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MONTHLY AUDIT BULLETIN – JULY 2013

Directorate General of Audit

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CENTRAL EXCISE

(1) GIST OF THE OBJECTION : Non payment of Excise Duty on sale of ET sludge
COMMISSIONERATE : Central Excise Commissionerate, Delhi-I
CONTRAVENTION OF PROVISION : Rule 6(3)(b)/6(3)(i) of the CENVAT Credit Rules, 2004 as amended

During the audit, it was found that the assessee had not shown the sale of ET sludge in their excise returns and has cleared the same without paying any duty. The ET sludge being produced during treatment of waste water was sold to contractors which were further used in cardboard industry for making cartons used for packing of shoes. The assessee was availing CENVAT Credit in respect of inputs/input services/capital goods being used in their Effluent Treatment Plant (ETP). The ET sludge is marketable goods. The ET sludge is of inferior quality of 'Pulps of fibres derived from recovered (waste and scrap) paper or paperboard or of other fibrous cellulosic material' and is classifiable under chapter heading 47069300 of the Central Excise Tarrif Act, 1985.

During the last 5 years (including FY 2012-13), the assessee had cleared the ET sludge without paying of any duty. Therefore the assessee stands liable to pay Central Excise Duty amounting to Rs.9,02,424/- along with applicable interest and penalty as per Rule 6(3)(b)/6(3)(i) of the CENVAT Credit Rules, 2004 as amended .

(2) GIST OF THE OBJECTION : Irregular / Wrong availment of CENVAT Credit on the activity not amounting to manufacture
COMMISSIONERATE : Central Excise Commissionerate, Raigad
CONTRAVENTION OF PROVISION : Rule 3 read with Rule 6 of the CENVAT Credit Rules, 2004

During the course of Audit & on scrutiny of manufacturing process, it was noticed that the assessee is manufacturing S.S.Bright Bar falling under Chapter heading 7222 of CETA, 1985 of diameter ranging from 5mm to 250mm. On detailed examination of the manufacturing process it was observed that SS Bars ranging from 26 mm to 250 mm do not undergo the process of drawing or redrawing of the stainless steel rounds/ bars. The process undertaken is merely heat treatment (optional), peeling or turning, straightening, center less grinding, cutting (optional),

inspection and packing. As per Chapter Note No. (4) of Chapter 72 of CETA, 1985, the process of drawing or redrawing a bar, rod, wire rod or any other similar article, into bright bar, shall amount to manufacture. Therefore, it is observed that since the 'SS Bars ranging from 26 mm to 250 mm do not undergo the process of drawing or redrawing of the stainless steel rounds/ bars, the activity do not amount to manufacture. As per the provisions of Rule 3 of the CENVAT Credit Rules, 2004, read with Rule 6, credit of duty paid on the inputs is allowed only if these inputs are used in the manufacture of a final product. Board vide circular dated 14.01.2010 issued from F.No.267/116/2009-CX8, had clarified that if the process does not amount to manufacture, duty is not required to be paid and hence no CENVAT Credit of duty paid on inputs is admissible and therefore availment of CENVAT Credit by the assessee on the stainless steel rounds/ bars is not proper.

(3) GIST OF THE OBJECTION : Short payment of duty on clearance to Oil Manufacturing Companies namely, HPCL, BPCL and IOCL (OMC's)

COMMISSIONERATE : Central Excise Commissionerate, Mumbai V

CONTRAVENTION OF PROVISION : Section 4 of the Central Excise Act, 1944

It was noticed that the assessee has allowed a trade discount to the OMC's for establishing and running of the assessee's outlets within their premises, which consequently appeared to be an additional consideration, flowing from OMC's to the assessee. Under this agreement, the assessee would automatically have facility to conduct retail sale of their products to the Vehicles. This additional consideration is in form of extended facility apparently includible in the transaction value of the supplies of CNG made to OMC's. It is observed that during the period from April-12 to November 12, the assessee has charged assessable value of Rs.23.60 per kg to the OMc's and charged assessable value of Rs. 25.72 to other outlets operated by pvt. Parties and MGL owned. As such the assessee offered discount of Rs. 2.12 per kg to the OMC's which further sold the CNG at the rate of Rs.25.72 at their retail outlets. As such the assessee is required to pay the duties on the differential value of the CNG cleared to the OMC's. The Department is regularly issuing SCN on this matter. However for the aforesaid period, the SCN is not issued yet. Total differential value for this period worked out to be Rs. 23,91,21,976/. Cenvat Duty: Rs.3,34,77,077/-, Ed Cess:Rs.6,69,542/-, SHE Cess: Rs. 3,34,771/-. Total Rs.3,44,81,389/- plus applicable interest and penalty.

(4) GIST OF THE OBJECTION : Wrong Classification of Masala and resultant non-payment of Central Excise duty

COMMISSIONERATE : Central Excise Commissionerate, Cochin

CONTRAVENTION OF PROVISION : Section 3 of the Central Excise Act, 1944 read with Rule 6 of the Central Excise Rules, 2002

On verification of the records of the assessee it is found that the assessee has been classifying Masala Mix viz. Meat Masala, Chicken Masala, Sambar Masala, Chat Masala, Prawns Masala etc. under CETH 0904 which are cleared at 'NIL' rate of duty. As per Chapter Note No. 1 of Chapter 9 of Central Excise Tariff Act, 1985, - Mixtures of the products of heading 0904 to 0910 are to be classified as follows:-

(a) mixture of two or more of the products of the same heading are to be classified in that heading;

(b) mixtures of two or more of the products of different headings are to be classified in heading 0910.

The mixture of spices, which are whole, ground or crushed, if retain their essential character even after mixing with other substances, are to be classified under Chapter 09, and if they lose their essential character after they are mixed with such other substances, they will be classified as mixed condiments or mixed seasonings falling under chapter 2103. Therefore, the mixed condiments and mixed seasonings cleared by the assessee are classifiable under Tariff sub-heading 21039040 of CETH, which attracts excise duty. Thus the assessee is liable to pay Excise duty of Rs.4,20,16,919/-(inclusive of cess) for the period 04/2012 to 02/2012.

(5) GIST OF THE OBJECTION : Undervaluation of finished goods cleared from EOU to related parties / concerns in DTA based on cost sheets where profit margin has been shown at a very less percentage than the actual profit percentage as per cost report submitted under category 'A'

COMMISSIONERATE : LTU Commissionerate, Bangalore

CONTRAVENTION OF PROVISION : Rule 8 of the Customs Valuation (Determination of Rules, 2007

During the course of audit, it is noticed that the valuation of goods cleared in DTA by an EOU is covered by Customs Valuation Rules, 2007 and not Central Excise Valuation Rules. Clearances of finished goods from EOU to related parties/concerns in DTA where value of

comparable/ identical goods is not available, value has to be computed as per Rule 8 of Customs Valuation Rules based on cost construction method. As in Central Excise where on the cost 10% profit margin is fixed as mandatory, there is no such condition under Customs Act. The profit margin should be more or less equal to overall profit margin of the company. Here the assessee is adding 10% margin including other general expenses. As per the cost audit report given by the Cost Auditors under Companies Act 1956, the profit margin of the company for 2010-11 was 26.60% and 14.50% for the year 2011-12. Hence it is clear that by adding 10% profit margin including general expenses is very low and deliberately done to evade duty on clearances to their own related units. Hence on the value of DTA clearances, 10% more needs to be added before arriving at the duty. The duty so worked for the period 2010-11 and 2011-12 comes to Rs.40,89,414/- which needs to be recovered along with interest.

(6)	**GIST OF THE OBJECTION**	**:**	**Short payment of duty on captive consumption as cleared under Notification No.30/2001 dated 01.03.2001 as amended**
	COMMISSIONERATE	**:**	**Central Excise Commissionerate, Ahmedabad – I**
	CONTRAVENTION OF PROVISION	**:**	**Notification No.30/2004, dated 09.07.2004 as amended by Notification No.30/2011, dated 24.03.2011**

The assessee is engaged in manufacturing various kinds of Yarns falling under chapter 54. On verification of ER-5 and ER-6 returns of the assessee it was noticed that the Input – Output ratio of all finished goods and consumption of raw materials is 1:1 i.e. no production loss except waste & scrap. The assessee also clarified the above in writing on being asked. However, on calculation of Input – Output ratio of different finished goods for the years 2007-08 to 2010-11, it was found that the production of finished products per kilogram was more than the raw materials consumed per kilogram for all the above mentioned years. Hence, there was a surplus difference in kilograms of finished goods produced compared to the raw materials used.

On further verification of documents, it was observed that the assessee had paid duty on raw materials i.e. Partially Fully Drawn Yarn, PTY, Polyester Draw Winder Yarn as captive consumption but had not paid duty on finished goods i.e. Circular Knitted Fabrics and Wrap Knitted Fabrics by availing Notification No.30/2001, dated 01.03.2001. The average price of the raw materials per year were determined for the respective years and the value of quantity less

quantity cleared as per Input-Output norms was calculated from 2007-08 to 2010-11. The assessee was liable to pay Central Excise duty to the tune of Rs.1,29,47,342/- in total.

On being explained, the assessee did not agree to the objection and forwarded calculation tables for 2009-10 and 2010-11 but the same did not match with the data declared in the Excise Returns.

(7) GIST OF THE OBJECTION : Wrongly availed exemption for clearance of Nulcear Power Corporation of India Ltd. and to follow the procedure of deemed export

COMMISSIONERATE : Central Excise Commissionerate, Ahmedabad – I

CONTRAVENTION OF PROVISION : Notification No.12/2012-CE, dated 17.03.2012; Notification No.21/2002-Cus dated 01.03.2002

The assessee is engaged in manufacturing Industrial filters/machinery/process equipments falling under chapter 84. During the course of audit, it has been observed that the assessee had availed full exemption from payment of Central Excise duty in respect of goods cleared by them to a state petroleum company under Project Authority Certificate. The assessee had failed to mention the Central Excise Notification (12/2012-CE, dated 17.03.2012, Sr. No. 336 of the table) under which the said clearance was made.

On perusal of the above Notification and other corresponding notifications such as 21/2002-Cus dated 01.03.2002, it is observed that the said notification is applicable in respect of goods covered under Heading 9801 which is meant for Project Import where as the goods supplied by the assessee are Pressure Vessels falling under chapter 8419 which is not a complete project.

The above condition laid down in the notification is not satisfied. Thus the clearance made under Notification No. 12/2012, exemption is wrongly claimed. The assessee is liable to pay duty on such clearances to the tune of Rs.44,58,727/-.

(8) GIST OF THE OBJECTION : Non-payment of proportionate CENVAT Credit on inputs/ input services used in generation of electricity not captively used but sold to Tamil Nadu generation and Distribution corporation limited and other third parties

COMMISSIONERATE : Central Excise Commissionerate, Chennai – II
CONTRAVENTION OF PROVISION : 2 (k) (iii) & 2 (l) (ii) of the CENVAT Credit Rules, 2004

During the course of audit, it is noticed that the assessee is manufacturing and clearing Sponge Iron, Billets & TMT Bars and also generating Electricity for Captive consumption. The assessee, installed 70 MW power plant for the generation of electricity that became operational from October 2011 onwards. Coal is the principal input for the generation of Electricity through 70 MW power plant. The assessee is availing CENVAT Credit of duty paid on Coal, Distilled Water and other inputs services such as clearing & forwarding charges, operation & maintenance, etc. During the course of audit, it has been noticed that during the period from 02/2012 to 02/2013, 543556570 units of electricity were generated through the assessee's plant. Out of these, 306498428 units of electricity were sold to TANGEDCO and to other third parties.

In terms of Rule 2 (k) (iii) of the CENVAT Credit Rules, 2004, input means all goods used for generation of electricity for captive use. In other words, the goods used for generation of electricity not captively used but sold to others would not fall under the definition of inputs.

In terms of Rule 2 (l) (ii) of the CENVAT Credit Rules, 2004, input service means any service used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearances of final products upto the place of removal. In other words, the services not used in or in relation to the manufacture of final products would not fall under the definition of input services.

In the instant case, the assessee used certain inputs and input services in the generation of Electricity partially used captively and partially sold to others. The credit taken on the inputs and input services used by the assessee in the generation of electricity sold to others appears to be incorrect and in contravention of the provisions of Rule 2 of the CENVAT Credit Rules 2004 as the said goods/services do not fall under the definition of input/input service. It, therefore, appears that CENVAT Credit taken by the assessee has to be reversed in proportion to the electricity sold to others out of the total electricity generated. Total proportionate credit to be reversed works out to Rs.3,37,82,222/-. However the assessee had debited an amount of Rs.1,14,32,260/- towards input reversal for the electricity sold to TANGEDCO and other third parties in their CENVAT Credit account.

(9) GIST OF THE OBJECTION: Clearances of finished goods in the guise of reprocessed goods
COMMISSIONERATE : Central Excise Commissionerate, Kolkata-IV
CONTRAVENTION OF PROVISION : Rule 21 of the Central Excise Rules, 2002

The assessee had removed 563.42MT of paper for re-processing during the period 2011-12 but fail to produce any documents for such clearance of goods when inquired about the same during audit. On verification of ER1 return filed in the same period no indication of said clearances could be noticed. The fact of re-processing and the processes undertaken had nowhere been mentioned. The goods cleared for re-processing and the reasons thereof were not reflected in their Daily stock account. Upon enquiries, the assessee replied that the said goods have been reprocessed within their factory but no evidences were produced to justify the same. Even in cases where such manufactured products are claimed by the manufacturer as unfit for consumption or for marketing, at any time before removal, they may seek remission of the duty payable on such goods, subject to such conditions as may be imposed on the assessee by order in writing in terms of Rule 21 of the Central Excise Rules, 2002. However, no such permission was obtained from the appropriate authority. As these goods are their finished goods and have been cleared without any document the assessee is required to discharge duty on them. In view of the above, the assessee is required to pay duty of Rs.31,50,183/- along with interest, for such clearances of paper in the guise of re-processing.

SERVICE TAX

(10) GIST OF THE OBJECTION : Non - payment of Service Tax on licensing of Software Service
COMMISSIONERATE : Central Excise Commissionerate, Delhi-I
CONTRAVENTION OF PROVISION : clause (f) of section 66E of the Finance Act, 1994

The assessee has been providing software on license basis and charging license fee from their customers but had not been discharging Service Tax liability on the same. As per clause (f) of section 66E of the Finance Act, 1994, transfer of goods by way of hiring leasing, licensing or any such manner without transfer of right to use such goods is declared as service. A license to use software which does not involve the transfer of 'right to use' would neither be a transfer of title in goods nor a deemed sale of goods. Such an activity would fall in the ambit of definition of 'service' and also in the declared service category specified in clause (f) of section 66E. On being pointed out, the party agreed to the objection raised and voluntarily deposited Service Tax Rs. 29,35,67,079/-.

(11) GIST OF OBJECTION : Wrong availment of input service credit on Ineligible Services
COMMISSIONERATE : Service Tax Commissionerate, Bhopal
CONTRAVENTION OF PROVISION : Rule 2 (l) of the CENVAT Credit Rules, 2004

The assessee is a manufacturer of Cement Clinkers and Cement having multi location units in the State of Madhaya Pradesh and other State. During the course of audit on scrutiny of the input service credit accounts, it was observed that the assessee has availed input service credit on various services which are not considered "input service" as defined under Rule 2 (l) of the CENVAT Credit Rules, 2004. On this irregularity, the amount of input service credit wrongly availed worked out to the tune of Rs.21,91,754/- and on being pointed out the assessee agreed and reversed credit of Rs.2,48,135/-. The assessee has not reversed CENVAT Credit availed on ineligible input service credit by claiming that such input service was used in business activity of Cement and therefore CENVAT Credit is eligible to them. The contention of the assessee is not tenable as they could not produced any documents to establish the fact that the service in question was used in business activity of Cement, moreover some of input services claimed by the assessee

were clearly excluded from the definition of input service. Thus wrong credit availed by the assessee amounting to Rs.4,68,729/- is liable to be recovered along with interest.

(12) GIST OF OBJECTION : Non-payment of service tax on the considerations received from various companies towards removal of waste and effluents
COMMISSIONERATE : Central Excise Commissionerate, Hyderabad-III
CONTRAVENTION OF PROVISION : Section 66B of the Finance Act, 1994

During the course of audit, it is observed that the assessee had procured 'spent carbon, organic residue, process organic salt' etc, which are waste and effluent products emerging in other industries. The assessee used those products as alternate fuel in his rotary kilns. During the year 2011-12, the assessee collected Rs.2.48Crores from various pharma-companies for lifting effluents from them. Though the said activity did not seem to fall under any of the defined services up to 01.07.2012, but from 01.07.2012 onwards, services other than those mentioned in the 'negative list' attract Service Tax. The aforesaid service was neither included in the negative list nor was exempted in terms of Notification No.25/2012, dated 20.06.2012. Therefore, the audit pointed out that Service Tax of Rs.1.89 lakhs is payable on Rs.15,31,542/- collected towards the said activity.

(13) GIST OF OBJECTION : Irregular availment of CENVAT Credit on items purchased and sold while executing Works Contract
COMMISSIONERAT : Central Excise Commissionerate, Hyderabad III
CONTRAVENTION OF PROVISION : Rule 7(c) of the CENVAT Credit Rules, 2004

The assessee who is a provider of Works contract services, entered into an agreement with a company for laying of Railway sidings/ construction of a bridge. The assessee opted to pay Service Tax under 'Works Contract service' as per Rule 2 A of the Service Tax (Determination of Value) Rules, 2007. The audit verified the Cenvat account of the assessee for the year 2011-12 and noticed that the he had availed CENVAT Credit of Rs.31.14 lakhs on certain inputs such as Rail sleepers and certain electrical items, purchased from three other companies and sold the same during the execution of works contract service by paying appropriate VAT / Sales Tax. In terms of Rule 2 A of Service Tax (Determination of Value) Rules, 2007, the assessee did not include the cost of inputs sold during the execution of woks contract, in the taxable value of services

rendered. The audit pointed out that the assessee is, therefore, not entitled for the CENVAT Credit on such inputs. On being pointed out the assessee agreed to the objection and reversed the credit**.**

(14) GIST OF OBJECTION : Non-payment of Service Tax on account of payment received towards sale of under construction flats
COMMISSIONERAT : Central Excise Commissionerate, Surat-I
CONTRAVENTION
OF PROVISION : Section 65(105)(zzza) of Finance Act, 1994

The assessee is registered with the department for the services namely "Construction of Residential Complex" and "Construction Service in respect of Commercial or Industrial Building and Civil Structure". During the course of audit, on scrutiny of income tax statement made by assessee under Section 132 of Income Tax Act, it has been observed that the assessee have made disclosure before income tax authorities for receipt of an undisclosed amount of Rs. 7,62,13,500/- in the F.Y. 2012-13. The assessee is engaged in construction of residential complex and not involved in any other activity and so, it can be inferred that the assessee had his undisclosed income on account of sale of the under construction flats. On being asked about the said income, the assessee clarified that the said amount has been received as advances from the customers on account of sale of the under construction flats and he had not discharged the Service Tax liability on the said amount. The auditors pointed out the assessee that the said amount is related to the under construction flats and no other source of income is reflected in the records. Hence, Rs.7,62,13,500/- received by the assessee is related to sale of under construction flats and the same is taxable under the category of construction (residential) complex which falls under Section 65(105)(zzza) of Finance Act, 1994. Therefore, amount of Rs.23,54,997/- is required to be recovered along with interest and penalty.

On being pointed out, assessee paid Service Tax of Rs.23,54,997/- along with interest of Rs. 9,038/-.

(15) GIST OF OBJECTION : Non - payment of appropriate Service Tax on the import of manpower service
COMMISSIONERAT : Service Tax Commissionerate, Chennai
CONTRAVENTION
OF PROVISION : Section 66 of the Finance Act, 1994

During the course of verification of the records of the assessee and their agreement with his holding company located in USA, the following facts were observed.

The holding Company in USA is deputing technically qualified personnel called as International Service Personnel (ISPs) to work with assessee from time to time. For this the assessee pays the amount to holding company in foreign currency for sending the ISPs on deputation.

The assessee pays the remuneration of the ISPs who are working in India and also approves his business trips and other Business expenses of ISPs.

As the Manpower supply is provided by the holding company in USA, the assessee has to pay the Service Tax under reverse charge mechanism in terms of Sec 66 of the Finance Act, 1994. The assessee is paying Service Tax on the amount paid in foreign currency to his holding Company; however, is not paying Service Tax on other expenses incurred for ISPs in India which are paid in Indian currency. The total amount of Salary and other reimbursement on which Service Tax is liable to be paid by the assessee is Rs.7,93,35,296/-.

(16) GIST OF OBJECTION : Wrong availment of Service Tax credit on " Wind Mill Maintenance" service installed elsewhere
COMMISSIONERAT : Central Excise Commissionerate, Coimbatore
CONTRAVENTION OF PROVISION : The CENVAT Credit Rules, 2004

The assessee (100% EOU) is the manufacturers of Cotton yarn falling under the heading 5205.

On scrutiny of CENVAT Credit register and input service credit invoices, it was found that the assessee had taken credit on Service Tax paid on maintenance of wind mills located at a place away from the registered premises. As the issue on eligibility of electricity generated from the wind mills situated away from factory (transferred to Power Grid which in turn supplies the same quantum to the unit) is pending in various appellate forums, necessary action is to be taken to safeguard the revenue.

Since the assessee had not utilized the credit taken for the past three years i.e. 2009-10, 2010-11 and 2011-12, the assessee was advised to reverse the credit of Rs.56.23 lakhs.

(17) GIST OF OBJECTION : Non-payment of Service Tax on account of foreign remittances, as recipient of service

COMMISSIONERAT : Service Tax Commissionerate, Kolkata

CONTRAVENTION OF PROVISION : Section 68 of the Finance Act, 1994

In the course of audit it was observed that the assessee had not discharged the Service Tax payable on account of foreign remittances, as recipient of service. Moreover, the assessee had also received advance payment in foreign currency which was not considered for the purpose of taxable value and the same was adjusted against royalty. In this process the assessee did not consider altogether an amount of Rs. 80,08,938.00 during 2010-11 and Rs.26,92,659/- during 2011-12 as taxable value towards discharging payment of Service Tax. This resulted in short payment of Service Tax amounting to Rs.10,37,033/- and Rs.3,45,277/- respectively during the period 2010-11 & 2011-12. Accordingly, the assessee had agreed to the audit observation and paid Service Tax amounting to Rs.13,82,310/- (including Cess) along with interest of Rs.5,28,298/- and penalty of Rs.3,45,578/-.