Chapter IV

Non-compliance with rules and regulations

4.1 Introduction

Section 16 of CAG's (DPC) Act, 1971 deals with CAG's duty in relation to Audit of Receipts and requires CAG to audit receipts payable into the Consolidated Fund of India and to satisfy that the rules and procedures are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed. To carry out our mandate as per the provisions of CAG's DPC Act, as part of our audit of field formations of CBEC, we verify records of assessees, which form the basis for tax calculation, to examine the extent of effectiveness of the systems in place in ensuring that assessees comply with extant rules and procedures in this era of self-assessment. The observations on specific failure of Department in carrying out their scrutiny, internal audit, tax base broadening etc are reported in a separate chapter on "Effectiveness of Internal Controls" and the observations on non-compliance by assessees in cases not scrutinised or audited by the Department are reported separately under the title "Non-compliance with rules and regulations.

We have been pointing out irregularities relating to (i) Payment of Central Excise duty (ii) Availment of CENVAT credit and (iii) other issues every year and it has been noticed that these irregularities are persistent as similar nature of observations are reported by audit every year as detailed below:

Table: 4.1

(₹ in crore)

Nature of Observation	2013-14		2014-15		2015-16	
	No.	Amount	No.	Amount	No.	Amount
Non-payment of Central Excise duty	8	3.71	6	21.62	4	1.55
Short payment of Central Excise duty	15	21.85	3	1.73	9	18.04
CENVAT credit	30	29.45	14	16.51	17	17.61
Other issues	4	11.40	2	0.69	6	14.02
Total	**57**	**66.41**	**25**	**40.55**	**36**	**51.22**

The Ministry takes rectificatory action only in individual cases pointed out by audit by recovering the amount from that individual assessee or by issuing

demand notice for the same. But no action is taken to strengthen systems in place to improve the level of compliance by assessees. This is evident from the fact that we again noticed 44 cases of non/short payment of Central Excise duty/ interest and irregular availing and utilisation of CENVAT credit having a total revenue implication of ₹ 45.40 crore. The Ministry needs to ensure that through use of technology and integration of databases, a system of tax levy and collection that would make it difficult for assessees to escape paying duties due.

Out of the 44 cases included in the current report, 31 cases which have been accepted by the Department and recoveries made/ recovery proceedings initiated are mentioned in Appendix-II and 13 cases are discussed in this chapter under the following three major headings:

- Non/Short payment of Central Excise duty
- Incorrect Availing/ Utilisation of CENVAT Credit
- Other issues

4.2 Non-payment/short payment of Central Excise duty

Audit noticed 15 cases where duty was not paid/short paid. Ministry/Department admitted observation in all 15 cases and initiated/taken corrective action. 6 cases are illustrated below. Remaining 9 cases are detailed in Appendix II.

4.2.1 Non-payment of duty on goods cleared to warehouse

As per Rule 20 of Central Excise Rules, 2002 governing warehousing provisions, excisable goods can be removed from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty. Further, if the goods dispatched for warehousing are not received in the warehouse, the responsibility for payment of duty shall be upon the consignor. Further, para 4 of Chapter 10 of CBEC's Excise Manual of Supplementary Instruction 2005 stipulates when assessee clears goods to various warehouses without payment of duty under ARE-3 and re-warehousing certificate is not produced within 90 days, he is liable to pay duty on that goods.

M/s Sintex Industries Ltd. (Plastic Division) in Ahmedabad-III Commissionerate had cleared goods to various warehouses without payment of duty, under ARE-3 form. On scrutiny of the clearance and re-warehousing received, it was found that in the financial year 2015-16 re-warehousing certificate in respect of some goods cleared under ARE-3 had not been received by the assessee even after lapse of more than 90 days from the date

of clearances. Hence, the assessee was liable to pay duty for such clearance. The total value of clearance for which re-warehousing certificates were not received worked out to ₹ 3.34 crore involving total duty amount ₹ 41.77 lakh which was required to be recovered alongwith applicable interest.

When we pointed this out (May 2016), the Department intimated (December 2016) that the assessee had paid ₹ 41.77 lakh alongwith interest of ₹ 3.89 lakh.

4.2.2 Non-levy of Central Excise duty and Clean Energy Cess on Coal found short

Rule 4(1) of the Central Excise Rules, 2002 stipulates that no excisable goods on which any duty is leviable shall be removed without payment of duty. As per rule 10(1) of said rules every assessee shall maintain proper records on a daily basis in a legible manner indicating the particulars regarding description of goods produced or manufactured, opening balance, quantity produced or manufactured etc. Further, rule 21(1) of above rules allows remission of duty on goods that have been lost or destroyed by natural causes or by unavoidable accident or are claimed by the manufacturer as unfit for consumption or for marketing at any time before removal. As per rule 4 of Clean Energy Cess Rules, 2010 every producer shall pay Clean Energy Cess (CEC) on the removal of the specified goods in the manner provided in Rule 6(1) of Clean energy Cess Rules 2010.

As per para No. 3 of the CBEC circular dated 24 June 2010, cess would apply to the gross quantity of raw coal raised and dispatched from the coal mine without any deduction from this quantity for loss if any on account of washing of coal or its conversion into any other product/ form prior to its dispatch from the mines. Clean Energy Cess at the rate of ₹ 200 per M.T is leviable on oal produced.

M/s Mahanadi Coalfields Ltd (MCL), Orient Area, Brajarajnagar under Rourkela Commissionerate, producers of Coal falling under Chapter 27 of Central Excise Tariff Act 1985, had disclosed closing balance of coal as 90367.86 MT in his books of accounts at the end of financial year 2014-15. The assessee also disclosed in ER-1 return for the month of March 2015 that the closing balance of coal at the end of financial year 2014-15 was 91,814 MT. However, on physical verification by coal inventory team of Coal India Ltd (CIL) it was found that the actual physical balance of coal was 47,296.22 MT only. Thus, there was a shortage of coal to the extent of 44,517.78 MT valuing ₹ 7.20 crore. Thus, actual physical stock was neither reflected in ER-1 return nor the assessee applied for remission of duty on such shortage under rule 22(1) of said Rules. This resulted in non-levy of duty of ₹ 43.20 lakh and

clean energy cess of ₹ 89.04 lakh on coal found short and the same was required to be recovered from the assessee along with interest.

When we pointed this out (March 2016), the Ministry admitted the objection (September 2017) and stated that SCN was being issued for Central Excise duty of ₹ 43.20 lakh and clean energy cess of ₹ 89.04 lakh for the period of 2014-15.

4.2.3 Short levy of duty on goods cleared to sister unit

Rule 8 read with proviso to 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 it or by a related person of the assessee in the manufacture of other articles, the assessable value of such goods shall be one hundred and ten per cent of the cost of production or manufacture of such goods. Further, as per provisions under Section 11AA of Central Excise Act, 1944 interest at applicable rate is leviable for non-payment/ short payment of duty.

M/s Steel Authority of India Limited – IISCO Steel Plant, Burnpur under Bolpur Commissionerate, cleared Blast Furnace (BF) Coke exclusively to its different sister units located at Bokaro, Bhilai, Durgapur etc. during 2013-14, for use in further manufacture. In some instances the assessable value at which the BF Coke was cleared was less than 110 per cent of cost of production, as provided by the assessee which resulted in undervaluation of BF Coke and consequential short payment of duty of ₹ 3.61 crore during the period 2013- 14.

When we pointed this out (January 2016), the Ministry admitted the objection (September 2017) and intimated that Show Cause Notice was under process of issuance.

4.2.4 Short payment of duty and non-payment of interest and penalty

As per rule 8(3) of Central Excise Rules, 2002, if the assessee fails to pay the amount of duty by due date, he shall be liable to pay the outstanding amount alongwith interest, at the rate specified by the Central Government vide notification issued under section 11AB of the Act on the outstanding amount, for the period starting with the first day after due date, till the date of actual payment of the outstanding amount.

Further, as per sub-rule 3A of Rule 8 of Central Excise Rules, 2002 if the assessee fails to pay the duty declared as payable by him in the return within a period of one month from the due date, then the assessee is liable to pay the penalty at the rate of one per cent on such amount of the duty not paid,

for each month or part thereof calculated from the due date, for the period during which such failure continues.

M/s Sona Alloys Pvt. Ltd. in Kolhapur Commissionerate is engaged in the manufacture of excisable goods falling under Chapter 72 of Central Excise Tariff Act, 1985. Scrutiny of ER-1 returns revealed that during the period from April 2015 to January 2016, the assessee paid excise duty with delay for every month. The assessee was liable to pay interest at the rate of 18 per cent per annum and penalty at the rate of one per cent per month from the due date of payment. However, the same was not paid by the assessee. This resulted in non-payment of interest of ₹ 2.00 crore and penalty of ₹ 1.35 crore. Further, for the months of February and March 2016 the assessee paid only ₹ 7.23 crore against payable duty of ₹ 10.44 crore. The short paid duty of ₹ 3.21 crore was also recoverable with interest.

When we pointed this out (August 2016), the Department intimated (December 2016) that the assessee had paid interest of ₹ 2.00 crore and penalty of ₹ 1.35 crore for delayed payments and also paid duty of ₹ 3.21 crore with interest of ₹ 29.37 lakh and penalty of ₹ 19.90 lakh.

4.2.5 Short payment of duty due to incorrect availment of concessional rate of Excise duty

Chapter note 3(B) under Section XX of Chapter 94 of Central Excise Tariff prescribes that 'Goods described in heading 9404, presented separately, are not to be classified in heading 9401, 9402 or 9403 as parts of goods'.

M/s Janak Health Care Pvt. Ltd. falling under Range-Umbergam-I, Division-Vapi, Daman Commissionerate is engaged in manufacture of medical, surgical, dental or veterinary furniture classifiable under chapter 94029010 and cleared the said goods at concessional Central Excise duty rate of six per cent under serial number 320 of Central Excise Notification No. 12/2012-CE. We noticed that assessee cleared parts of medical, surgical, dental or veterinary furniture also at the concessional rate of six per cent under which it cleared mattresses as well which are classifiable under heading 9404. Assessee had cleared mattresses which were accompanied with furniture, at concessional rate while the mattresses cleared as solitary items were cleared at normal rate of Excise duty during the audit period.

Clearance of mattresses at concessional rate of duty was incorrect since chapter note 3(B) above clearly prescribes that goods described in heading 9404 cannot be classified as parts of goods under heading 9401, 9402 and 9403. Further, sales invoices raised by the assessee clearly showed mattresses as a distinct product under a distinct product code and were

classified under CTH 94.04. This was also evident from its product catalogue which showed the product mattress separately.

When we pointed this out (March 2014), the Department admitted the observation (October 2016) and intimated confirmation of demand of ₹ 1.67 crore with interest and penalty of ₹ 83.30 lakh.

4.2.6 Short payment of duty due to misclassification of goods

As per Note 1(e) under Chapter 30 of the CETA 1985, 'preparations of headings 3303 to 3307' even if they have therapeutic or prophylactic properties are not classifiable under Pharmaceutical products. Note 3 under Chapter 33 of the CETA, 1985 states that headings 3303 to 3307 apply, inter alia, to such products, whether or not mixed (other than aqueous distillates and aqueous solutions of essential oils), suitable for use as goods of these heading and put up in packing of a kind sold by retail for such use. Heading 3304 includes 'Beauty or Make-up Preparations and Preparations for the Care of the Skin (other than Medicaments), including Sunscreen or Suntan Preparations' etc.

During the course of audit of Central Excise records of the office of the Superintendent of Central Excise, Gaganpahad Range II, Hyderabad, it was noticed from the ER-1 returns for the period from April 2013 to March 2016 of M/s. Ashwini Homeo and Ayurvedic Products Pvt. Ltd., that the assessee paid Central Excise duty at the rate of six per cent on "Herbal Bath Powder/ Sunni Pindi" by classifying it under heading 30039014. The said product was cleared for retail sale and not for the cure of any skin ailments/ disease. As per the chapter notes ibid, Herbal Bath Powder/ Sunni Pindi is classifiable under chapter heading 3304 which attracts duty at the rate of 12.36 per cent/ 12.5 per cent (with effect from 1 March 2015). This misclassification resulted in short payment of duty of ₹ 56.23 lakh which was required to be recovered from the assessee along with interest.

When we pointed this out (August 2016), the Ministry admitted the observation (August 2017) and stated that Show Cause Notice demanding duty of ₹ 90.14 lakh covering the period from January 2012 to November 2016 had been issued to the assessee.

4.3 CENVAT credit

Audit noticed 28 cases of incorrect availing/utilisation of CENVAT Credit by the assessees. Ministry/Department admitted observations in 26 cases and initiated/taken corrective action while in one case, reply was awaited. Six cases are illustrated in following paragraphs. Remaining 22 cases are detailed in Appendix II.

4.3.1 Incorrect availing of CENVAT credit on Works Contract Services

"Input service" as per Rule 2(l) (A) of the CENVAT Credit Rules, 2004 excludes service portion in the execution of a Works Contract and Construction Services including service listed under clause (b) of section 66E of the Finance Act in so far as they are used for Construction or execution of works contract of a building or a civil structure or a part thereof.

M/s Ford India Pvt. Ltd., an assessee under LTU Commissionerate, Chennai had incorrectly availed Service Tax credit amounting to ₹ 1.05 crore paid under reverse charge basis relating to Works Contract Service for construction of factory building during 2013-14 and 2014-15. The incorrect credit availed was recoverable.

When we pointed this out (June, July 2015), the Ministry admitted the observation (September 2017) and stated that Show Cause Notice for recovery of an amount of ₹ 1.14 crore covering the period from 2013-14 to 2014-15 would be issued to the assessee.

4.3.2 Irregular availment of CENVAT credit on input service not used in manufacture of finished goods

As per Rule 2(1) of the CENVAT Credit Rules, 2004, input service means any service (i) used by a provider of output service for providing an output service or (ii) used by a manufacturer whether directly or indirectly in or in relation to the manufacture of final products and clearance of final products upto the place of removal. Rule 14 of the said rules provides for levy of interest on irregular availment and utilisation of CENVAT credit.

M/s Mahanadi Coalfields Ltd (MCL), IB Valley Area, Brajarajnagar under Rourkela Commissionerate, engaged in producing of coal falling under Chapter 27 of Central Excise Tariff Act 1985, had availed CENVAT credit of ₹ 30.37 lakh on Service Tax paid on hire charge of tipper for loading of coal of M/s MCL, from Lakhanpur area during the years 2013-14 and 2014-15. Since the duty on coal was paid by M/s MCL, Lakhanpur area, the credit was admissible only to M/s MCL, Lakhanpur area. The irregular availment and utilisation of input service credit of ₹ 30.37 lakh was required to be recovered from the assessee alongwith interest.

When we pointed this out (March 2016), the Ministry contested the observation (September 2017) stating that the assessee had 26 mines under 10 different areas and obtained different registration for each mining area. In this case IB valley area and Lakahnpur area were involved. Due to administrative convenience, invoice was issued by the contractor to IB valley

area, whole credit was availed by them and issue was revenue neutral. It was also stated that from March 2011 centralised registration has been allowed by which the problems faced by different mining area of coal manufacturing unit has overcome.

Ministry's reply is not acceptable as the assessee obtained centralised registration on 1 April 2015. Prior to that he was to follow the CENVAT Credit Rules and credit should have been availed by the respective mining areas.

4.3.3 Availing of CENVAT credit twice on the same invoices

As per Rule 3 of CENVAT Credit Rules, 2004, a manufacturer or provider of output service can avail CENVAT credit of duty/ tax mentioned therein. Further, rule 14 stipulates that where CENVAT credit has been taken and utilised wrongly, the same shall be recovered alongwith interest.

M/s Heavy Vehicles Factory, Avadi under Chennai-I Commissionerate is an ordnance factory under the Ministry of Defence. The assessee produces high power diesel engines for armored vehicles/ tanks and also provides training to army personnel regarding the maintenance and usage of such vehicles. Audit observed from the CENVAT records that during the period ended March 2016, the assessee had availed CENVAT credit of ₹ 68.55 lakh based on 8 Excise invoices issued by M/s Bharat Electronics Ltd., Chennai, as input credit and also as input service credit. Similarly, during the month of April 2016, the assessee had availed credit of ₹ 15.83 lakh based on four Service Tax invoices issued by M/s Steel Authority of India, New Delhi as input service credit and also as input credit. This resulted in availing of double credit. The assessee also availed credit of ₹ 18.11 lakh on invoices issued by SSI units which have actually availed exemption and not paid any duty in respect of the invoices. Thus, the assessee availed credit of ₹ 1.02 crore which was required to be reversed alongwith applicable interest.

We pointed this out to the Department in January 2017. Reply of the Department/Ministry was awaited (August 2017).

4.3.4 Incorrect utilisation of CENVAT credit for payment of duty by Export Oriented Unit

Rule 3(4) of CENVAT Credit Rules, 2004 provides that the CENVAT credit may be utilised for payment of:

(a) Any duty of Excise on any final product; or

(b) An amount equal to CENVAT credit taken on inputs, if such inputs are removed as such or after being partially processed; or

(c) An amount equal to the CENVAT credit, taken on capital goods if such capital goods are removed as such; or

(d) An amount under sub-rule (2) of rule 16 of Central Excise Rules 2002; or

(e) Service Tax on any output service.

This implies that all payments other than the above should be made in cash.

(i) Audit observed that M/s Sun Pharma (100 per cent EOU) under Vadodara II Commissionerate paid total duty of ₹ 51.32 crore on raw material in stock and capital goods on debonding from EOU scheme, out of which, ₹ 34.19 crore was paid in cash through challan and remaining ₹ 17.13 crore was paid through CENVAT credit. Assessee utilised CENVAT of ₹ 17.13 crore for payment of duty of Excise on raw material/input, capital goods, finished goods and for payment of Customs duty on goods imported duty free.

As per the rule above, assessee was eligible to utilise CENVAT credit only for payment of Central Excise duty payable on finished goods amounted to ₹ 1.48 crore. Thus, the assessee incorrectly utilised credit of ₹ 15.65 crore for payment of duty on goods procured duty free and for payment of Custom duty.

When we pointed this out (August 2014), the Ministry stated (July 2017) that two SCNs for ₹ 7.34 crore and ₹ 8.31 crore had been issued to the assessee and demand had also been confirmed.

(ii) M/s BASF India Limited (100 per cent EOU) under the jurisdiction of Bharuch Commissionerate, cleared imported raw material and capital goods (procured under procurement certificate) of worth ₹ 3.63 crore as such. Assessee also wrote off capital goods of worth ₹ 1.55 crore. Assessee paid duty of ₹ 1.06 crore on the above goods from CENVAT credit instead of paying it in cash as per the provision ibid. This resulted in incorrect utilisation of CENVAT credit for ₹ 1.06 crore.

When we pointed this out (September 2015), the Ministry admitted the observation (August 2017) and stated that SCN for ₹ 1.14 crore for the period from 2011-12 to 2015-16 had been issued to the assessee and same had been confirmed.

4.3.5 Non-reversal of CENVAT credit on slow moving stock

As per rule 3(5B) of the CENVAT Credit Rules, 2004 if the value of any, (i) input, or (ii) capital goods before being put to use, on which CENVAT credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of accounts, then the

manufacturer or service provider, as the case may be, shall pay an amount equivalent to the CENVAT credit taken in respect of the said input or capital goods.

M/s Rieter India Pvt. Ltd. In Kolhapur Commissionerate, engaged in the manufacture of excisable goods falling under chapter heading 84 of the Central Excise Tariff Act, 1985 made provisions for allowances for slow moving stock of ₹ 6.97 crore. The assessee was required to reverse equivalent amount of CENVAT credit taken in respect of this stock which was not done. This resulted in non-reversal of CENVAT credit of ₹ 87.10 lakh.

There is no mechanism requiring the assessee to intimate the Department in case of any write-off/provision for write-off is made in finance accounts where reversal of CENVAT credit is required. Ministry may ensure that suitable mechanism exist in GST system.

When we pointed this out (September 2016), the Ministry admitted the observation (June 2017) and stated that amount involved in the case was ₹ 1.15 crore and same has been reversed by the assessee from CENVAT account. Ministry further stated that suggestion relating to incorporation of certain provisions in the upcoming GST system is noted for future compliance.

4.4 Other issues

Audit noticed one case of short payment of cess which is illustrated below.

4.4.1 Short payment of Clean Energy Cess

As per Section 83 of Finance Act, 2010 read with Notification No. 01/2010 Customs (NT) (Clean Energy Cess) dated 22 June 2016, a cess namely Clean Energy Cess as duty of Excise, was imposed by the Central Government with effect from 1 July 2010 on goods specified in the Tenth Schedule, being goods produced in India at the rate set forth in the said schedule.

Further, as per Notification No. 01/2015-Clean Energy Cess dated 1 March 2015, rate of Clean Energy Cess on coal was fixed as ₹ 200 per tonne which was enhanced to ₹ 400 per tonne from 1 March 2016.

M/s ECL, Mugma Area (assessee) under jurisdiction of Central Excise and Service Tax Commissionerate, Dhanbad deposited ₹ 42.08 crore as Clean Energy Cess for clearance of 19,30,921 MT of coal during March 2015 to March 2016 as per Form-I. Audit observed that the clearance of coal as per ER-1 return during the period from March 2015 to March 2016 was 19,35,144 MT and the Clean Energy Cess payable on it was ₹ 42.17 crore. Thus the

assessee had short paid the Clean Energy Cess amounting to ₹ 8.94 lakh which was recoverable with interest and penalty.

When we pointed this out (February 2017), the Department accepted the audit observation (March 2017) and intimated (May 2017) that SCN amounting to ₹ 16.81 lakh along with interest and penalty had been issued to the assessee.