis* i.e. provisions relating to adjudication of SCN shall apply in this case.

3.6.1.3 Audit observed that in respect of M/s K.P. Pan Masala Private Limited in Ghaziabad Commissionerate, the Board vide its order dated 4 April 2012 raised a demand of ₹ 10.37 crore with instructions that the Commissioner (Special Adjudication) Central Excise, Delhi would act as an adjudicating authority.

Despite, pending adjudication, the Assistant Commissioner, Division-I Ghaziabad ordered for removal of 20 pouch packing machines and 65 single track pouch packing machines vide his orders dated 22 July 2013 and 10 January 2014. Assessee closed his business and surrendered the registration certificate in February 2014. It was also noticed (October 2016) that a new registration was issued to M/s Kay Pan Fragrance Private Limited (AAECK8045QEM003: U-III) on 23 June 2014 for manufacturing of chewing tobacco and pan masala at the same premises. Details of disposal of SCN were not even shown in the Monthly Technical Report.

Pending adjudication of SCN, the Department allowed the assessee to remove the machines, and a new registration was issued to another assessee in the same premises. Further, the assessee closed his business operations in February 2014. Thus, recovery of arrears, if any, became remote.

When we pointed this out in October 2016, the Ministry stated (October 2017) that in Central Excise law there is no provision to stop any assessee from selling machines or any other goods without any unstayed

confirmed demands pending against them. It was stated that the adjudicating authority is Commissioner (Special Adjudication) Central Excise, Delhi; the SCN may not be reflected in MTR. Further, it was also stated that there is no bar in granting of registration to another unit where no confirmed demand is pending against assessee at the same premises.

The reply is not tenable, as Rule 18 and Rule 19 of Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 and Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010 all provisions of the Act and Central Excise Rules, 2002 shall apply *mutatis mutandis* i.e. provisions relating to adjudication of SCN shall apply in this case. Further, allowing the assessee to remove machines pending adjudication of SCNs was in contradiction to the Ministry's reply to para 3.6.1.1 wherein the Ministry stated that the application for surrender of registration was kept pending as an SCN was pending adjudication against the assessee. Moreover, the Department issued registration to a new registrant in the same premises.

3.6.1.4 Audit observed from the records of adjudication register for the period 2013-14 and 2014-15 at Purnea Range under Patna Commissionerate that 48 cases were not adjudicated within the stipulated period of six months. The period of delay ranged from 3 days to 255 days.

When we pointed this out (December 2016), the Ministry replied (October 2017) that the concerned Division Office had been instructed to keep a vigil on SCNs pending for adjudication and issue adjudication orders within stipulated time. Further, it was also stated that the delay in adjudication occurred due to work overload.

Fact remains that SCNs were not adjudicated within the stipulated time.

3.6.2 Non-conduct of inspection of cigarette units by Divisional officer

As per paragraph 83 of Manual of Departmental Instructions on Excisable Manufactured Products on Cigarette - (Cigarette Manual), the Divisional officer must inspect each cigarette factory in his charge not less than once in each quarter on a working day. He must specially examine between theoretical and actual output regularly with adequate care and necessary action to be taken wherever necessary. He must also satisfy himself that Excise control in the factory is fully adequate for the security of the revenue.

Audit observed that in Secunderabad Division under Hyderabad II Commissionerate, no inspection reports of visits in respect M/s VST Industries, Azamabad, Hyderabad and M/s Hyderabad Deccan Cigarette Pvt. Ltd., Musheerabad, Hyderabad were available for the period 2013-14 to 2015-16.

When we pointed this out (December 2016), the Ministry stated (October 2017) that inspection for quarter ending March 2017 was conducted (April 2017) by the Divisional Officer and stated that in future the inspection reports would be issued biennially.

The reply is not tenable, as the inspections need to be carried out not less than once in each quarter as per the Manual of Departmental Instructions on Excisable Manufactured Products - Cigarettes.

3.6.3 Revenue loss of ₹ 309.18 crore due to deficiency in procedure for fixation of 'deemed production'

As per Rule 5 of Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 and Rule 5 of Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010, the 'Quantity deemed to be produced' – means the quantity of notified goods, having retail sale prices as specified in the Rules *ibid*.

Rule 7 of Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 and Rule 7 of Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010 specify that the duty payable for a particular month shall be calculated by application of the appropriate rate of duty specified in the Notification No. 42/2008-CE, dated 1 July 2008 and Notification No. 16/2010-CE, dated 27 February 2010 respectively to the number of operating packing machines in the factory during the month.

Further, Rule 6(2), Rule 8 and Rule 13 of the said rules have enabling provisions for manufacturers to file fresh declaration in Form-1 to make any subsequent changes with respect to any of the parameters declared in Form-1 under Rule 6(1), alteration in number of operating packing machines (addition or installation or removal or uninstallation) under Rule 8, and in a case where manufacturer does not intend to operate a packing machine under Rule 13(1).

As per Rule 12 of the Central Excise Rules 2002, every person liable to pay Central Excise Duty has to submit monthly (ER-1) Return by 10th day of the following month to which it relates. The return includes quantity manufactured and quantity cleared.

From the sample check of selected assesseees, Audit observed 10 cases where the assesseees manufactured chewing tobacco and pan masala much more than the capacity of production, as reflected in their ER-1 returns, thereby, paying excise duty on much less quantity of the production based on

'deemed production'¹⁹ which resulted in non-payment of duty of ₹ 309.18 crore. A few illustrative cases are given below:

3.6.3.1 Audit observed that M/s Fasttrack Packers Pvt Ltd under Nasik-II Commissionerate actually manufactured 222 crore pouches as compared to 52 crore pouches of 'deemed production' taken into account for payment of excise duty during the period 2012-13 to 2014-15. Thus, the actual production was more than 325 per cent of the 'deemed production' on which duty was paid. This resulted in excess production of 170 crore pouches and possible short payment of duty of ₹ 215.08 crore

3.6.3.2 Audit observed that M/s Kay Flavours Pvt. Ltd, Unit-I under Lucknow Commissionerate actually manufactured 139 crore pouches as compared to 104 crore pouches of 'deemed production' taken into account for payment of excise duty during the years 2013-14 and 2014-15. This resulted in excess production of 35 crore pouches and possible short payment of duty of ₹ 12.28 crore.

When we pointed this out (between October 2016 and December 2016), the Ministry stated (October 2017) as follows:

As per Rule 4, Rule 5 and Rule 6(3) *ibid*, duty is levied on the basis of 'deemed production' determined by the Department and not on actual production.

Further, Board has clarified vide its Circular No. 980/04/2014-CX dated 24 January 2014 that the duty payable may be determined based on 'deemed production' with respect to the number of operating packing machines in the factory during the month and the Retail Sale Price printed on the pouches and not on the basis of actual production by a unit. Thus, it is clear that the Department and assesseees are bound by the 'deemed production' determined and not on the actual production. In view of these provisions, there is no revenue loss as contended by Audit, as duty has been levied and collected correctly as per the provisions of the Act, and under the cover of rules/notifications made thereunder.

The reply of the Ministry is untenable. The audit findings point to serious problems related to the rules regarding determination of 'deemed production' and the failure of departmental officers in carrying out due diligence to determine the same. The Ministry continues to defend the rules and its execution instead of taking note of the audit findings indicating lacunae leading to loss of revenue to the Government. The very occurrence of the incidents of abnormal excess production over the 'deemed production', to the extent of 325 per cent, of installed capacity of machines is

¹⁹ Form-1 – Declaration to be filed by the manufacturer

indicative of failure on part of the divisional officer to realistically fix 'deemed production', leading to loss of revenue. Further, as per the latest position, in the case of M/s Fasttrack Packers Pvt. Ltd. under Nasik-II Commissionerate continued to manufacture 135.09 crore of pouches as compared to 19.97 crore of pouches of 'deemed production' for the year 2015-16 which was in excess of 'deemed production' by 115.13 crore (576.51 per cent) which resulted in a possible short payment of duty of ₹ 306.69 crore. Even after abnormal excess production of pouches over and above the 'deemed production', the Department failed to take cognizance of the same in reviewing and re-fixing the deemed capacity. The higher authorities also failed to ensure effective check.

Had there been a mechanism under the rules for levy of duty, based on 'deemed production' or actual production as per ER-1 whichever is higher, the interests of revenue from duty on production of chewing tobacco and pan masala could have been duly protected. In the absence of such an enabling provision under the rules, the role of divisional officer in realistic determination 'of 'deemed production' assumes great significance for ensuring revenue to Government'.

3.7 Other issues

Audit selected 173 number of assessee records from the selected units that were other than the ones due/selected by the Department for internal audit/detailed scrutiny. These assessees who had not paid/short paid the duty during any of the three years were selected from the data furnished by the Board and based certain risk parameters like revenue, CENVAT etc.

Audit observed 40 cases of non-compliance by the assessees with a revenue implication of ₹ 97.72 lakh involving misclassification of goods, non/short payment of duty, irregular availing of CENVAT credit and interest etc. A few illustrative cases are given below:

3.7.1 Excess/irregular availing of CENVAT credit

Rule 3 of CENVAT Credit Rules, 2004 provides that a manufacturer/service provider shall be allowed to take CENVAT credit of duties specified therein paid on inputs, capital goods and input service received for use in or in relation to manufacturer of final products or provision of output service, on the basis of documents specified in rule 9 *ibid*.

Audit observed 8 cases of lapses of excess/irregular availment of CENVAT credit amounting to ₹ 67.82 lakh. One instance, involving three cases of one assessee is illustrated below:

3.7.1.1 M/s Miraj Products Pvt. Ltd (Unit-III) under Udaipur Commissionerate availed CENVAT credit of service tax of ₹ 57.65 lakh paid on the consultancy services provided in connection with brand “Miraj” during the year 2015-16 to M/s Miraj Products Pvt. Ltd. group consisting of three units. The assessee was entitled to avail CENVAT credit of ₹ 19.22 lakh pertaining to it, instead of ₹ 57.65 lakh involving all three units of the group. This resulted in excess availing of CENVAT credit of ₹ 38.43 lakh pertaining to the other two units.

When we pointed this out (October 2016), the Ministry stated (October 2017) that Show Cause Notice for ₹ 49.00 lakh had been issued (May 2017).

3.7.1.2 Non-payment of interest in provisional assessment

Rule 8 (i) of Central Excise Rules, 2002 stipulates that the duty shall be paid by the 6th day or 5th day of the following month as the case may be. If the assessee fails to pay duty by the due date, he shall be liable to pay the outstanding amount along with interest under section 11AA of the Act. Provisional assessment is dealt with under Rule 7 of Central Excise Rules 2002. Further, Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 states that where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be 110 per cent of the cost of production or manufacture of such goods.

Audit noticed that M/s Miraj Products Private Limited (Unit-II), Nathdwara under Udaipur Commissionerate requested the jurisdictional Assistant Commissioner of Central Excise on 1 April 2014 for provisional assessment of loose chewing tobacco cleared to its sister unit. The Assistant Commissioner vide order dated 6 May 2014 allowed the assessee to clear the excisable goods at the rate of ₹ 30 per kg on provisional basis subject to furnishing of bond with security. The assessee cleared goods at the rate of ₹ 27 per kg instead of ₹ 30 per kg to its own unit during the year 2014-15. Clearing of the goods at a rate lower by ₹ 3 per kg resulted in short payment of duty of ₹ 121.84 lakh. The assessee deposited the short duty ₹ 121.84 lakh on 18 December 2015. The final assessment order was issued by Assistant Commissioner on 22 December 2015 wherein the rate decided was ₹ 30 per kg. The assessee deposited differential duty on 18 December 2015. However, the interest on differential duty of ₹ 24.45 lakh was not paid by the assessee which was yet to be recovered.

When we pointed out this out (January 2017), the Ministry stated (October 2017) that Show Cause Notice for recovery of interest on differential duty of ₹ 24.45 lakh was under process of issuance.

In the remaining 36 cases the Ministry stated (October 2017) as follows:

- In 24 cases, the Ministry admitted the audit observations. Out of these, in seven cases reported recovery of ₹2.53 lakh, and in 17 cases action has been taken/initiated.
- In eight cases, as seen from the replies furnished by the Ministry it was noticed that it referred to payment of duty and misclassification of goods etc., which are not relevant to the audit observations pointed out.
- In three cases, it was stated that the reply would follow.
- In one case, it was stated that the assessee availed 'input service credit' on services used in construction of 'Experience Centre' which is related to manufacturing activity. Reliance is placed on CESTAT Bangalore order in the case of CCE Bangalore vs. M/s Bharat Fritz Werner Limited. Further, this issue raised by Internal Audit which was dropped by adjudicating authority, and the CENVAT credit was allowed.

The reply is not tenable, as the 'Experience Centre' was not completed and abandoned during implementation. Therefore, the input service credit was not entitled to be availed as the said project was abandoned and not utilised in or in relation to the manufacturing activity.

3.8 Conclusion

Audit observed inadequacies in compliance to rules and procedures by the Department as indicated by inadequate monitoring of returns, shortfall in detailed scrutiny and inadequacy in criteria of selection of returns for detailed scrutiny, deficiency in Internal Audit and monitoring mechanism.

Lacunae in the rules related to levy of duty on pan masala and chewing tobacco products and implementation thereof led to substantial loss of revenue. Inadequacies in compliance to the Act/Rules/Notifications relating to other tobacco products as indicated by lack of effective mechanism to identify and ensure filing of returns by beedi units which operate mostly in the informal sector; poor enforcement of maintenance of prescribed records and non-conducting of quarterly inspection of cigarette units by the Department also led to loss of revenue.