

# HUNDRED AND FOURTH REPORT

## PUBLIC ACCOUNTS COMMITTEE (1995-96)

(TENTH LOK SABHA)

### MODVAT SCHEME—FRAUDULENT AVAILMENT OF CREDITS

MINISTRY OF FINANCE  
(DEPARTMENT OF REVENUE)



*Presented to Lok Sabha on 9.8.1995*  
*Laid in Rajya Sabha on 9.8.1995*

LOK SABHA SECRETARIAT  
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### PART II\*

Minutes of the sittings of Public Accounts Committee held on  
21 June, 1995 and 2 August, 1995

\*Not printed (one cydostyled copy laid on the Table of the House and five copies placed in Parliament Library).

COMPOSITION OF PUBLIC ACCOUNTS COMMITTEE  
(1995-%)

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## INTRODUCTION

1. the Chairman of the Public Accounts Committee, as authorised by the Committee, do present on their behalf this Hundred and Fourth Report on Paragraph 3.48 of the Report of the Comptroller and Auditor General of India for the year ended 31 March, 1992, No. 4 of 1993, Union Government (Revenue Receipts—Indirect Taxes) relating to Modvat Scheme—Fraudulent availment of Credits.

2. The Report of the Comptroller and Auditor General of India for the year ended 31 March, 1992, No. 4 of 1993, Union Government (Revenue Receipts—Indirect Taxes) was laid on the Table of the House on 27 April, 1993.

3. In this Report, the Committee have examined a case wherein a manufacturer of motor cars in Bangalore Collectorate of Central Excise, viz., Sipani Automobiles Ltd. took modvat credits of Rs. 76.84 lakhs which were more than the duty paid on the inputs during the period February 1991-March 1992 and the excess credits so taken were utilised towards payment-of duty on final products. The Committee have found that there was an absolute breakdown of excise control and proper supervision and monitoring of the unit in availing modvat credit. There were vital lapses on the part of the departmental officers which enabled the assessee in perpetrating the fraud. These included failure to obtain the requisite documents in time, failure to order provisional assessment pending finalisation of price list, inadequacies in conducting Internal Audit, inadequate performance of anti-evasion wing to detect these cases, failure to take action promptly on the observations made by the Internal Audit, other inadequacies in internal control, delay in registering the case and issuing show-cause-notices to the assessee, delay in attachment to property of the party to realise the governmental dues even after the decision of the appellate tribunal, delay in taking action against the officers etc. The Committee are of the firm view that the assessee would not have succeeded in his efforts in defrauding the Government repeatedly without the active connivance of the departmental officers. While deploring such an unhealthy tendency in the prime revenue earning department of the country, the Committee have recommended that the facts stated in this report should be thoroughly inquired into with a view to finding out as to how and why the lapses occurred, to what extent they were *bona fide* mistakes and taking stern action against all the officers found responsible for the same. Government should also ensure that such economic offences are dealt with sternly and promptly so that it acts as a deterrent for similar fraudulent activities. The Committee have desired the action taken in the matter to be reported to them within a period of three months.

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4. During the course of examination, the Committee have found several similar **cases** of misuse of modvat scheme involving the same assessee as well as others. In their opinion this clearly showed that misuse of modvat facility is fairly wide-spread. They have been concerned to note that even after the introduction of the invoice based assessment w.e.f. 1 April, 1994 which **was** intended *inter-alia* to prevent misuse of the scheme, similar instance of misuse continue to recur unabated. Pointing out that modvat was a facility extended to the manufacturers, the Committee have recommended that Government should consider making necessary provisions in the Law to withdraw the facility whenever the same is found to have been misused/abused.

5. While pointing out the inadequacies in the internal control mechanism of the department, the Committee have emphasised that internal audit is an important tool of management control particularly in an organisation like Central Excise which is responsible for administering vital revenues of the Government and therefore, it is imperative that the Board take suitable steps and ensure that this instrument is efficiently used in exercising effective control and checking leakage of revenue. The Committee have therefore, recommended that Ministry of Finance should look into the functioning of the Internal Audit of the Central Excise Department with a view to improving its efficacy. In this connection they have also recommended that the Ministry/Board should proscribe a time frame for the follow up action on objections raised by internal audit.

6. The Committee have observed that the excess /fraudulent credits availed by the assessee in the cases under examination had enabled him of interest free funds at different points of time. In this connection, the Committee have noted that although provisions have been made in the Central Excise Law, through recent amendments, for charging of interest for delayed payments, the amended provision does not take into account the present type of cases where the assessee had himself rectified the mistake and the Excise Department had not determined the duty payable. They have, therefore, recommended that the Ministry of Finance should consider the desirability of incorporating suitable provisions in the law for collection of interest on excess/fraudulent modvat credit as in the present cases examined by the Committee.

7. The Modified scheme of Value Added Tax has been in existence in India for more than nine years. The Committee have found that no comprehensive Evaluation of the system has been undertaken so far. They were, however, informed that the Ministry have now asked the National Institute of Public Finance and Policy to make a comprehensive study of the system and suggest measures for the simplification of the procedures relating to Modvat, particularly in the light of the instances of misuse of modvat credit noticed in recent times. The Committee has emphasised, the need for expeditious completion of the study and for initiating further necessary measures in order to ensure that the scheme sub-serves its purpose.

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8. The Committee examined Audit Paragraph 3.48 at their sitting held on 21 June, 1995. The Committee considered and finalised the report at their sitting held on 2 August, 1995. Minutes of the sittings form Part-II\*of the Report.

9. For facility of reference and convenience, the observations and recommendations of the Committee have been printed in thick type in the body of the report and have also been reproduced in a consolidated form in Appendix-V to the Report.

10. The Committee place on record their appreciation of the commendable work done by the Public Accounts Committees, 1993-94 and 1994-95 in obtaining information for this Report.

11. The Committee would like to express their thanks to the officers of the Ministry of Finance (Department of Revenue) for the co-operation extended by them in giving information to the Committee.

12. The Committee place on record their appreciation of the assistance rendered to them in the matter by the Office of the Comptroller and Auditor General of India.

New Delhi;  
4 August, 1995  
13 Sravana, 1917 (Saka)

RAM NAIK,  
Chairman,  
Public Accounts Committee.

\*Not printed (one cyclostyled copy laid on the Table of the House and five copies placed in Parliament Library).

## REPORT

### MODVAT SCHEME—FRAUDULENT AVAILMENT OF CREDITS

#### Modvat Scheme—an introduction

The Modified Value Added Tax (Modvat) Scheme was introduced with effect from 1 March, 1986 with a view to progressively relieve inputs from excise and countervailing duties so as to mitigate the cascading effect of duties and to provide a transparency which discloses full taxation of the product. The scheme provides for taking instant credit of duty paid on specified inputs and its utilisation towards payment of duty on specified final products. The provisions of the scheme are contained in Rules 57 A to 57 J of the Central Excise Rules, 1944. Application of the Rules is guided by issue of notification by the Government and instructions by the Central Board of Excise and Customs (CBEC).

2. Rule 57 G of the Central Excise Rules, 1944 prescribes the procedure to be followed and observed by the manufacturers who intend to avail the benefit of Modvat Scheme. According to this Rule, a manufacturer who intends to avail the benefits of Modvat Scheme shall file a declaration with the jurisdictional Assistant Collector indicating the description of the final products manufactured in his factory and the inputs intended to be used in each of the said final products. Only after obtaining a dated acknowledgement of the said declaration from the Department the manufacturer is eligible to take credit of duty paid on the inputs available under the Scheme. Credit can be taken by the manufacturer only on the basis of Original duty paying documents such as gate pass, ARI, Bill of entry under cover of which the inputs have been received in the factory or any other documents proscribed by the CBEC evidencing payment of duty on such inputs. It is mandatory on the part of the manufacturer to maintain a register in the form of RG 23A in Parts-I and II for accounting the quantity of inputs received and their utilisation in the manufacture of the final products (Part-I), amount of credit taken on the inputs, the amount of credit utilised towards payment of duty on the final product and the balance available with him (Part-II). It is the duty of the manufacturer to submit a monthly statement to the Jurisdictional Superintendent of Central Excise indicating the particulars of inputs received and the amount of credit taken alongwith extracts of Part I & Part II of form RG 23A within five days of the close of the month. The original duty paying documents evidencing the payment of duty on the inputs is also required to be submitted alongwith the monthly statement.

### Audit Paragraph

3. This Report is based on paragraph 3.48 of the report of the Comptroller and Auditor General of India for the year ended 31 March, 1992, No. 4 of 1993, Union Government (Revenue Receipts—Indirect Taxes) which is reproduced as Appendix-I. The Audit paragraph dealt with certain cases wherein a manufacturer of motor cars in Bangalore Collectorate of Central Excise was stated to have fraudulently taken modvat credits of Rs. 76.84 lakhs which was more than the duty paid on the inputs and the excess credits so taken were utilised towards payment of duty on final products.

### Facts of the Case

4. The assessee involved in the cases pointed out by audit was stated to be Sipani Automobiles Ltd. a manufacturer of Motor Car located at No. 2S26, Industrial Suburb, II stage, Tumkur road, Bangalore, falling under the jurisdiction of Yeshwanthpur-I Range of Bangalore VII Division of the Central Excise Collectorate, Bangalore. The fraudulent & irregular credits were reportedly availed of by the assessee in the following manner:

- (i) Inward gate pass dated 31 October, 1991 showed that duty of Rs.8,800 was paid by the assessee and the same was taken as credit on 26 December, 1991. The assessee however, again took the credit for Rs.8,80,000 on 19 March, 1992 on the basis of the same gate pass.
- (ii) On another gate pass dated 18 February, 1991 duty paid on inputs was Rs. 43,116 for which credit was initially taken by the assessee on 19 February, 1991. However, the assessee took credit again for Rs.43,11,600 on the same gate pass on 29 March, 1991.
- (iii) On yet another gate pass dated 30 March, 1992 duty paid was Rs. 22,690 but the assessee took credit for Rs.22,69,000 on the same day.
- (iv) The closing balance in the register prescribed for accounting the duty paid on the inputs and the credits taken there against on the final products viz. RG 23A Part-II for the month of September, 1991 worked out was Rs. 1,41,113 whereas the assessee showed the closing balance as Rs. 4,30,379 resulting in excess account of credit of Rs. 2,89,266.

SI. No.	Number/date of GP-I	Initial credit taken as per GP-I	Fraudulent credit	Abusus Operandi adopted	Operandi (Out of Col taken	Credit reco (Out of Col taken	f
1	2000	1000	1000	1000	1000	1000	1000
2	2001	1000	1000	1000	1000	1000	1000
3	2002	1000	1000	1000	1000	1000	1000
4	2003	1000	1000	1000	1000	1000	1000
5	2004	1000	1000	1000	1000	1000	1000
6	2005	1000	1000	1000	1000	1000	1000
7	2006	1000	1000	1000	1000	1000	1000
8	2007	1000	1000	1000	1000	1000	1000
9	2008	1000	1000	1000	1000	1000	1000
10	2009	1000	1000	1000	1000	1000	1000
11	2010	1000	1000	1000	1000	1000	1000
12	2011	1000	1000	1000	1000	1000	1000
13	2012	1000	1000	1000	1000	1000	1000
14	2013	1000	1000	1000	1000	1000	1000
15	2014	1000	1000	1000	1000	1000	1000
16	2015	1000	1000	1000	1000	1000	1000
17	2016	1000	1000	1000	1000	1000	1000
18	2017	1000	1000	1000	1000	1000	1000
19	2018	1000	1000	1000	1000	1000	1000
20	2019	1000	1000	1000	1000	1000	1000
21	2020	1000	1000	1000	1000	1000	1000
22	2021	1000	1000	1000	1000	1000	1000
23	2022	1000	1000	1000	1000	1000	1000
24	2023	1000	1000	1000	1000	1000	1000
25	2024	1000	1000	1000	1000	1000	1000
26	2025	1000	1000	1000	1000	1000	1000
27	2026	1000	1000	1000	1000	1000	1000
28	2027	1000	1000	1000	1000	1000	1000
29	2028	1000	1000	1000	1000	1000	1000
30	2029	1000	1000	1000	1000	1000	1000
31	2030	1000	1000	1000	1000	1000	1000
32	2031	1000	1000	1000	1000	1000	1000
33	2032	1000	1000	1000	1000	1000	1000
34	2033	1000	1000	1000	1000	1000	1000
35	2034	1000	1000	1000	1000	1000	1000
36	2035	1000	1000	1000	1000	1000	1000
37	2036	1000	1000	1000	1000	1000	1000
38	2037	1000	1000	1000	1000	1000	1000
39	2038	1000	1000	1000	1000	1000	1000
40	2039	1000	1000	1000	1000	1000	1000
41	2040	1000	1000	1000	1000	1000	1000
42	2041	1000	1000	1000	1000	1000	1000
43	2042	1000	1000	1000	1000	1000	1000
44	2043	1000	1000	1000	1000	1000	1000
45	2044	1000	1000	1000	1000	1000	1000
46	2045	1000	1000	1000	1000	1000	1000
47	2046	1000	1000	1000	1000	1000	1000
48	2047	1000	1000	1000	1000	1000	1000
49	2048	1000	1000	1000	1000	1000	1000
50	2049	1000	1000	1000	1000	1000	1000
51	2050	1000	1000	1000	1000	1000	

6. Under the Central Excise rules the assesses are required to maintain an account current, [Personal Ledger Account (PLA)] with the Excise Department showing the cash deposits made in the nominated bank and debits made on account of duty paid on the excisable goods manufactured and removed by him. It is the responsibility of the manufacturer to see that there is adequate balance in the PLA to cover the duty due on the goods intended to be removed. It was brought to the notice of the Committee by Audit that the excess credits taken by the assessee in the four cases mentioned above at different points of time had resulted in overdrawing atleast in 45 instances in the PLA during the period 1990—92. When enquired about overdrawals during 1990—92 the Ministry of Finance (Department of Revenue) in a note furnished to the Committee after evidence stated that it was a fact that the assessee had resorted to clearance of goods without having sufficient balance in their PLA amounting to overdrawals on 50 different occasions.

#### Failure in Scrutinising the Documents

7. The Committee enquired about the procedures prescribed in the Department in order to ensure that no manufacturer wrongly or fraudulently avails of credit of duty paid or inputs used in manufacture of final products. The Ministry of Finance (Department of Revenue) in a note enumerated the various instructions issued by the Central Board of Excise and Customs to the field formations in this regard. According to the Ministry, an assessee availing MODVAT Credit was required to file a monthly return within five days after the close of each month, indicating the particulars of the inputs received and utilised alongwith credit taken and submit extracts of RG-23A Parts-I and II and the original duty paying documents. The instructions *inter-alia* also required that:

- (a) 100% check of duty paying documents be done by the departmental officers where credit taken exceeded Rs. 10,000 from the units from where the said inputs have been received in order to ensure that the duty paying documents were original and genuine.
- (b) the duty paying documents should be verified and defaced within 15 days of the close of the month so that no manufacturer avails of the credit twice on the same documents.
- (c) the departmental officers verify the correctness of the entries in the relevant register RS-23A with the original duty paying documents.

8. According to the Ministry the fraudulent credit availed by any assessee, if any, would have been detected during such verification by the Range Officer himself.

9. The Committee desired to know whether the prescribed procedure was followed in this case and if so as to why the fraudulent availment of

excess credit of duty in these cases could not be detected by the excise officers. The Ministry of Finance (Department of Revenue) in a note stated that the Departmental Officer failed to detect the case essentially for the reasons that the concerned officer did not cross check in time the entries in the RG-23A with the original duty paying documents and that the assessee did not furnish the duty paying in respect of inputs, while submitting the extracts of RG-23A as required under Rule S7G of the Central Exise Rules, 1944.

10. From the copies of certain documents furnished to the Committee it was seen that although the assessee was required to submit within five days after the close of each month original duty paying documents alongwith extracts of RG-23A Part-I and Part-II, he had not been submitting the original duty paying documents from April, 1989 to 20 July, 1992. It was also seen that in one case the assessee had taken MODVAT credit on the same date of the issue of Gate Pass although the goods had been despatched from far off placc like Bombay by road.

11. As regards compliancc of the prescribed defacing of documents, the Ministry in their note stated that the original gate passes were not defaced as the assessee had not produced them alongwith the monthly extracts of RG-23A submitted with the RT-12 returns. The Ministry added that the gate passes had subsequently been defaced.

12. When asked about the departmental failure in scrutinising the documents, the Secretary, Department of Revenue deposed in evidence:

“I must admit that this is a dear-cut case of failure on the part of the officers in exercising the checks that they were required to cxrcisc in regard to MODVAT schcmc on the basis of the instructions dearly issued to them from time to time since the introduction of the MODVAT. The Officers who arc in chargc of receiving the documents, *i.e.* monthly returns, did not bother to see whether the Gate Passes have been defaced or they arc in accordance with the monthly returns which are used for cross-check or whether the papers that have been given are correct or whether they arc not tampered with. Even after the lapse of time they did not check these things. There has been complete failure on the part of the officers and on this account action has already been initiated against the people who were supposed to check.”

13. While explaining the failure to detect the irregularity the Ministry of Finance (Department of Revenue) in another note stated that the Range Officer had kept verification of RG 23A as well as the prescribed monthly returns *i.e.* RT-12 pending since the approval of the price list was held up on account of pending Valuation dispute.

14. The Committee asked whether it was the practice in the department to keep such verifications pending till approval of price lists particularly where it is held up due to valuation dispute. The Secretary, Revenue deposed in evidence:

“The provision in the law is that if the price list has not been approved, then with the approval of the Assistant Collector, the provisional assessment can be made. The Assistant Collector Has to pass an order saying that the goods be assessed provisionally and take a bond from the manufacturer to cover the difference in the duties based on the final approved prices. That is how the system is working, if the price list is not approved.”

15. On being further asked whether it was justifiable in this case to keep the checkings prescribed for MODVAT pending, the Member, CBEC replied in evidence:

"We have issued guidelines on this point. In case there is any provisional assessment, as far as the returns arc concerned, they must be verified because 'the credit has already been taken and: utilised. In this case, the price list had not been approved but the Range Suptt. had no justification to do away with verification whether all the documents had been submitted or not. At least that should have been done. Had he done that, he would automatically be required to comply with the related instructions. Thereby soon as they were submitted, the second time use of the very same documents could have been prevented. Even the case of double zero could have been prevented. There was a failure on his part by not checking the documents when they were submitted.”

16. Commenting on the departmental failure to carry of the prescribed check, the Secretary, Revenue deposed during evidence :

“If the officers had' checked it the way in which they were required to check it, as per the instruction given by the Government in the implementation of MODVAT, then these things would have come to light. They did not do it; they have failed to do it.”

17. When asked to comment on the failure of the departmental officers in carrying out the instructions issued by the Board from time to time, the Member, CBEC stated in evidence:

“It has been a matter of quite an anxiety for us also.”

18. Recounting the remedial action available in this regard the witness further stated:

“The remedial action or the monitoring system in a big organisation like ours is through inspection. Since the field formations arc well institutionalised, we have a s^tem of inspections by officers. Assistant Collectors and upward also by members. They arc required to send their inspection reports'to the Director General of Inspection who analyses them and then in the

light of the findings that are thrown up in these inspection reports they issue further instructions.”

19. In this connection the Secretary, Revenue further added that yet another mechanism of check was available through the inspection conducted by the Director General (Anti-evasion).

20. The Committee desired to know whether any records were maintained indicating the details of the assesses whose records had been verified by the departmental officers and whether these records were made available to Audit, the Member, CBEC stated in evidence that a register was being maintained by the range officer assesses-wise in which he states the work done by him during the course of a particular month and these records are to be seen by whosoever will be visiting the office.

#### Failure of Internal Control Mechanism

21. The Committee desired to know the mechanism available in the department to exercise effective control in ensuring that the prescribed procedures are actually followed. The Ministry of Finance (Department of Revenue) in a note stated that the internal Audit parties of the department at the time of periodical audits are also required to re-check the duty paying documents and statutory records. Further in the course of inspection of the range/factory the Divisional Assistant Commissioner was required to look into among other things on the various aspects of MODVAT credit availment and utilisation thereof.

22. The Ministry in their note also enumerated the following types of controls prescribed for checking fraudulent availment of MODVAT.

- Scrutiny of records of factories by anti-evasion wing of all units availing MODVAT credit of Rs. 25 lakhs and above annually.
- Special audit of all units availing credit of 10 lakhs and above per annum.
- Collectors to set up surprise squads for verification of MODVAT credit and cases of fraud/misuse were to be proceeded against expeditiously.

23. When asked as to what were the reasons for the failure of the control mechanism in detecting the irregularities in the cases under examination in time, the Ministry of Finance, (Department of Revenue) stated in a note submitted after evidence as follows:

“Had the Range Officer compared the amount of duty in the gate pass with the credit taken he would have easily detected the fraud committed by the assessee. The R.O. instead gave an explanation that the assessee did not produce the original duty paying documents for defacement alongwith the extracts of RG-23A submitted with the RT-12 return. He could not therefore verify the entries in RG-23A extract in the absence of original duty paying

documents. This explanation has not been accepted. Therefore, this is a case of human failure and not due to an inadequacy in the system control.”

24. The Committee wanted to know the frequency of visits proscribed for the internal audit to visit the premises of the asscsccs and scrutinise the documents. The Ministry of Finance (Department of Revenue) stated in a note submitted after evidence that as per para 6 of audit manual Central Excise-compiled as on 31.3.1981 for units under Record Based Control, the frequency of audit prescribed was twice a year.

25'. In reply to a question as to whether the premises of the assessee were visited and necessary scrutinise carried out in this case as per the time frame laid down, the Ministry of Finance (Department of Revenue) stated in a note submitted after evidence as follows:—

“During the period from 1990 to 1992. the Internal Audit visited the unit on the following dates covering the periods mentioned against each of them:

Date of visit of the unit	Periodcovered
5.12.90 to 8.12.90	12/89 to 11/90
29.7.91 to 31.7.91	12/90 to 6/91
17.8.92 to 20.8.92	7/91 to 7/92

The Commissioner, Central Excise, Bangalore has informed that the prescribed frequency of visit could not be done due to pressure of heavy work and constraint of required number of audit parties.”

26. The Committee wanted to know the reasons for the failure of the internal audit in detecting all the irregularities committed by the assessee in the case under examination. The Ministry of Finance (Department of Revenue) stated in a not submitted after evidence as follows:—

“Internal Audit Department (IAD) had undertaken the audit of records for the period from 12/90 to 6/91 during their visit from 29.7.91 to 31.7.91 and were able to detect one case of fraudulent availment of MODVAT to the tunc of Rs. 43.12 lakhs. Audit of the subsequent period from 7/91 to 7/92 was undertaken by IAD from 17.8.92 to 20.8.92, after CERA had already detected the other cases.”

27. It was seen from the information furnished to the Committee that the internal audit report for the period December, 1990 to June, 1991 which was conducted from 29 July, 1991 to 31 July, 1991 was issued in October, 1991 and the cop'y was issued to the Assistant Collector and also to the Range staff. It was only on 2 March, 1992 i.e. after five months, the range officer had asked the assessee to produce the documents for verification and defacing. The documents were handed over by the assessee voluntarily on 20 July, 1992.

28. The Committee also enquired about the other types of control exercised for checking misuse of MODVAT. When asked to indicate the number of mandays of surprise checks conducted by the Collectors in each of the last three years and the additional amount of revenue demanded and collected on the basis of such surprise verifications, the Ministry of Finance (Department of Revenue) in a note submitted after evidence stated that the information was being collected from the field formation and will be submitted as soon as received.

29. From the information made available to the Committee it was also seen that the assessee had paid duty through RG 23A amounting to Rs. 63.13 lakhs in 1990-91 and Rs. 59.97 lakhs in 1991-92. Thus, the records of the Unit ought to have been scrutinised by anti-evasion wing during those years since the MODVAT credit availed by them had exceeded Rs. 25 lakhs per annum. Similarly, the Unit also ought to have been subjected to special audit since the Modvat credit availed by them had exceeded Rs. 25 lakhs per annum.

30. Commenting on the performance of the internal control mechanism in the case under examination, the Secretary, Ministry of Finance (Department of Revenue) stated in evidence:

"We have gone through the case in the last few days and we found that probably higher level checks which should have been exercised have also not been done."

31. On being asked about the measures proposed by the Ministry to strengthen the mechanism of internal control including internal audit in order to make excise control more effective, the Ministry of Finance, (Department of Revenue) stated in a note submitted after evidence:

"Central Excise Rules were amended in March, 1986 to provide for the facility of Modvat credit. Since this scheme was introduced for the first time, the field formations had raised number of doubts and sought for clarifications on various matters. Detailed instructions, therefore, were issued not only after introduction of the Budget in March, 1986 but also subsequently issued and clarifications were given by the CBEC on the doubts expressed by the field formations."

#### Action Taken against the Assessee

32. The Committee wanted to know the penalties which were prescribed under the law to punish such manufacturers who fraudulently take credit of duty paid on inputs. The Ministry of Finance (Department of Revenue) in a note stated that action could be initiated under Rules 571, 173Q and 209 of the Central Excise Rules. Further, Section 9 of the Central Excises and Salt Act, 1944 provides for imprisonment for a period upto seven years.

33. On being asked about the action taken against the assessee in the present case, the Ministry of Finance (Department of Revenue) in a note stated that two offence cases O.R.No. 4/92 dated 1, June, 1992 and 5/92

dated 27 July, 1992 were registered by the Range Superintendent against Sipani Automobiles Ltd. For the contravention of Rule 9(1), 173G, 173F, 57A, 57F, 57G and for the specific offence under Rule 173(Q) (bb) and 173Q (1) (d) of the Central Excise Rules, 1944. A combined show cause notice for both the offence cases was also stated to have been issued by the Collector of Central Excise, Bangalore.

34. When asked about the status position, the Member, CBEC deposed in evidence:

'The show cause notice covering the four cases was issued on 3.8.1993 and was adjudicated on 16.11.1993. Penalty of Rs. 10 lakhs has been imposed. As far as the duty differential is involved *i.e.* credit taken by him, that had already been reversed. Against this order, he went to Tribunal. The Tribunal ordered him to pre-deposit Rs. 5 lakhs before the case could be heard by them. He failed to comply and CEGAT dismissed the appeal on 2 January, 1995. In the meanwhile we have recovered Rs. 4.78 lakhs from the party and for the balance we have attached some assets of the party whose value is more than Rs. 10 lakhs.'

35. In reply to a question the Member, CBEC stated in evidence that the attachment order was issued on 16.6.1995.

36. On being enquired about the reasons for the delay in issuing the order of attachment, the Ministry of Finance (Department of Revenue) have stated in a note furnished after evidence as follows:

“Conditional stay order was given by Tribunal for pre-depositing Rs. 5 lakhs of penalty vide order dated 9.3.1994. This was subsequently extended finally upto 13.12.1994. Hence no attachment order could have been issued upto 31.12.1994 since this was covered by CEGAT's stay order. However after 31.12.1994 efforts were made to initially recover the amount by persuasion. Since party failed to pay the amount of entire penalty, finally the attachment was done on 16.6.1995 for the rest of the amount of penalty due *i.e.* for Rs. 5.22 lakhs and goods valued Rs. 12.6 lakhs have been detained.”

37. The Committee enquired about the adequacy of penalty imposed in this case term of the provisions of the law. They were informed that as per Central Excise Law the assessee could be penalised by way of confiscation of goods and imposition of penalty, not exceeding three times the value of the offending goods. When asked about the penalty that could have been levied in terms of the above provision, the Member, CBEC stated in evidence.

“It could be Rs. 4 crores to Rs. 5 crores. From the nature of the transaction, it can be seen that although it is a mala fide intention and he did it repetitively\* the duty that was evaded by him was made good after a lapse of time.’\*’

38. The Committee further desired to know about the interest that the party might have earned on the excess credits availed by the party. The Secretary, Revenue stated in evidence:

“We have done the calculation taking 18 per cent of the rate of interest. He would have got a benefit of Rs. 2.2 lakhs. The penalty imposed was Rs. 10 lakhs.”

The witness further stated:

“Now we have made a provision in the law to levy interest on such delayed payment.”

39. When asked for the details of the new provisions incorporated in the law referred to above, the Ministry of Finance (Department of Revenue) in a note furnished after evidence stated:

“Through Finance Act, 1995, new provision namely Section 11 AA and Section 11 BB have been introduced to the Central Excises and Salt Act, 1994. The new Section 11 AA provides for charging of interest on the duty determined under sub-section 2 of Section 11 A and not paid within three months from the date of such determination. The interest chargeable had been prescribed as 20%. Similarly, the new Section 11 BB provides for paying interest to the manufacturers/persons where amount due to them is not refunded within three months from the receipt of the application under sub-section 1 of Section 11 B of Central Excise & Salt Act, 1944. The interest rate prescribed in this regard is 15%. Similar provision have also been made by amending Rule 571, 57P and 57U and 1731 of Central Excise Rules, 1944 for non-payment of irregular Modvat credit availed by the manufacturers.”

40. Asked whether those provisions were relevant in the type of cases under examination particularly where the assessee had himself rectified the mistake and the Excise Department had not determined the duty payable, the Ministry in a note furnished subsequent to evidence stated:

“The amended provision provide for charging of interest in such situation where the irregular Modvat credits taken is noticed by the department/or the audit and a demand notice is issued. However in cases pointed out by the audit the department can proceed against the assessee by issuing a show-cause-notice for penal action and the adjudicating authority can impose a penalty upto three times the value of the goods and which will cover even the interest element gained by the assessee.”

41. In this connection it was seen from the correspondence exchanged between the Collectorate and the Ministry that the Collector in his letter dated 14 October, 1992 had indicated about demanding of interest 18% for the excess credits taken but in the absence of specific provisions, the

show-cause-notice was not issued and it was felt that the quantum of interest is to be considered in the form of penalty.

42. As regards initiation of prosecution proceedings, the Ministry in a note stated that they have launched prosecution under Section 9 of the Central Excises and Salt Act, 1944 against the company, its Managing Director and the Deputy Commercial Manager on 15 July, 1994 in the Economic Offences Court. On 30 November 1994, the assessee had filed a writ petition in the Karnataka High Court for quashing of the prosecution complaint filed by the Department and hence hearing was adjourned. According to the Ministry, the matter was being vigorously pursued to move the Court for an early hearing and the decision.

43. When asked about the adequacy of the action taken against the assessee keeping in view the seriousness of the offences committed by him, Secretary, Revenue during evidence stated:

“In fact, he should have been arrested for these offences and the officers have got the power to arrest in such cases where fraud has been perpetrated against the Government by manipulating the documents which he is supposed to submit to the Government to form part of a permanent record. He has manipulated those documents and tried to defraud the Government. He should have been arrested. He do take stringent action against the people concerned. In this particular case, action should have been taken. We have to find out why such action has not been taken, how dubious methods and unhealthy methods were adopted in evading the duty to the Government. Also, he has tried to defraud the Government. In fact, this is a case where a senior officer has to investigate why there has been a total failure to check the malpractices of this man over the years/”

#### Action Against Departmental Officers

44. The Committee desired to note whether any inquiry had been conducted to ascertain the extent of involvement of the departmental officials in facilitating fraudulent availing of credits and its utilisation by the assessee. The Ministry of Finance (Department of Revenue) in a note stated:

“It has been reported that the Collector did not find any indication of involvement of the departmental officials in facilitating the assessee availing and utilising the excess modvat credit fraudulently. However, it does appear that there were lapses on the part of the concerned officials which enabled the party to avail and utilise the excess credit for some time and that these lapses were responsible for the non-conduction of the said irregularities by the same officials. The explanation of the concerned officials has been called to ascertain how such lapses had occurred/”

45. When asked as to whether any inquiry had been carried out to find out if there is any conspiracy to cheat the Government, the Secretary, Revenue *inter-alia* stated during evidence:

“I do not think we have carried out any inquiry whether it was an effort to cheat the Government. In any case they cheated the Government, there is no doubt about it. There has been an effort to establish a conspiracy with these officers that will come out only in the inquiry which has been ordered. Chargesheet has been issued. We have to find out whether they are hand in glove with them.”

46. On being asked as to why plugging of the fraudulent system was not done when in October, 1991 itself the Department were aware of the irregularities through the Internal Audit, the Secretary, Revenue *inter-alia* stated:

“I agree that the officers who were there had totally failed to carry out the instructions of the Government in this case and they deserve to be punished. And that is why the chargesheet has been issued to them.

47. Asked as to when the chargesheet was issued, the Secretary, Revenue stated that it was issued on 15 June, 1995.

48. The Committee desired to know the details in respect of the officers against whom chargesheets had been served and the present status of the same. The Ministry of Finance (Department of Revenue) stated in note submitted after evidence as follows:

“Chargesheets to three departmental officers of the rank of Inspector have already been issued on 15.6.1995:—

- (i) Shri G. Prakash
- (ii) Shri U.N. Sharma
- (iii) Shri J.K. Sudhakara

The proceedings against the range officer, since retired, and against the Assistant Commissioner are also in process in consultation with the Commissioner Vigilance and Central Vigilance Commission.”

49. As regards the question as to why it had taken such a long time to issue the Chargesheet, the Member, CBEC deposed:

“The cases against the officers were taken up according to reports that we had from the Collectorate. After the case has been adjudicated by the concerned Collector. The explanation of the officer was called for and I have no hesitation in admitting that there has been an inexplicable delay in proceeding against the officer.”

50. In a subsequent note submitted after evidence the Ministry of Finance (Department of Revenue) indicated the following reasons for the delay in serving the chargesheet:

“The initial impression of the then Collector was that there was no involvement of the officials in facilitating availment of credit and its subsequent utilisation. On re-examination it was noticed that the Range Officer had not taken up the verification of extracts of Part-I & Part-II of RG 23A alongwith other statements of RT 12 returns for want of approval of price lists, which were pending on account of valuation dispute. Thereafter the explanation of all the officers concerned was called for. Their explanations were received and scrutinised. There was certain delay in finally deciding to proceed against the officers. This part frequent long leave availed of by Superintendent (Vigilance) on health grounds delayed the processing of the case from the vigilance angle. As regards the chargesheets against the range officer and the Assistant Commissioner, the chargesheets have not been issued as the report of the Commissioner has been received recently and the same has to be examined in consultation with the Central Vigilance Commission.”

51. The Committee enquired about the role of the Collector concerned at the relevant time. The Secretary, Department of Revenue stated in evidence:

“No inquiry has yet been ordered against the Collector because on the scrutiny of the entire cases we found that the responsibility of the Collector is slightly remote. But now I find that as the internal audit functions directly under him, we will not probably be penalising him too much by asking him to furnish his explanation as to why, when the internal audit memo was seen by him, he had not taken any action to supervise the company himself.”

The witness subsequently added:—

“Definitely, the Collector has also not exercised his supervisory responsibility to the extent to which he should have done. We will ask for the explanation and on that, action will be taken against the Collector also.\*’

52. On being asked whether, any action has since been taken against the Collector concerned for his lapse, the Ministry of Finance (Department of Revenue) stated in note submitted after evidence:

“After the hearing before the Committee on 21.6.95 an officer of the rank of Additional Secretary was deputed to conduct on the spot inquiry about the possible lapse on part of the then Collector. The matter is under examination”.

## Other Similar Cases

53. At the instance of the Committee, the Ministry of Finance (Department of Revenue) furnished a list of similar cases of fraudulent availment of Modvat credit noticed which has been shown as Appendix II.

54. A scrutiny of the cases revealed that the involved either excess/double of fraudulent availment of Modvat credit. The same assessee, *i.e.* Sipani Automobiles Ltd. was found having availed of fraudulent credit of Rs. 1,23,090. The irregularity was detected by the Department on 15 July, 1993 and an offence case booked on 16 July, 1993.

55. When the above mentioned case which indicated repeated indulgence by the assessee in the same irregularity, was brought to the notice of the Ministry/Board, the Member, CBEC stated in evidence:

"I am informed that since 1993, there has been no such case... What we have done is to tighten our control over the factory through our Collector...The (the assessee) have shifted their operations from the earlier premises to another premises and it is the new premises where we are exercising this control."

In this connection, the Secretary, recommended:

"The Collector has told us that he has physical control over the movement of everything to ensure that this kind of fraud is not perpetrated by him. We will have to see how long he is going to behave in this manner."

56. It was also seen that the Collector of Central Excise Bangalore in his letter dated 1 September, 1993 addressed to the Member, CBEC has stated that an undertaking was obtained from the assessee that will not avail any irregular Modvat credit in future.

57. The Committee asked whether in addition to the cases mentioned in the audit paragraph and the one additional case referred to above any further similar cases involving the same assessee were detected and if so, the action taken thereon. In a note furnished after evidence, the department of Revenue indicated the following details:

Fraudulent Availment of Mods at Credit By M S Sipani Automobiles Ltd During April & May, 1995

Sl. No.	Invoice No. and date	Date of taking credit	Total credit due	Total credit taken	Excess credit taken	Date of recovery reversal
1	2	3	4	5	6	7
1.	1/3.4.95	14.4.95	37. (KKi-	92.5(10-	55,500-	22.4.95
2.	ms.4.95	25.4.95	37.UHO-	92.500 •	55,500-	22.6.95

1	2	3	4	5	6	7
3.	1 £20.4.95	8.5.95	37.<HKK	92.5(Ky-	55.50(y.	22.6 95
4.	14*21.4.95	8.5.95	IS'-	1.501*	1.48V-	9.6.95
5.	B4E2129' 25.5.95	27.5.95	3.81.157/-	3,91,157'-	10,00(K-	9.6.95
Total:			4.92.172'-	6.70.157/-	1.77.98V-	

Note:—In respect of invoices at SI.Nov 1.2 & 3 credit has been taken to the extent of value of the goods shown in the invoices instead of duty of excise; in r/o invoice at S.No. 4 credit has been taken at HIM times inflated rate and in respect of invoice at S.No. 6, instead of credit of Rs. 3.81.157/- as duty of excise paid on the input invoice the assessee took credit of Rs. 3.91.157/- i.e. excess credit of Rs. 10,000.

58. As regards the action taken thereon, the Ministry have stated in the same note that an offcncc ease was booked under OR No. 16/95 dated 4 July, 1995 after detailed investigation and the show cause notice was being issued. According to them further necessary action including action against officers found responsible for not initiating timely action was being initiated.

#### Role of The Ministry/Board

59. The pragraph was selected for detailed examination by the Public Accounts Committee (1993-94 and 1994-95) earlier.

60. From the details of the correspondence made between the CBEC and the Commissioner of Central Excisc. Bangalore on the paragraph under examination it was seen that the draft audit paragraph was referred to the Ministry on 31 August, 1992.

61. The correspondence indicated that the Board/Ministry were fully aware of the relevant details of the eascs including the extent of irregularity, role of the officer and status of the case atleast since October, 1992. It was also seen that at the instance of the Member. CBEC. the case was examined and a report given by the Principal Collector of Central Excisc. Hyderabad. In his report submitted on 11 August, 1993 addressed to the Member. CBEC. the Principal Collector while narrating the facts of the case, role of the officers etc. had *inter-alia* stated that “in view of the repeated irregularities committed by the asscsce, for some time to come, greater and frequent checks should be excrciscd over the functioning of the unit”. He had also in his report stated that “proposals for prosecution arc to be considered quickly.”

62. The correspondence also revealed that the last rcfrcncc made by the Ministry to the Commissioner of Central Excisc, Bangalore was on 6 July, 1994 enquiring about the penal action taken against the asscsce and the action initiated against the officers. This was replied 49 by the

Commissioner on 13 July, 1994 intimating that prosecution of the assessee was approved by Chief Commissioner Departmental Counsel has been told to prepare the draft complaint and the same was being filed. As regards action against the officers, the Commissioner had intimated that the explanations given by the Officer were being processed. Thereafter on 15 July, 1994 the Commissioner of Central Excise again reported that the complaint had been filed against the assessee. Subsequent to the above no references were made in the Board/Ministry. It was on 15 June, 1995 that the Commissioner of Central Excise reported that chargesheets against three Inspectors have been issued and proposal for action against the Assistant Commissioner had been sent to the Central Board of Excise and Customs.

#### Other Central Excise Offence Cases Against The Same Assessee

63. In reply to a question whether the Department have come across other cases where the assessee involved in the present case was found to have indulged in evasion of Central Excise Duty, the Ministry of Finance (Department of Revenue) have in a note submitted after evidence furnished a list of cases along with action taken thereon (Appendix-III). It will be seen therefrom that in all there were 12 cases involving a total duty of over Rs. 6 crores. These cases were stated to be either pending adjudication before Collector, CEGAT or pending before the Court, pending recovery, pending issue of Show-cause-notice etc. One case involving duty of Rs. 45.41 lakhs was stated to have been dropped by the department after the decision at the first appellate stage itself.

#### Need for Cheeking Irregularities/Frauds under Modvat

64. Offering his comments on the cases of misuse of Modvat facility under examination, the Secretary, Department of Revenue stated in evidence:

‘it is not lack of procedure or instructions. Definitely, officers responsible for checking have failed in their duties.’\*\*

65. In a further note furnished after evidence the Ministry of Finance (Department of Revenue) *inter-alia* added:

"This is a case of human failure and not due to any inadequacy in the system control."

66. Subsequent to the Audit Report 1991-92 a paragraph of which is under examination, a review on Modvat Scheme also features in paragraph 1.03 of the latest report of the C&AG *i.e.* No. 4 of 1995. The relevant sub para namely 16 of the review deals with cases of fraudulent/double/excess avilment of Modvat Credit. It has *inter-alia* pointed out that in 11 cases (in six collectorates) excess avilment of Modvat Credit amounting to Rs. 28.52 lakhs were noticed. The details of these cases are shown in Appendix-IV. The department was stated to

have accepted the irregular availment in 10 cases involving credit of Rs. 26.46 lakhs and reported recovery in eight cases of Rs. 22.49 lakhs.

67. In the light of the increasing number of instances of misuses of Modvat facility referred to above, the Committee asked as to how it could be concluded that the cases under examination were not a system failure but was only a human failure. The Secretary, Department of Revenue stated in evidence:

“Sir, we do acknowledge it. What I would like to submit before the honourable Committee is in 1986-87 our net revenue rose to Rs. 14407 crores and Modvat was Rs. 1913 crores and at that particular point of time not all the chapters had been covered. Only about 37 chapters were covered. Over the year we have provided Modvat for Capital goods also..... 1993-94 revenue was Rs. 38411 crores and the Modvat was over Rs. 2000 crores .... Therefore, as years rolled by larger number of units will be coming in. Some aberrations, of course, are bound to be there. The system can not be perfect. There will be this kind of irregularities or frauds being committed. But what has to be seen is to the extent possible the Government should evolve a system whereby it is possible to check this and detect it. That is why this computer based system is being installed. The reasons for trying to expedite the computerisation is to ensure that frauds of this nature are not committed.... it may be difficult for us to eliminate altogether this kind of a fraud or irregularity. We can at best ensure you that we will try within our capabilities. We have to have a system which will be more or less foolproof so that at least frauds can be detected in time and checked and action can be initiated.”

68. Since Modvat was a facility extended to a party, the Committee asked whether the Department could not consider denying it to an assessee or blacklist him who is found to have misused it. The Secretary, Department of Revenue stated in evidence:

“I do not think we can close down his factory and blacklisting virtually means stopping the production. I do not think we have a legal system to stop production because it will involve so many other things.”\*

#### Introduction of Invoice Based Assessment

69. The Committee have been informed that invoice based assessment has been introduced in Central excise w.c.f. 1.4.1994. The assessee's invoice will now be used as a transport document as well as the basis for determining the assessable value under Section 4 of the Central Excises and Salt Act, 1994, in lieu of Gate Pass and Price List. System of endorsement of duty paying documents by the dealer for the purpose of Modvat credit has been discontinued and now the Registered dealers are also authorised to issue Excise invoices on the basis of which the buyers

can take the Modvat credit. Invoices are issued by the manufacturer/dealer in quadruplicate to be signed by the owner or authorised agent. Original is sent to the buyer, duplicate to the transporter, triplicate to the proper officer and quadruplicate to the registered person. Modvat credit is available only on duplicate invoices.

70. In reply to a question as to whether any study was conducted before introduction of invoice as document for availing Modvat credit and whether the shortcomings noticed in the earlier system were taken care of in the new system, the Ministry of Finance (Department of Revenue) stated in a note submitted after evidence as follows:

“Rckhi Committee had recommended for invoice based assessments. Besides, very often disputes were arising regarding endorsement of Gate Passes. Cases had also come to the notice of the Department where Gate Passes were misused. In view of the above and also with a view to simplify and make the scheme of Modvat more transparent the Gate Passes were replaced by the invoice. The invoices have certain merits over the Gate-Passes in as much as they cannot be endorsed to any other user. The proforma of invoice also contains certain additional particulars like mentioning the duty and value both in the words and figures. They are also required to be pre-authenticated by the owner of the company. Since, the invoices are assessee's own document their introduction also reduced the complaints on harassment. For any error or misconstruction of these invoices, the owner of the Company will be responsible and as such more stringent action can be taken in case it is found that they have been issued fraudulently.”

71. When asked as to what were the checks prescribed by the Department in respect of the issue of invoice, the Ministry of Finance (Department of Revenue) in a note submitted after evidence stated as follows:

“The invoices to be issued by Manufacturers/registered dealers have the following inbuilt checks:

- (1) Invoices under Rule 52A/57G can be issued provided the person issuing such invoice has taken registration under Rule 174 of the Central Excise Rules and is valid for the premises as mentioned in the registration certificates.
- (2) Invoices issued under Rule 52A or 57G have to be made out in four copies wherein original is for the buyer, duplicate is for the transporter, triplicate to be submitted alongwith RT 12 return and quadruplicate is for the assessee.

- (3) The invoices have to bear a printed serial number for the entire financial year beginning on the 1st April of each year except where invoices are computer generated.
- (4) Only one invoice book shall be used for removal of excisable goods at any given time unless permitted otherwise by the Collector of Central Excise.
- (5) Each invoice book shall be pre-authenticated and each foil of the invoice book has to be authenticated by the owner or the working partner or Managing Director or the Company Secretary.
- (6) The details to be given on 52A/57GG invoice have been prescribed *vide* Circular No. 29/29/94-CX dated 21.3.94 and notifications No. 33/94-CX dated 4.7.94 as amended by 24/95 dated 30.5.95.
- (7) Certain particulars on the Rule 57GG invoice are to be pre-printed like name and address of the person issuing the invoice, name of the Range/Division/Collectorate having jurisdiction over the person issuing the invoice registration No., Sales Tax No., Income Tax No. etc.
- (8) Invoices issued under Rule 57GG to have prescribed colour Code as well.
- (9) Such invoices are required to be preserved for a period of five years."

72. As regards the checks on availment of credit only on duplicate copy the Ministry of Finance (Department of Revenue) have stated that the Modvat is available only on duplicate copy of invoice. Credit on original copy of invoice can be taken only with specific permission of Assistant Commissioner and that too if duplicate is lost in transit. According to them the Assistant Commissioner has to satisfy himself in such cases before allowing such credit.

73. The Committee wanted to know if there was any system of cross verification to see the genuineness of the invoice. The Ministry of Finance (Department of Revenue) stated in a note submitted after evidence as follows:

"A manufacturer is required to submit monthly return alongwith extracts of RG-23 A Part I and II the original duty paying documents on the strength of which credit has to be taken to the jurisdictional superintendent (RO) by the 5th of the following month. The registered dealer has also to submit a monthly return alongwith extracts of RG-23 D register and duplicate copies of Rule 52 A/57 GG invoice on the strength of which he has received the material inside his premises for issue of Modvatable invoices. To check the authenticity of invoices Range Superintendent is to verify the

correctness from the Range office in whose jurisdiction invoices were originated. Such verification is to be made cent percent where credit involved is Rs. 10.00CKV or more and 5% where credit is less than Rs. 10,00<y-. Computerisation would further strengthen detection of bogus invoices. Amended Rule 1730 of the Central Excise Rules, 1944 provides for imposition of penalty on dealers who enter willingly any wrong or incorrect particulars in the invoice for excisable goods with the intention to facilitate the buyer to avail of credit which is not permissible under the law.”

74. The Committee drew attention of the Ministry to reports appearing in a section of Press pointing out mis-use of Modvat credit on invoice system by the traders dealing with excisable goods. On being asked whether the Department were aware of such reports and what action has been taken, the Ministry of Finance (Department of Revenue) stated in a note submitted after evidence as follows:

“Central Excise offices in Bombay have detected certain irregularities with reference to invoice issued by dealers namely:

- (a) the registered dealers did not have their godown premises, and
- (b) the goods were cleared under the original invoice.

The action taken in this regard were in keeping with the Law and if the applicant met the conditions as per instructions No. 96/7/95-CX dated 13.2.1995, no penal action has been taken. It had also been decided that no reversal of Modvat credit be required if duplicate copy of Rule 52A/57G invoice is available with the unit or the registered dealer and the original copy of the invoice moved with the goods in question provided that both the original and duplicate are got defaced by the jurisdictional Range Superintendent.”

75. The Committee desired to know the steps taken by the Department to plug the loopholes and strengthen controls. The Ministry of Finance (Department of Revenue) in a note submitted after evidence stated as follows:

“Detailed instructions have been issued *vide* Board’s Circular No. 96/7/95-CX dated 13.2.1995 clarifying the various points. The scheme of issue of invoice by dealers was also referred to a Committee which consisted of two Principal Collectors and one officer of the Collector rank. This Committee had reviewed the entire scheme of passing the credit by dealers, in consultation with the Distributive Trade. On the recommendations of this Committee certain changes have been effected, namely:

- (i) Providing the colour code to the invoice.
- (ii) Pre-printing of certain particulars of the invoice.
- (iii) Preservation of Modvatable documents for five years.”

## Review of Modvat

76. The Modvat scheme has been in existence for about a decade. The Committee desired to know whether the Department had carried out any exercise with a view to finding out the extent of misuse of the scheme and to take corrective measures for plugging loopholes. The Member, CBEC stated during evidence:

“Sir, I would like to submit that we have not undertaken any systematic study of the working of the procedure of the Modvat as such. But from time to time when any *modus operandi* comes to our notice, through the preventive wings, we try to see whether any systematic improvement or procedural changes are required in the system or not.”

Clarifying on the point Secretary, Revenue added:

“A few days ago I have taken a decision that a comprehensive study, considering all points of view, on this should be taken up. The National Institute of Public Finances and Policy have agreed to undertake the study.... We would be carrying out the comprehensive study.”

77. When asked whether the study has since been referred to the Institute and about the terms of reference etc. the Ministry of Finance (Department of Revenue) have stated in a note submitted after evidence:

“The matter has already been referred to National Institute of Public Finance and Policy and they have been requested to, *inter alia*, conduct a study on the simplification of the procedures relating to Modvat, particularly in the light of the instances of misuse of Modvat credit noticed in recent times. Terms of reference are being finalised and will be intimated to the Committee.”

78. The Modified Value Added Tax (Modvat) Scheme which was introduced from 1 March, 1986 provides for taking instant credit of duty paid on specified inputs and its utilisation towards payment of duty on specified final products. The scheme is governed by Rules 57A to 57J of the Central Excise Rules, 1944. Application of the Rules is guided by issue of notification by the Government and instructions by the Central Board of Excise & Customs (CBEC). The Audit paragraph under examination deals with certain cases wherein an assessee fraudulently took Modvat credit was more than the duty paid on the inputs and the excess credit so taken was utilised towards payment of duty on final products. The Committee's examination of the paragraph has revealed certain disquieting facts which are dealt with in the succeeding paragraphs.

79. As per the procedure prescribed, the assessees availing Modvat credits were required to submit a monthly statement to the Jurisdictional Superintendent of Central Excise within five days of the close of the month

indicating the particulars of inputs received and utilised and the amount of credit taken alongwith the extracts of the relevant document, viz., Part I & II of form RG 23A and also the duty paying documents in original evidencing the payment of duty. The instructions issued by CBEC to the field formations envisaged 100% check of duty paying documents by the departmental officers where credit taken exceeded Rs. 10,000, from the range office in whose jurisdiction duty paying documents originated. The entries in the RG 23A were also required to be checked with the original duty paying documents by the departmental officers. After verification, the documents were to be defaced within 15 days of the close of the month to prevent the manufacturer from availing of the credit twice on the same document.

80. The Committee find that a manufacturer of motor cars in Bangalore Collectorate of Central Excise, viz., Sipani Automobiles Ltd. took Modvat credits of Rs. 76.84 lakhs which were more than the duty paid on the inputs during the period February 1991 — March 1992 and the excess credits so taken were utilised towards payment of duty on final products. The assessee is reported to have done this by manipulating the documents/records and availed credit twice on the same gate passes and inflated the figures therein to hundred times on two occasions, inflated the amount in the gate pass to hundred times on one occasion and also inflated the closing balance of the RG 23A Part II without the same being detected by the departmental officers. The excess credits resulted in overdrawals on as many as 50 occasions during 1990-92 in the Personal Ledger Account (PLA) of the assessee through which payment of central excise duty is accounted for.

81. According to the Ministry of Finance the departmental officers failed to detect the irregularities as the assessee did not furnish the duty paying documents in respect of inputs while submitting the extracts of RG 23A and therefore, the concerned officer could not cross check in time the entries in the RG 23A again with the original duty paying documents. Astonishingly, the Committee found that the assessee had not been submitting the original duty paying documents at all from April 1989 to 20 July 1992; The Department also had not resorted to any firm coercive action either to obtain the requisite documents as prescribed in the Law. In the absence of such cross verification, the Committee wonder as to how the Department ensured that amount of credit during this period was correctly availed particularly in the case where the assessee had taken Modvat credit on the same date of the issue of Gate Pass although the goods had been despatched from far off place like Bombay by road.

82. It was further stated by the Ministry that the Range Officer had also kept verification of the documents pending since the approval of the price list was held up on account of pending valuation dispute. Pertinently, according to Rule 9 of the Central Excise Rules, 1944 it is mandatory to resort to provisional assessment in such cases till the dispute is finally settled. Unfortunately, this was also not done in this case. The Secretary,

Ministry of Finance (Department of Revenue) admitted during evidence that it was a clear case of failure on the part of the officers in exercising the prescribed checks in regard to modvat scheme. According to him if the officers had checked the documents the way in which they were required to check, the fraudulent methods resorted to by the assessee would have come to light in time. The representative of the Board also admitted in evidence the departmental failure in ordering provisional assessment ' pending approval of price lists. The Committee deplore the laxity on the part of the officers concerned on these scores and desire that the precise reasons for the same needs to be looked into. They also recommend that the Ministry should ensure that the provisions of the Central Excise Law are administered both in letter and spirit and also that the instructions of the Board are scrupulously followed with by the field formations.

83. The Committee And that as per the procedures prescribed in the Central Excise Manual, the Internal Audit parties of the department are required to visit the premises of the assessee twice a year and recheck the duty paying documents and statutory records. The Committee find that in respect of the present assessee, the Internal Audit were able to detect only one of the four cases of irregularities pointed out by CAG. It was stated that prescribed frequency of visits was not observed by the Internal Audit due to pressure of heavy work and constraint of required number of Audit parties. The Committee would like to emphasise that Internal Audit is an important tool of management control particularly in an organisation like Central Excise which is responsible for administering vital revenues of Government and therefore it is imperative that the Board take suitable steps and ensure that this instrument is efficiently used in exercising effective control and checking leakage of revenue. The Committee would therefore, like the Ministry to look into the functioning of the Internal Audit Department with a view to improving its efficacy.

84. In this context, the Committee further find that the scrutiny of records of the assessee in the present case for the period December, 1990 to June, 1991 was done by the Internal Audit from 29 to 31 July, 1991. The Internal Audit Report was issued in October, 1991 and the copy was endorsed to the Assistant Collector and also to the Range. Surprisingly, it was only on 2 March, 1992, i.e. after a period of five months that the Range Officer asked the assessee to produce the documents for verification and defacing. Eventually, the documents were handed over by the assessee voluntarily on 20 July, 1992. While deprecating the departmental delay in acting upon the Internal Audit Report promptly, the Committee would also like to point out that this delay is also indicative of the inadequate system of monitoring the internal audit objections at various levels including Collectorate/Board which needs to be remedied. The Committee, in this connection would also recommend that the Ministry/Board should prescribe a time frame for the follow-up action on objections raised by Internal Audit.

85. The Committee have been informed that in addition to the mechanism of Internal Audit, control have also been prescribed for checking fraudulent avilment of credits in the form of scrutiny of records of factories by anti-evasion wing of all units availing modvat credit of Rs.25 lakhs and above annually, special audit of all units availing credit of Rs.10 lakhs and above per annum, setting up of surprise squads by Collectors for verification of modvat credit etc. Significantly, the assessee had paid duties amounting to Rs.63.13 lakhs and Rs.59.97 lakhs In the years 1990-91 and 1991-92 respectively. The Committee are, however, yet to be informed whether these controls were exercised in the case under examination and if so the reasons for the failure of these mechanisms in detecting the fraud. What has further concerned them is that the Ministry/Board do not seem to have any system to monitor and generate the data on this score as the query raised by the Committee to apprise them of the number of surprise checks conducted by the Collectors in respect of modvat and its impact during the last three years still remains to be answered fully. This is indicative of the fact that the different controls stipulated through the instructions are not being followed properly. The Committee cannot but express their concern over this and desire that the Ministry of Finance should look into the effectiveness of the controls prescribed and take appropriate steps to make the internal control mechanism more effective.

86. The Committee are distressed to note that in spite of the serious nature of the offences committed by the assessee, the response of the Ministry thereto has not been inspiring. Although the irregularities were initially detected as early as in 1991, the offence case was registered as late as June 1992 and a show cause notice was ultimately issued to the assessee only on 3 August, 1993, *i.e.* after the Audit paragraph was selected by the Committee (1993-94) for detailed examination. The case was adjudicated on 16 November, 1993 and a penalty of Rs.10 lakhs was imposed on the assessee by the adjudicating authority. Against the Adjudicatory Order, the assessee filed an appeal with the Custom, Central Excise and Gold Control Appellate Tribunal (CEGAT). The CEGAT is stated to have ordered pre-deposit of Rs.5 lakhs out of the penalty of Rs.10 lakhs imposed. As the assessee could not comply with this order, though an amount of Rs.4.78 lakhs had been recovered, the CEGAT on 2 January, 1995 rejected the appeal filed by the assessee. The Committee were informed that for the balance amount of penalty *i.e.* Rs.5.22 lakhs some assets of the party have been attached on 16 June, 1995. It is evident from the facts stated above that besides the inordinate delay in registering the offence case and issuing show-cause notice, the department had again delayed the issue of attachment order of the property for realising the dues from the party on account of penalty. Apparently, it was done only after this Committee's decision to take oral examination of the subject on 21 June, 1995. The Committee deprecate this tendency and desire that the Ministry of Finance should take suitable steps to obviate the same and ensure that penal and recovery actions are initiated in time. The Committee would like to be

apprised of the further developments including the dues realised from the property of the assessee attached by the department.

87. What has further caused concern to the Committee is that despite the serious nature of offences committed, no steps were taken in time to launch prosecution against the party under the Central Excise Law/Indian Penal Code. The Department launched prosecution under Section 9 of the Central Excises and Salt Act, 1944 against the Company, its Managing Director and the Deputy Commercial Manager on 15 July, 1994 only in the Economic Offences Court. The Committee were informed that on 30 November, 1994, the assessee filed a Writ Petition in Karnataka High Court for quashing the prosecution complaint filed by the department and hence the hearing has been adjourned by the Offences Court. While admitting the inadequacy in launching of prosecution proceedings in this case, in the Secretary, Revenue stated in evidence that the assessee should have been arrested. The Committee express their displeasure over the inadequacies in launching prosecution in this case and desire that the matter should be enquired into and responsibility fixed. They would also like to be informed of the further developments with regard to the prosecution action that has been initiated. The Committee also recommend that the Ministry of Finance should take adequate steps to ensure that stringent and prompt action is taken against unscrupulous assesseees found indulging in such dubious methods of defrauding the Government.

88. The excess credit of Rs. 76.84 lakhs availed of by the assessee was stated to have been recovered/adjusted subsequently. It had thus enabled the assessee of interest free funds at different points of time. In this connection, the Committee note that although provisions have been made in the Central Excise Law through recent amendments for providing for charging of interest for delayed payments, the amended provision does not take into account the present type of cases where the assessee had himself rectified the mistake and the Excise Department had not determined the duty payable. The Ministry of finance maintained that such situations will be taken care of by the existing provisions of Central Excise Law which provides for imposition of penalty upto three times the value of goods and will cover even the interest elements gained by the assessee. The Committee are hot inclined to agree with this. While the payment of interest is mandatory, penalty is discretionary and it is upto the Assessing Officer to work out the amount. Further, finalisation of penalty amount may also take its own time. The Committee would therefore, recommend that the Ministry of Finance should consider the desirability of incorporating suitable provisions in the Law for collection of interest on excess/fraudulent modvat credit as in the case under examination.

89. Another disquieting aspect observed by the Committee related to the action taken against departmental officers for their various lapses. The irregular availment of excess credit was Initially known to the department through the objection raised by the internal audit department as far back as

in October, 1991. The authorities concerned were already aware of the lapses committed by the departmental officer in the scrutiny of documents, exercise of control etc. in 1991-92 itself. The principal Collector of Central Excise, Hyderabad was asked by the Board to conduct detailed examination of the case. In his report dated 11 August, 1993 he had clearly brought out the lapses on the part of the officers concerned. The Committee are astonished to note that in spite of the above, charge sheets to three departmental officers of the rank of inspector were issued on 15 June 1995, only, *i.e.* after the subject matter was taken up by this Committee for oral examination. The charge sheets against the Range Officer and the Assistant Collector/Assistant Commissioner are yet to be issued. This clearly is indicative of the lack of seriousness in punishing the guilty for the serious lapses committed by them. During evidence the representative of the Central Board of Excise & Customs admitted that there has been an "inexplicable delay" in proceeding against the officers. The Secretary, Revenue also admitted that the Collector concerned had also not exercised his supervisory/responsibility to the extent to which he should have done. The Committee deplore the delay in initialing action against the officers concerned. They desire that the cases under examination should be thoroughly investigated and responsibility fixed including that of the Collector concerned. They would like to be informed of the further action taken in the matter. The Ministry of Finance should also ensure that action in such cases is taken promptly so that it acts as a deterrent.

90. During the course of examination the Committee found that the irregular/fraudulent availment of excess credit in the case under examination was not an isolated one. Cases from other Collectorates also were reported of similar irregularities pertaining to the same period the details of which are given elsewhere in the Report. In addition to the cases referred to in the audit paragraphs, the same assessee was again stated to have indulged in yet another similar malpractice which was detected by the department in July, 1993. When the repeated indulgence by the assessee in the same irregularity was brought to the notice of the representatives of the Ministry/Board during evidence, the Committee were informed that the Collector concerned has presently tightened the control and a stricter vigil was now being exercised in respect of this assessee. It was also seen by the Committee that the Collector of Central Excise Bangalore in his letter dated 1 September, 1993 addressed to the Member, CBEC had stated that an undertaking was obtained from the assessee that they will not avail any irregular Modvat credit in future. The Committee are, however, shocked to note from the information furnished by the Ministry of Finance subsequent to evidence that the same assessee resorted to similar type of availment of excess credits in five cases during the months of April-May, 1995 involving a total excess credit of Rs. 1.78 lakhs, which was stated to have been recovered subsequently. This clearly shows that the so-called "tightening of the control" and the extra vigil stated to have been exercised by the

authorities have not produced any desired results and similar instances continue to recur unabated. The Committee cannot but express their serious concern over the inability of the authorities concerned in checking such malpractices by one single assessee repeatedly. The Committee, therefore, desire the Ministry to address themselves to this issue with the seriousness it deserves and take stern measures against the party concerned for the offences and also the officers found responsible for their omissions and commissions.

91. The Committee have been informed that an offence case in respect of the five cases detected in April-May, 1995 has since been booked and action was being initiated against the officers found responsible. The Committee desire the matter to be pursued vigorously and would like to be informed of the further action taken in the matter.

92. The Committee are constrained to point out that in the cases pointed out by Audit in the paragraph under examination the response of the Ministry of Finance/Board was also somewhat casual. From the information made available to the Committee it was seen that the Board/Ministry were fully aware of the relevant details of the cases including the extent of irregularity, role of the officers and status of the case at least since October, 1992. Pertinently, as per the instructions of the Member, CBEC, the case was examined and a report given by the principal Collector of Central Excise, Hyderabad. In his report submitted in August, 1993 and addressed to the Member, CBEC, the Principal Collector while narrating the facts of the case, role of the officers etc. had *inter-alia* stated that "in view of the repeated irregularities committed by the assessee, for some time to come, greater and frequent checks should be exercised over the functioning of the unit." He had also in his report stated that "proposals for prosecution are to be considered quickly." Unfortunately, adequate action was not taken by the Board/Ministry to ensure that stern action is taken promptly against the party as well as the officers responsible. In fact, the Committee found that after 15 July, 1994 the Ministry had not bothered to enquire about the further action taken in the matter at all. It was only after the subject was taken up by this Committee for oral evidence that the matter seems to have been pursued and action initiated against the officers and also for attachment of property of the party against the amount due to the department. The Committee express their strong displeasure over the same and desire that the Board/Ministry should in future act with more promptitude and decisiveness in dealing with such economic offences.

93. The facts stated in the foregoing paragraphs clearly establish that there was an absolute breakdown of excise control and proper supervision and monitoring of the unit in availing modvat credit. There were vital lapses on the part of the departmental officers which enabled the assessee in perpetrating the fraud. These included failure to obtain the requisite documents in time, failure to order provisional assessment pending finalisation of price list, inadequacies in conducting Internal Audit, failure

to take action promptly on the observations made by the Internal Audit, inadequate performance of anti-evasion wing to detect these cases, other inadequacies in internal control, delay in registering the case and issuing show-cause-notices to the assessee, delay in attachment of property of the party to realise the government dues even after the decision of the appellate tribunal, delay in taking action against the officers etc. While admitting the seriousness of the matter, the Secretary, Department of Revenue stated in evidence that this is a case where a senior officer has to investigate as to why there has been a total failure to check the malpractices of one assessee over the years. The Committee are of the firm view that the assessee would not have succeeded in his efforts in defrauding the Government repeatedly without the active connivance of the departmental officers. While deploring such an unhealthy tendency in the prime revenue earning department of the country, the Committee recommend that the facts stated in this report should be thoroughly inquired into with a view to finding out as to how and why the lapses occurred, to what extent they were bonafide mistakes and taking stern action against all the officers found responsible for the same. Government should also ensure that such economic offences are dealt with sternly and promptly so that it acts as a deterrent for similar fraudulent activities. The Committee would like to be informed of the action taken in the matter within a period of three months.

94. From the information made available to the Committee it was also seen that the assessee involved in the present case was found to have indulged in evasion of central excise duty in as many as 12 cases involving a total duty of over Rs. 6 crores. The details of these cases have been given elsewhere in the Report. These cases were stated to be either pending adjudication before Collector, CEGAT or pending before the Court, pending recovery, pending issue of show cause notice etc. One case involving duty of Rs. 45.41 lakhs was stated to have been dropped by the department after the decision at the first appellate stage itself. The Committee desire that all the cases should be pursued to their logical conclusions and would also like to be apprised of the further progress made with regard to all the cases. They would also like to be informed of the details in respect of the case in which further proceedings were stated to have been dropped by the department after the appellate decision at Collector's level and the reasons for not contesting it.

95. During evidence, the Committee were informed that the case under examination was one of human failure and not due to any inadequacy in the system control. In this connection, the Committee find that in addition to the cases of misuse by the same assessee and other identical cases observed during the relevant period, the Report of the C&AG for the year 1993-94 (No. 4 of 1995) has also after a test Audit found 11 such cases in six Collectorates involving excess availment of credit amounting to Rs. 28.52 lakhs. This clearly shows that misuse of Modvat facility is fairly widespread. Since Modvat is a facility extended to the manufacturers, the Committee

strongly feel that Government should consider making necessary provisions in the Law to withdraw the facility wherever the same is found to have been misused/abused.

96. The Committee were informed during evidence that Government were contemplating installation of Computer based system in the Central Excise Department which was expected to minimise frauds of the nature under examination. The Committee would like to be kept apprised of the progress made in the area.

97. The Committee note that the invoice based assessment has been introduced in Central Excise w.e.f. 1 April, 1994. The assessee's invoice will now be used as a transport document in lieu of gate pass and price list. Modvat credit is available only on duplicate invoices. According to the Ministry, in order to prevent misuse of gate pass and also with a view to simplifying and making the scheme of Modvat more transparent, the gate passes were replaced by invoice. According to them the invoices have certain merits over the gate passes inasmuch as they cannot be endorsed to any other user, the proforma for invoice also contains certain additional particulars like mentioning the duty and value both in the words and figures (which was not there in the case of gate passes), they are also required to be pre-authenticated by the owner of the Company and the invoices have certain inbuilt checks. The Committee are constrained to point out that in spite of the inbuilt checks stated to have been provided in the invoice system fraudulent availment of Modvat credit could not be prevented in respect of the same assessee in April-May 1995 (discussed earlier) where the invoices were also found to have been misused. Further, certain other irregularities were also brought to the notice of the Committee relating to availment of credit after the introduction of invoice based assessment. The Committee therefore recommend that the Ministry of Finance should critically look into those cases and initiate further necessary control measures to check misuse of the scheme effectively.

98. The Modified system of Value Added Tax has been in existence in India for more than 9 years. During evidence the representatives of the Ministry of Finance stated that no comprehensive evaluation of the system has been undertaken \*so far. The Committee were informed that the Ministry have now asked the National Institute of Public Finance and Policy to make a comprehensive study of the system and suggest measures for the simplification of the procedures relating to Modvat, particularly in the light

of the instances of misuse of Modvat credit noticed in recent times. The Committee trusts that the study will be expeditiously completed and further necessary measures initiated in order to ensure that the scheme subserves its purpose. They would like to be informed of the details of the study and the follow-up action taken thereon.

**NEW DELHI;**

*4 August, 1995*

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**RAM NAIK,**

*Chairman,*

*Public Accounts Committee.*

APPENDIX—I

(Vide Para 3)

PARAGRAPH 3.48 OF THE REPORT OF C&AG OF INDIA FOR  
THE YEAR ENDED 31ST MARCH, 1992 (NO. 4 OF 1993), UNION  
GOVERNMENT (INDIRECT TAXES) RELATING TO “MODVAT  
SCHEME—FRAUDULANT AVAILMENT OF CREDITS”

3.48 Fraudulent availment of credits

As per rule 57-G of the Central excise Rules, 1944 every manufacturer intending to take credit of the duty paid on inputs under rule S7A shall file declaration to the proper officer of the department indicating the description of the final product manufactured in his factory and the inputs intended to be used in each of the final products and obtain a dated acknowledgement of the said declaration. Further, sub rule (2) of rule S7G provides that no credit shall be taken unless the inputs are received in the factory under the cover of gate pass, AR-I, bill of entry or any other document as may be prescribed by the Central Board of Excise' and Customs in this behalf evidencing payment of duty on such inputs.

Rule 173-Q further provides that if a manufacturer takes credit of duty in respect of inputs for being use in manufacture of final products wrongly then all such goods shall be liable to be confiscated and manufacturer shall be liable to a penalty not exceeding three times the value of excisable goods in respect of which any contravention has been committed, or rupees five thousand whichever is greater.

A test check of records of a manufacturer of motor cars (sub heading 8703.00) disclosed that the assessee was allowed to take credits of duty paid on inputs by virtue of declarations filed from time to time under rule S7G and while taking such credits, he took credits which were much more than the duty paid on the inputs mentioned in the relevant gate passes. Further, such excess credit taken were also allowed to be utilised for payment of duty on the clearance of his final product. Some of the cases noticed in audit are detailed below:-

(i) (a) Inward gate pass (GP-I) dated 31 October 1991 showed that a duty of Rs. 8,800 [(Rs. 8,000 (BED) and Rs. 800 (SED)] was paid by the assessee on the value of goods of Rs. 39,998 and the same was taken as credit in RG 23A part II account on 26 December 1991. The assessee fraudulently took the credit of Rs. 8,80,000 [(Rs. 8,00,000 (BED) and Rs. 80,000 (SED)] again on 19 March 1992 against the aforesaid gate pass as

supporting document by making alteration on the gate pass. The amount so credited in RG 23A part II account was utilised to the extent of Rs. 8,21,056 towards duty due on the output goods cleared upto 30 March 1992. Neither the amount of credit so utilised (Rs. 8,21,056) has been recovered (June 1992) nor the remaining amount got reversed in RG 23A part II.

(b) As per another gate pass dated 18 February 1991, the assessee discharged duty of Rs. 43,116 in respect of inputs received at an assessable value of Rs. 43116. But the assessee fraudulently took a credit of Rs. 43.11,600 [(Rs. 41,06,300 (BED) and Rs. 2,05,300 (SED)] on 29 March 1991 out of which utilised a credit of Rs. 42,02,076 (Rs. 9,20,002 on 29 March 1991 and Rs. 32,82,074 on 30 March 1991) as against a credit of Rs. 77.287 on 29 March 1991 and Rs. 2,670 on 30 March 1991 available in RG 23A part II account for payment of duty due on the final product. This resulted in fraudulent utilisation of credits of Rs. 41,22,199 (Rs. 8,42,715 on 29 March 1991 and Rs. 32,79,404 on 30 March 1991). The excess utilisation of credits were, however, made good through Personal Ledger Account only on 9 May 1991. Thus, assessee utilised the government money fraudulently during the period from 29 March 1991 to 9 May 1991).

(ii) As per yet another gate pass dated 30 March 1992, the assessee discharged duty of Rs. 22,690 [(Rs. 19,730 (BED) and Rs. 2,960 (SED)] but fraudulently took the duty credit of Rs. 22,69,000 [Rs. 19,73,000 (BED) and Rs. 2,96,000 (SED)] and utilised the same towards payment of duty due on the final product cleared on 30 March 1992. The excess credit so availed was, however, paid back to government through his Personal Ledger Account on 9 May 1992 i.e. during the course of audit. Thus, the assessee fraudulently utilised the government money during the period 30 March 1992 to 9 May 1992.

(iii) The closing balance in RG 23A part II for the month of September 1991 worked out to Rs. 1,29,817 (BED) and Rs. 11,296 (SED) after accounting for the credits upto serial No. 464 dated 30 September 1991, whereas manufacturer took the closing balance as Rs. 3,92,786 (BED) and Rs. 37,593 (SED), resulting in excess account of credit of Rs. 2,62,969 (BED) and Rs. 26,297 (SED). The excess credits were utilised towards payment of duty on the final products during September 1991 to November 1991. Such excess account of credit was however, expunged only in December 1991. Thus, the assessee utilised the government money fraudulently during the aforesaid period.

In view of the position as explained above, it is evident that:-

- (a) the assessee had resorted to take excess credits fraudulently which were irregularly utilised towards payment of duty on final product;
- (b) the fraudulent claims of manufacturer could have been detected by the department as soon as monthly returns (RT 12) were submitted alongwith supporting documents to the range officer; and
- (c) the original inward gate passes in support of which credits were taken should have been defaced by the range officer after correlating the entry with the extract of RG 23A part II account as laid down in rule 57G(4) ibid. Such defacement was, however, not resorted to by the department, which facilitated fraudulent availment of Modvat credit and its utilisation by the assessee.

The total credits of Rs. 76.84 lakhs fraudulently taken was also utilised towards payment of duty on the final products, out of which a sum of Rs. 8.80 lakhs was yet to be recovered from the assessee. In addition, no penal action as required under rule 173Q was initiated against the assessee.

The irregularities leading to fraudulent claims were pointed out to the department in June 1992 and to Ministry of Finance in September 1992.

Ministry of Finance have stated (November 1992) that the amount of Rs. 8.80 lakhs has been recovered through PLA (June and August 1992). Besides two offence cases have also been registered against the party.



The unit took credit of Rs. 41,925/- (BED) The entire amount has been recovered. and Rs. 3,731/- during August, 1991 as Besides a penalty of Rs. 400/- was imposed against the available credit of Rs. 14,625/- which has been deposited by the assessee. (BED) and Rs. 731.25 (SED). The assessee themselves detected the irregularity and irregular credit was deposited during the same month (August, 1991).

The assessee availed of fraudulent credit of An offence case has been booked on 16.7.93 Rs. 1,23,090/-. The irregularity has been noticed by the Deptt. office on 15.7.93.

The assessee availed of credit of Rs. 82,195/- The entire irregular credit has been in Nov. 1991 instead of actual admissible recovered besides imposing a penalty of credit of Rs. 8219/-. The assessee reversed Rs. 1500/-. The order-in-original imposing the credit before issuance of S.C.N. the penalty was however, set aside in appeal on the ground that the assessee reversed the credit at their own.

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{Vide Para 63)  
LIST OF OTHER OFFENCE CASES REGISTERED AGAINST M/S. SIPANI AUTOMOBILES LTD., BANGALORE

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Taking credit of Rs. 45 lakhs prior to acknowledgement of receipt of amount by the bank and utilisation of the Rs. 4486290/- towards clearances of 20 cars.

The assessee deposited 7 TR-6 challans amounting to Rs. 45 lakhs on 31.3.95. The receipt of the amount was acknowledged by the bank on 4.1.95 and delivered TR-6P to the assessee on 6.1.95. However, the assessee took

PLA on 31.3.95  
and utilised Rs.  
**44.86 lakhs**  
towards payment  
of duty on 20 cars  
against invoices  
dated 31.3.1995.

**SHOW CAUSE NOTICES ISSUED FOR TECHNICAL VIOLATION OF MODVAT RULES PROCEDURES:--**

<p>1. Irregular availment of Modvat credit on Bills of Entry/CPIs addressed in the name of their Registered Office, but goods received in their factory.</p>	<p>1,6987,349/-</p>	<p>SCN issued/ Pending adjudication</p>	<p>—</p>
<p>2. Irregular availment of Modvat credit. The SCN was issued since the party has imported cars in SKD which is not an input for cars. The SCN was issued as a precautionary measure. The matter is pending before CEGAT for consideration whether the party has imported* can or component parts of can.</p>	<p>—</p>	<p>SCN issued by Collr./ Adjudicated vide Collector's O.I.O. No. 108/95, dated 22.5.95 and dropped the proceedings except Rs. 2,060/- being the credit taken on xerox copies and imposed a penalty of Rs. 1,000/-</p>	<p>—</p> <p>The adjudication order is yet to be issued.</p>

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APPENDIX—V

*Conclusions and Recommendations*

SI. No	Para No.	Ministry / Dcptt.	Recommendation
1	2	3	4
1.	78.	Finance (Revenue)	The Modified Value Added Tax (Modvat) Scheme which was introduced from 1 March, 1986 provides for taking instant credit of duty paid on specified inputs and its utilisation towards payment of duty on specified final products. The scheme is governed by Rules S7A to 57J of the Central Excise Rules, 1994. Application of the Rules is guided by issue of notifications by the Government and instructions by the Central Board of Excise & Customs (CBEC). The Audit paragraph under examination deals with certain cases wherein an assessee fraudulently took modvat credit which was more than the duty paid on the inputs and the excess credit so taken was utilised towards payment of duty on final products. The Committee's examination of the paragraph has revealed certain disquieting facts which are dealt with in the succeeding paragraphs.
2.	79.	-do-	As per the procedure prescribed, the assessesees availing modvat credits were required to submit a monthly statement to the Jurisdictional Superintendent of Central Excise within five days of the close of the month indicating the particulars of inputs received and utilised and the amount of credit taken alongwith the extracts of the relevant document, viz., Part I and II of form RG 23A and also the duty paying documents in original evidencing the payment of duty. The instructions issued by CBEC to the field formations envisaged 100%

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check of duty paying documents by the departmental officers where credit taken exceeded Rs. 10,000, from the range office in whose jurisdiction duty paying documents originated. The entries in the RG 23A were also required to be checked with the original duty paying documents by the departmental officers. After verification, the documents were to be defaced within 15 days of the close of the month to prevent the manufacturer from availing of the credit twice on the same document.

3. 80. Finance The Committee find that a manufacturer of (Revenue) motor cars in Bangalore Collectorate of Central Excise, viz., Sipani Automobiles Ltd. took modvat credits of Rs. 76.84 lakhs which were more than the duty paid on the inputs during the period February 1991—March 1992 and the excess credits so taken were utilised towards payment of duty of final products. The assessee is reported to have done this by manipulating the documents/records and availed credit twice on the same gate passes and inflated the figures therein to hundred times on two occasions, inflated the amount in the gate pass to hundred times on one occasion and also inflated the closing balance of the RG 23A Part II without the same being detected by the departmental officers. The excess credits resulted in overdrawals on as many as 50 occasions during 1990-92 in the Personal Ledger Account (PLA) of the assessee through which payment of central excise duty is accounted for.
4. 81. -do- According to the Ministry of Finance the departmental officers failed to detect the irregularities as the assessee did not furnish the duty, paying documents in respect of inputs while submitting the extracts of RG 23A and therefore, the concerned officer could not cross check in time the entries in the RG 23A again with the original duty paying documents.

Astonishingly, the Committee found that the assessee had not been submitting the original duty paying documents at all from April, 1989 to 20 July 1992. The Department also had not resorted to any firm coercive action either to obtain the requisite documents as prescribed in the Law. In the absence of such cross verification, the Committee wonder as to how the Department ensured that amount of credit during this period was correctly availed particularly in one case where, the assessee had taken Modvat credit on the same date of the issue of Gate Pass although the goods had been despatched from far off place like Bombay by road.

- S. 82. Finance (Revenue) It was further stated by the Ministry that the Range Officer had also kept verification of the documents pending since the approval of the price list was held up on account of pending valuation dispute. Pertinently, according to Rule 9 of the Central Excise Rules, 1994 it is mandatory to resort to provisional assessment in such cases till the dispute is finally settled. Unfortunately, this was also not done on this case. The Secretary, Ministry of Finance (Department of Revenue) admitted during evidence that it was a dear case of failure on the part of the officers in exercising the prescribed checks in regard to modvat scheme. According to him if the officers had checked the documents the way in which they were required to check, the fraudulent methods resorted to by the assessee would have come to light in time. The representative of the Board also admitted in evidence the departmental failure in ordering provisional assessment pending approval of price lists. The Committee deplore the laxity on the part of the officers concerned on these scores and desire that the precise reasons for the same needs to be looked into. They also recommend that the

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Ministry should ensure that the provisions of the Central Excise Law are administered both in letter and spirit and also that the instructions of the Board are scrupulously followed with by the field formations.

6. 83. Finance The Committee find that as per the procedures (Revenue) prescribed in the Central Excise Manual, the Internal Audit parties of the department are required to visit the premises of the assessee twice a year and recheck the duty paying documents and statutory records. The Committee find that in respect of the present assessee, the Internal Audit were able to detect only one of the four cases of irregularities pointed out by CAG. It was stated that prescribed frequency of visits was not observed by the Internal Audit due to pressure of heavy work and constraint of required number of Audit parties. The Committee would like to emphasise that Internal Audit is an important tool of management control particularly in an organisation like Central Excise which is responsible for administering vital revenues of Government and therefore it is imperative that the Board take suitable steps and ensure that this instrument is efficiently used in exercising effective control and checking leakage of revenue. The Committee would therefore, like the Ministry to look into the functioning of the Internal Audit Department with a view to improving its efficacy.
7. 84. -do- In this context the Committee further find that the scrutiny of records of the assessee in the present case for the period December, 1990 to June, 1991 was done by the Internal Audit from 29 to 31 July, 1991. The Internal Audit Report was issued in October, 1991 and the copy was endorsed to the Assistant Collector and also to the Range. Surprisingly, it was only on 2 March, 1992, i.e. after a period of five months that the Range Officer asked the assessee to produce the documents for verification and

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defacing. Eventually, the documents were handed over by the assessee voluntarily on 20 July, 1992. While deprecating the departmental delay in acting upon the Internal Audit Report promptly, the Committee would also like to point out that this delay is also indicative of the inadequate system of monitoring the internal audit objections at various levels including Collectorate/Board which needs to be remedied. The Committee, in this connection would also recommend that the Ministry/Board should prescribe a time frame for the follow-up action on objections raised by Internal Audit.

8. 85. Finance      The Committee have been informed that in (Revenue) addition to the mechanism of Internal Audit control have also been prescribed for checking fraudulent availment of credits in the form of scrutiny of records of factories by anti-evasion wing of all units availing modvat credit of Rs. 25 lakhs and above annually, special audit of all units availing credit of Rs. 10 Lakhs and above per annum, setting up of surprise squads by Collectors for verification of modvat credit etc. Significantly, the assessee had paid duties amounting to Rs. 63.13 lakhs and Rs. 59.97 lakhs in the years 1990-91 and 1991-92 respectively. The Committee are, however, yet to be informed whether these controls were exercised in the case under examination and if so the reasons for the failure of these mechanisms in detecting the fraud. What has further concerned them is that the Ministry/Board do not seem to have any system to monitor and generate the data on this score as the query raised by the Committee to apprise them of the number of surprise checks conducted by the Collectors in respect of modvat and its impact during the last three years still remains to be answered fully. This is indicative of the fact that the different controls

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stipulated through the instructions are not being followed properly. The Committee cannot but express their concern over this and desire that the Ministry of Finance should look into the effectiveness of the controls prescribed and take appropriate steps to make the internal control mechanism more effective.

9. 86. Finance (Revenue) The Committee are distressed to note that in spite of the serious nature of the offences committed by the assessee, the response of the Ministry thereto has not been inspiring. Although the irregularities were initially detected as early as in 1991, the offence case was registered as late as June 1992 and a show cause notice was ultimately issued to the assessee only on 3 August, 1993, i.e. after the Audit paragraph was selected by the Committee (1993-94) for detailed examination. The case was adjudicated on 16 November, 1993 and a penalty of Rs. 10 lakhs was imposed on the assessee by the adjudicating authority. Against the Adjudicatory Order, the assessee filed an appeal with the Custom, Central Excise and Gold Control Appellate Tribunal (CEGAT). The CEGAT is stated to have ordered pre-deposit of Rs. 5 lakhs out of the penalty of Rs. 10 lakhs imposed. As the assessee could not comply with this order, through an amount of Rs. 4.78 lakhs had been recovered, the CEGAT on 2 January, 1995 rejected the appeal filed by the assessee. The Committee were informed that for the balance amount of penalty i.e. Rs. 5.22 lakhs some assets of the party have been attached on 16 June, 1995. It is evident from the facts stated above that besides the inordinate delay in registering that offence case and issuing show-cause notice, the department had again delayed the issue of attachment order of the property for realising the dues from the party on account of penalty. Apparently, it was done only after this Committee's decision to

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take oral examination of the subject on 21 June, 1995.

The Committee deprecate this tendency and desire that the Ministry of Finance should take suitable steps to obviate the same and ensure that penal and recovery actions are initiated in time. The Committee would like to be apprised of the further developments including the dues realised from the property of the assessee attaching by the department.

10. 87. Finance (Revenue) What has further caused concern to the Committee is that despite the serious nature of offences committed, no steps were taken in time to launch prosecution against the party under the Central Excise Law/Indian Penal Code. The Department launched prosecution under Section 9 of the Central Excises and Salt Act, 1944 against the Company, its Managing Director and the Deputy Commercial Manager on 15 July, 1994 only in the Economic Offences Court. The Committee were informed that on 30 November, 1994, the assessee filed a Writ Petition in Karnataka High Court for quashing the prosecution complaint filed by the department and hence the hearing has been adjourned by the Offences Court. While admitting the inadequacy in launching of prosecution proceedings in this ease, the Secretary, Revenue stated in evidence that the assessee should have been arrested. The Committee express their displeasure over the inadequacies in launching prosecution in this ease and desire that the matter should be enquired into and responsibility fixed. They would also like to be informed of the further developments with regard to the prosecution action that has been initiated. The Committee also recommend that the Ministry of Finance should take adequate steps to ensure that stringent and prompt action is taken against unscrupulous assesssccs found indulging in such dubious methods of defrauding the Government.

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11. 88. Finance The excess credit of Rs. 76.84 lakhs availed of (Revenue) by the assessee was stated to have been recovered/adjusted subsequently. It had thus enabled the assessee of interest free funds at different points of time. In this connection, the Committee note that although provisions have been made in the Central Excise Law through recent amendments for providing for charging of interest for delayed payments, the amended provision does not take into account the present type of case where the assessee had himself rectified the mistake and the Excise Department had not determined the duty payable. The Ministry of Finance maintained that such situations will be taken care of by the existing provisions of Central Excise Law which provides for imposition of penalty upto three times the value of goods and will cover even the interest elements gained by the assessee. The Committee are not inclined to agree with this. While the payment of interest is mandatory, penalty is discretionary and it is upto the Assessing Officer to work out the amount. Further, finalisation of penalty amount may also take its own time. The Committee would therefore recommend that the Ministry of Finance should consider the desirability of incorporating suitable provisions in the Law for collection of interest on excess/fraudulent MODVAT credit as in the case under examination.
12. 89. -do- Another disquieting aspect observed by the Committee related to the action taken against departmental officers for their various lapses. The irregular availment of excess credit was initially known to the department through the objection raised by the internal audit department as far back as in October, 1991. The authorities concerned were already aware of the lapses committed by the departmental officer in the scrutiny of documents, exercise of

control etc. in 1991-92 itself. The Principal Collector of Central Excise, Hyderabad was asked by the Board to conduct detailed examination of the case. In his report dated 11 August, 1993 he had clearly brought out the lapses on the part of the officers concerned. The Committee are astonished to note that in spite' of the above, chargesheets to three departmental officers of the rank of inspector were issued on 15 June, 1995, only, i.e. after the subject matter was taken up by this Committee for oral examination. The charge sheets against the Range Officer and the Assistant Collector/Assistant Commissioner are yet to be issued. This clearly is indicative of the lack of seriousness in punishing the guilty for the serious lapses committed by them. During evidence the representative of the Central Board of Excise & Customs admitted that there has been an "inexplicable delay" in proceeding against the officers. The Secretary, Revenue also admitted that Collector concerned had also not exercised his supervisory/responsibility to the extent to which he should have done. The Committee deplore the delay in initiating action against the officers concerned. They desire that the cases under examination should be thoroughly investigated and responsibility fixed including that of the Collector concerned. They would like to be informed of the further action taken in the matter. The Ministry of Finance should also ensure that action in such cases is taken promptly so that it acts as a deterrent.

13. 90. Finance (Revenue) During the course of examination the Committee found that the irregular/fraudulent availment of excess credit in the case under examination was not an isolated one. Cases from other Collectorate also were reported of similar irregularities pertaining to the same period, the details of which are given elsewhere in the Report. In addition to the cases referred

to in the audit paragraphs, the same assessee was again stated to have indulged in yet another similar malpractice which was detected by the department in July, 1993. When the repeated indulgence by the assessee in the same irregularity was brought to the notice of the representatives of the Ministry/Board during evidence, the Committee were informed that the Collector concerned has presently tightened the control and a stricter vigil was now being exercised in respect of this assessee. It was also seen by the Committee that the Collector of Central Excise Bangalore in his letter dated 1 September, 1993 addressed to the Member, CBEC has stated that an undertaking was obtained from the assessee that they will not avail any irregular MODVAT credit in future. The Committee are, however, shocked to note from the information furnished by the Ministry of Finance subsequent to evidence that the same assessee resorted to similar type of availment of excess credits in five cases during the months of April-May, 1995 involving a total excess credit of Rs. 1.78 lakhs, which was stated to have been recovered subsequently. This clearly shows that the so-called "tightening of the control" and the extra vigil stated to have been exercised by the authorities have not produced any desired results and similar instances continue to recur unabated. The Committee cannot but express their serious concern over, the inability of the authorities concerned in checking such malpractices by one single assessee repeatedly. The Committee, therefore, desire the Ministry to address themselves to this issue with the seriousness it deserves and take stern measures against the party concerned for the offences and also the officers found responsible for their omissions and commissions.

14. 91. Finance The Committee have been informed that an  
(Revenue) offence case in respect of the five cases detected

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in April-May, 1995 has since been booked and action was being initiated against the officers found responsible. The Committee desire the matter to be pursued vigorously and would like to be informed of the further action taken in the matter.

15. 92. Finance The Committee are constrained to point out (Revenue) that in the cases pointed out by Audit in the paragraph under examination the response of the Ministry of Finance/Board was also somewhat casual. From the information made available to the Committee it was seen that the Board/Ministry were fully aware of the relevant details of the cases including the extent of irregularity, role of the officers and status of the case at least since October, 1992. Pertinently, as per the instructions of the Member, CBEC, the case was examined and a report given by the Principal Collector of Central Excise, Hyderabad. In his report submitted in August, 1993 and addressed to the Member, CBEC, the Principal Collector while narrating the facts of the case, role of the officers etc. had *inter-alia* stated that "in view of the repeated irregularities committed by the assessee, for some time to come, greater and frequent checks should be exercised over the functioning of the unit." He had also in his report stated that "proposals for prosecution are to be considered quickly." Unfortunately, adequate action was not taken by the Board/Ministry to ensure that stern action is taken promptly against the party as well as the officers responsible. In fact, the Committee found that after 15 July, 1994 the Ministry had not bothered to enquire about the further action taken in the matter at all. It was only after the subject was taken up by this Committee for oral evidence that the matter seems to have been pursued and action initiated against the officers and also for attachment of property of the party against the amount due to

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the department. The Committee express their strong displeasure over the same and desire that the Board/Ministry should in future act with more promptitude and decisiveness in dealing with such economic offences.

16. 93. Finance (Revenue) clearly establish that there was an absolute breakdown of excise control and proper supervision and monitoring of the unit inavailing modvat credit. There were vital lapses on the part of the departmental officers which enabled the assessee in perpetrating the fraud. There included failure to obtain the requisite documents in time, failure to order provisional assessment pending finalisation of price list, inadequacies in conducting Internal Audit, failure to take action promptly on the observations made by the Internal Audit, inadequate performance of anti-evasion wing to detect these cases, other inadequacies in internal control, delay in registering the case and issuing show-cause-notice to the assessee, delay in attachment of property of the party to realise the governmental dues even after the decision of the appellate tribunal, delay in taking action against the officers etc. While admitting the seriousness of the matter, the Secretary, Department of Revenue stated in evidence that this is a case where a senior officer has to investigate as to why there has been a total failure to check the malpractices of one assessee over the years. The Committee are of the firm view that the assessee would not have succeeded in his efforts in defrauding the Government repeatedly without the active connivance of the departmental officers. While deploring such an unhealthy tendency in the prime revenue earning department of the country, the Committee recommend that the facts stated in this report should be thoroughly inquired into with a view to finding out as to

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how and why the lapses occurred, to what extent they were bonafide mistakes and taking stern action against all the officers found responsible for the same. Government should also ensure that such economic offences are dealt with sternly and promptly so that it acts as a deterrent for similar fraudulent activities. The Committee would like to be informed of the action taken in the matter within a period of three months.

17. 94. Finance

(Revenue)

From the information made available to the Committee it was also seen that the assessee involved in the present case was found to have indulged in evasion of central excise duty in as many as 12 cases involving a total duty of over Rs. 6 crores. The details of these cases have been given elsewhere in the Report. These cases were stated to be either pending adjudication before Collector, CEGAT or pending before the Court, pending recovery, pending issue of show cause notice etc. One case involving duty of Rs. 45.41 lakhs was stated to have been dropped by the department after the decision at the first appellate stage itself. The Committee desire that all the cases should be pursued to their logical conclusions and would also like to be apprised of the further progress made with regard to all the cases. They would also like to be informed of the details in respect of the case in which further proceedings were stated to have been dropped by the department after the appellate decision at Collector's level and the reasons for not contesting it.

18. 95. -do-

During evidence, the Committee were informed that the case under examination was one of human failure and not due to any inadequacy in the system control. In this connection, the Committee find that in addition to the cases of misuse by the same assessee and

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other identical cases observed during the relevant period, the Report of the C&AG for the year 1993-94 (No.4 of 1995) has also after a test Audit found 11 such cases in six Collectorates involving excess availment of credit amounting to Rs. 28.52 lakhs. This clearly shows that misuse of Modvat facility is fairly widespread. Since Modvat is a facility extended to the manufacturers, the Committee strongly feel that Government should consider making necessary provisions in the Law to withdraw the facility wherever the same is found to have been misused/abused.

19. 96. Finance  
(Revenue)

The Committee were informed during evidence that Government were contemplating installation of Computer based system in the Central Excise Department which was expected to minimise frauds of the nature under examination. The Committee would like to be kept apprised of the progress made in the area.

20. 97. -do-

The Committee note that the invoice based assessment has been introduced in Central Excise w.e.f. 1 April, 1994. The assessee's invoice will now be used as a transport document in lieu of gate pass and price list. Modvat credit is available only on duplicate invoices. According to the Ministry, in order to prevent misuse of gate pass and also with a view to simplifying and making the scheme of Modvat more transparent, the gate passes were replaced by invoice. According to them, the invoices have certain merits over the gate passes inasmuch as they cannot be endorsed to any other user, the proforma for invoice also contains certain additional particulars like mentioning the duty and value both in the words and figures (which was not there in the case of gate passes), they are also required to be pre-authenticated by the owner of the Company and the invoices have certain inbuilt

checks. The Committee are constrained to point out that inspite of the inbuilt checks stated to have been provided in the invoice system fraudulent availment of Modvat credit could not be prevented in respect of the same assessee in April-May 1995 (discussed earlier) where the invoices were also found to have been misused. Further, ccrtain other irregularities were also brought to the notice of the Committee relating to availment of credit after the introduction of invoice based assessment. The Committee therefore recommend that the Ministry of Finance should critically look into those eases and initiate further necessary control measures to cheek misuse of the scheme effectively.

21. 98. Finance (Revenue)      The Modified system of Value added Tax has been in existence in India for more than 9 years. During evidence the representatives of the Ministry of Financc stated that no comprehensive evaluation of the system has been undertaken so far. The Committee were\* informed that the Ministry have now asked the National Institute of Public Financc and Policy to make a comprehensive study of the system and suggest measures for the simplification of the procedures relating to Modvat, particularly in the light of the instances of misuse of Modvat credit noticed in recent times. The Committee trust that the study will be expeditiously completed and further ncessary measures initiated in order to ensure that the scheme subserve\* its purpose. They would like to be informed of the deatils of the study and the follow-up action taken thereon.

