

Chapter 3 : Internal control

The department has three methods of internal controls viz. scrutiny, audit and anti-evasion, for ensuring compliance with all legislations and rules relating to levy and collection of excise duty/service tax including rules made for Cenvat credit scheme. Keeping in view the system of self assessment the department controls the non/short levy of duty or erroneously refunds through issuance of show cause notices and confirming the same through adjudication process.

3.1 Submission of returns

As per central excise statute a manufacturer is required to file various returns viz. ER-1, ER-2, ER-3, ER-4, ER-5, ER-6, ER-7 and ER-8. Further, as per service tax statute the assessee is required to file ST-3 return.

A monthly return for production and removal of goods and other relevant particulars and Cenvat credit in the form of ER-1 by 10th of the following month is to be submitted by a manufacturer those who are not eligible for Small Scale Industries (SSI) concession.

An annual return regarding information relating to principal inputs in the form of ER-5 is to be submitted by the assessee paying duty of ₹ one crore or more per annum (either through PLA or Cenvat or both together) for the previous financial year and those manufacturing goods falling under specified chapters and headings by 30th April every year for the current financial year.

A monthly return of receipt and consumption of each of principal inputs by 10th of the following month by those assessee required to submit ER-6.

A half yearly return of taxable services provided in the form of ST-3 is to be submitted by the person liable to pay service tax within 25 days from close of half year.

During test check we observed some discrepancies in filing of various returns which are narrated below:-

3.1.1 ER-1 and ST-3 returns

As per sub-rules (7) and (9) of rule 9 of Cenvat Credit Rules, 2004, the manufacturer and service provider availing Cenvat credit shall submit within the stipulated days a monthly (ER-1) and a half yearly return (ST-3) respectively to the superintendent of central excise. Non-submission of these returns attract penalty under rule 15A of Cenvat Credit Rules, 2004.

During scrutiny of the figures furnished by 33 selected Commissionerates we observed that 244 ER-1 returns were not submitted during the period of review, but department initiated action only in respect of 89 ER-1 returns. Three² selected Commissionerates did not furnish the information. The remaining five³ Commissionerates did not deal with central excise.

During scrutiny of the figures furnished by 32 Commissionerates we observed that 8,346 ST-3 returns were not submitted during the period 2012-15, but department initiated action only in respect of 276 ST-3 returns. Seven⁴ selected Commissionerates did not furnish the information. The remaining two Commissionerates viz., Delhi I and Noida I did not deal with service tax.

When we pointed this out (April and June 2015), the Ministry stated (February 2016) that remedial action is being initiated against the defaulters.

3.1.2 ER-5 return

As per rule 9 A (1) of Cenvat Credit Rules, 2004, all assessee (other than those who have paid less than ₹ one crore for the previous financial year and those manufacturing goods falling under specified chapters and headings) are required to file ER-5 returns which is annual information on principal inputs, by 30 April every year for the previous financial year.

We observed in selected ranges of 34 selected Commissionerates that 722 number of ER-5 returns were not submitted by the assesseees during the period of review. However, the department initiated action only in 113 cases. Mumbai LTU and Raigad Commissionerates have not furnished the details. The remaining five⁵ Commissionerates did not deal with central excise.

When we pointed this out (April and June 2015), the Ministry stated (February 2016) that remedial action is being initiated against the defaulters.

3.1.3 ER-6 return

Rule 9A(3) of Cenvat Credit Rules, 2004, prescribes for submission of a monthly return of receipt and consumption of each of principal inputs in the form ER-6 return by assesseees paying those who are filing ER-5 return.

We observed in selected ranges of 33 selected Commissionerates that 4,315 number of ER-6 returns were not submitted by the assesseees during the period of review. However, the department initiated action only in 783 cases. Mumbai LTU, Hyderabad IV and Raigad Commissionerates have not

² Bilaspur, Gwalior and Pune III

³ Delhi-I ST, Kolkata-I ST, Mumbai-II ST, Mumbai-VII ST and Noida ST.

⁴ Bilaspur, Dehradun, Mumbai LTU, Noida-I, Pune III, Raigarh and Thane-I

⁵ Delhi-I ST, Kolkata-I ST, Mumbai-II ST, Mumbai-VII ST and Noida ST.

furnished the details. The remaining five⁶ Commissionerates did not deal with central excise.

When we pointed this out (April and June 2015), the Ministry stated (February 2016) that remedial action is being initiated against the defaulters.

Audit opines that non-submission of returns may lead to non-verification of duty payment by assesseees, correctness of valuation, availing of Cenvat credit, admissibility of exemption etc. It further lead to skewed population for selection of returns for detailed scrutiny. Further, in the absence of filing of ER-5 and ER-6 the department may not be able to detect the clandestine production and removal of goods by the assesseees.

During the exit conference, the Ministry stated four returns have been proposed to be discontinued from the current fiscal. It is further mentioned that difference in number of returns received corresponding to the assesseees registered is due to gap in active and non-active assesseees and provision to suspend registration temporarily for non active assesseees is being considered actively in the Goods and Service Tax (GST) law.

3.2 Scrutiny of returns

3.2.1 Preliminary scrutiny/Review and Correction

After the introduction of Automation of Central Excise and Service Tax (ACES), preliminary scrutiny of returns is being done by the system itself. The purpose of the preliminary scrutiny is to ensure completeness of information, timely submission of returns, time payment of duty, arithmetical accuracy of the amount computed as duty, closing and opening balance of Cenvat credit etc. The range superintendent is required to verify the returns thrown by the system for review and correction. He is also required to rectify the errors, if any, in the returns in consultation with the concerned assessee.

During scrutiny of 2,580 returns in selected ranges of 41 Commissionerates we observed in two cases, in Jamshedpur and Patna Commissionerates, that there were differences in the closing balance and opening balances of Cenvat credit as per the returns furnished by the assesseees. Although the system had marked the returns for review and correction, the department did not verify the differences involving availing of Cenvat credit of ₹ 14.01 lakh during the period of review. One case is illustrated below:-

M/s. TML Driveline Ltd., in Jamshedpur Commissionerate, showed the closing balance of ₹ 3.10 crore Cenvat credit in the return for the month of

⁶ Delhi-I ST, Kolkata-I ST, Mumbai-II ST, Mumbai-VII ST and Noida ST.

September 2013. However, in the return of October 2013 the opening balance of Cenvat credit was shown as ₹ 3.23 crore. Thus, there is a difference of ₹ 13 lakh, which needs examination by the department.

When we pointed this out (June 2015), the Ministry intimated (February 2016) the reversal of Cenvat credit of ₹ 13.33 lakh along with interest of ₹ 3.93 lakh.

3.2.2 Detailed scrutiny

The purpose of detailed scrutiny is to establish the validity of information furnished in the tax return and to ensure 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 upto five per cent of total returns received for a detailed scrutiny of assessment on the basis of risk parameters. Paragraph 4.2A of the Manual for Scrutiny of Service Tax Returns, 2009 stipulates that upto two per cent of the returns need to be examined in detailed scrutiny.

The data relating all India detailed scrutiny of returns for the year 2012-13 and 2013-14 have been included vide paragraph No.1.15.2 and 1.14.2 for Central Excise and Service Tax in the Audit Report Nos.7 of 2015 and 4 of 2015 respectively. However, the details of detailed scrutiny for the year 2014-15 were not supplied by the department.

Selected ranges of 21 Commissionerates⁷ out of selected ranges of 41 Commissionerates, stated that no detailed scrutiny of returns was undertaken by them. The reply from the remaining 20 Commissionerates is still awaited.

When we pointed this out (between April and June 2015), the Ministry stated (February 2016) that the work of detailed scrutiny has been initiated and during exit conference it intimated that instructions with further modalities of undertaking detailed scrutiny has been issued in June 2015.

⁷ Ahmedabad-III, Alwar, Bharuch, Bhubaneswar-I, Bhubaneswar-II, Bilaspur, Chennai-III, Dehradun, Ghaziabad, Gwalior, Hyderabad-III, Hyderabad-IV, Indore, Kochi, Noida-I (CX), Noida ST, Patna, Raipur, Ranchi, Silvassa and Thiruvananthapuram

3.3 Verification of Cenvat credit availed

ER-1/ER-3 and ST-3 returns contain a table for details of Cenvat credit taken and utilised for furnishing information regarding various types of credit taken and its utilisation for different purposes during a month/quarter. It is very important on the part of the department to verify the amount of “credit taken” as shown in these returns with the source documents such as invoices, bill of entries etc. At present department verifies the amount of credit shown in the returns in course of detail scrutiny and internal audit of the assessees.

Scrutiny of the figures as furnished by the department⁸ regarding verification through detailed scrutiny and internal audit done by department of Cenvat credit availed by the assessees falling under the selected ranges, revealed that during the period of review on an average of 33.67, 30.47 and 47.37 per cent respectively, of Cenvat credit availed by the assessees remained unverified. Specifically during 2014-15, 16 ranges out of 38 ranges had not verified the correctness of Cenvat credit availed by the assessees to the extent of 90 per cent of the credit availed by them. Further, we also noticed that most of the selected ranges as pointed out in paragraph 3.2.2 of this report had not conducted detailed scrutiny of returns and Cenvat verification was being carried for selected units by internal audit of the department. As a result a large portion of Cenvat credit which the assessees used for payment of duty/tax was not verified.

When we pointed this out (between April and July 2015), the Ministry stated (February 2016) that the action has already been initiated.

Two cases are illustrated below:-

3.3.1 We observed in Bettiah central excise and service tax range in Patna Commissionerate that neither internal audit nor detailed scrutiny of returns of M/s. HPCL Biofuels, Lauria was carried out by the department during the period of review. Consequently, Cenvat credit of ₹ 8.09 crore availed by the assessee during the aforesaid period could not be verified from the source documents like input, capital goods and input service invoices and the department completely relied upon the information provided by the assessee in its return defeating the very purpose of compliance verification mechanism of detailed scrutiny and internal audit.

When we pointed this out (June 2015), the Ministry stated (February 2016) that the assessee has been selected for audit for the period for 2015-16.

⁸ Only 38, 40 and 38 ranges out of total 129 selected ranges furnished the data for 2012-13, 2013-14 and 2014-15 respectively.

3.3.2 Similarly, in Mumbai-VII ST Commissionerate, we observed that Cenvat credit amounting to ₹ 2,835.80 crore availed and utilised by M/s. Reliance Communication Ltd., during the period of review remained unverified by the department as the department did not conduct internal audit of the unit for the period 2010-11 to 2014-15 despite the unit being one of the top service tax paying units and falling under mandatory category for internal audit. During our audit we observed non-reversal of Cenvat credit of ₹ 24.36 crore as detailed in Para 4.2.1.

When we pointed this out (June 2015), the Ministry stated (February 2016) that the assessee will be selected for internal audit in future.

During the exit conference, the Ministry stated that due to manpower constraints there is skewed coverage of internal audit and detailed scrutiny.

While acknowledging man power constraints, audit is unable to appreciate how such cases were left out from the 2,183 number of assessees paying more than ₹ three crore covered by internal audit during 2014-15.

Audit is of the view that there is a need for department to revisit the parameters for selection of cases for internal audit/detailed scrutiny keeping the existing man power constraints in view.