# CHAPTER II
# ACCUMULATION OF CENVAT CREDIT

Irregular availing (taking) of cenvat credit adds to the credit kitty of an assessee which can thereafter be used to pay excise duty/ service tax. This results in revenue loss because if the assessee had not wrongly availed and accumulated the credit, he would have had to pay the duty/ tax to the government in cash. We found that large accumulation of cenvat credit had occurred due to

- Absence/ inadequacy of provisions
- Availing of credit on ineligible inputs, input services and capital goods
- Non reversal of credit
- Procedural shortcomings

## SECTION A: ABSENCE/ INADEQUACY OF PROVISIONS

We have identified certain shortcomings in the provisions, rules and regulations, which translated to accumulation of credit and potential revenue loss of ₹ 190.61 crore. We have recommended that these problems may be rectified by suitable amendments/ clarifications.

### 2.1 Absence of penal provisions for non-submission of ER 5 and ER 6 returns

According to Rule 9A of the Cenvat Credit Rules, 2004, a manufacturer of specified goods who had paid duty of ₹ one crore or more during the preceding financial year has to submit:

- an annual return (ER 5) declaring all excisable goods to be manufactured and the quantity of principal inputs required
- a monthly return (ER 6) giving information of the receipt and consumption of each principal input with reference to the quantity of final products.

Such returns enable the department to verify whether the ratio between input and output is within acceptable norms. This is a critical check because overstating input or understating output would enable a manufacturer to evade duty.

We found that 35 out of 93 assessees test checked in 11 commissionerates, who had paid more than ₹ one crore of duty, did not furnish these returns and three assessees submitted declaration after a delay between 9 to 20 months. We observed that the department did not have a mechanism to periodically identify defaulters and follow up to ensure submission of these returns.

Moreover, the Rules do not specify any penal provisions for non-submission or delayed submission of these returns. Therefore, this important check was not being exercised properly and the attendant risk of evasion was not being addressed adequately. We found two cases where large discrepancies had not been examined and remained unexplained. They are detailed below:

ER 5 returns of M/s Bharat Aluminium Company Ltd., Korba showed that it had manufactured 8.44 lakh tonne of aluminium products during the years 2005-06 to 2007-08 for which 488.99 lakh litres of furnace oil was required as per output norms. However, it showed consumption of 1,523.93 lakh litres. Thus there was an unexplained excess consumption of 1,034.94 lakh litres of furnace oil with consequential excess availing of cenvat credit of ₹ 29.45 crore.

The ER 5 and ER 6 returns also showed that against the requirement of 29,581 tonne of caustic soda for manufacture of 2.22 lakh tonne of alumina during 2006-07, 32,635 tonne of caustic soda was consumed. Thus, there was excess consumption of 3,054 tonne of caustic soda which translated to excess availing of cenvat credit of ₹ 77.74 lakh. The cenvat credit availed in excess was recoverable with interest. These cases had not been detected by the department.

On the observation being pointed out (February 2009), the department stated that the matter would be examined.

Since these kinds of discrepancies can be detected from ER 5 and ER 6 returns, the monitoring needs to be strengthened.

***Recommendation No. 1***

- *Government may consider introducing a penal provision for non-submission of ER 5 and ER 6 returns.*

In the exit conference, the Board stated that Rule 15A of Cenvat Credit Rules provided a penal provision for non-submission of any type of return. It also stated that it would issue an instruction that penalty should be imposed under Rule 15A for non-submission of ER 5 and ER 6 returns.

## 2.2 Absence of provisions for reversal of Cenvat credit on input services used for written off output services

Rule 3 (5B) of the Cenvat Credit Rules, 2004, provides that if the value of any input or capital goods on which credit has been taken, is fully written off or provision is made to write off the value fully, then the manufacturer shall pay an amount equivalent to the credit taken in respect of the said input or capital goods.

We observed that Cenvat Credit Rules are silent about recovery or reversal of credit of input service in cases where taxable output services are written off because they have become irrecoverable for any reason. The input service credit attributable to such write offs is required to be reversed as there is no cascading effect of tax as service tax is not paid on the output service. Therefore, the input service credit is required to be reversed.

We found that 26 service providers, in 14 commissionerates had written off bills receivable of ₹ 1,427.34 crore between the years 2004-05 and 2007-08. The written off amounts were primarily unpaid credit card and post paid mobile phone bills. Cenvat credit of ₹ 23.17 crore was attributable to the input services used in output services written off. In the absence of any provisions, this amount could not be recovered and represented a loss of revenue to the Government. One illustrative example is given below: -

- M/s SBI Cards and Payments Services (P) Ltd, Gurgaon, in New Delhi commissionerate of service tax, engaged in providing credit card services under banking and other financial services, could not realise some amounts billed against customers and recorded them under sundry debtors in the financial accounts of the relevant years. The assessee fully wrote off such unrealised amount aggregating to ₹ 329.41 crore subsequently during the years from 2005-06 to 2007-08 as these became irrecoverable. The proportionate cenvat credit attributable to input services against such irrecoverable dues worked out to ₹ 15.09 crore. This was not paid back to the Government or reversed.

When we pointed this out (March 2009), the department intimated (September 2009) that output service did not loose its status of being taxable merely because the same was not received by the service provider or was received in part. Therefore, writing off of the amount due towards output service would not affect cenvat credit paid on input services.

The reply of the department is not acceptable. Although, the output service remains taxable, there is no cascading of tax as the amount receivable is written off. Therefore, credit of input services should not be admissible.

***Recommendation No. 2***

- *The Government should introduce appropriate provision in the Cenvat Credit Rules for reversal of Cenvat credit on input services used for output services that are written off.*

In the exit conference, the Board accepted the recommendation and stated that this requirement has been addressed in the draft Point of Taxation Rules. It also agreed to examine the feasibility of an interim provision to safeguard revenue pending finalisation of the draft rules.

## 2.3 Absence of provisions for recovery of cenvat credit taken on inputs and input services used in the production of non-excisable goods

Rule 6 of the Cenvat Credit Rules, 2004 enunciates that a manufacturer of both dutiable and exempted goods has to maintain separate accounts of inputs and input services used in dutiable and exempted final products so that he does not avail cenvat credit for inputs and input services used for exempted goods. If he chooses not to maintain separate accounts then he shall pay an amount equal to 8/10 per cent of the price of the exempted final product.

**Non-excisable goods**

As quoted above, Rule 6 gives a clear provision for a manufacture of both dutiable and exempted goods. However, no such provision has been prescribed in the Rules in respect of inputs or input services used in relation to the manufacture of goods for which nil rate of duty has been prescribed or non-excisable goods i.e. though they find a place in tariff, neither rate of duty nor nil rate has been prescribed but instead a blank is left in the column of rate. Consequently, the entire cenvat credit taken on the inputs/input services used for producing non excisable/nil rate of duty goods becomes available for paying duty on other dutiable items.

We observed that 26 manufacturers in 12 commissionerates of central excise, besides manufacturing various excisable goods also produced non-excisable goods viz., rectified spirit, zinc dross, electricity etc. and cleared these without payment of duty. The electricity was partly used within the factory for manufacture of final products and partly sold to State Electricity Boards/other factories or was cleared to the residential colonies. These assessees availed full cenvat credit of duty and tax paid on inputs and input services but did not maintain separate inventory in respect of inputs and input services used in production of such non-excisable goods.

If the criteria of 10 per cent of the price of the non excisable product had been applied, as provided for exempted goods in the Rule 6, an amount of ₹ 96.79 crore would have been realised during the period from April 2003 and March 2008.

**2.3.1** Six assessees, in Raipur commissionerate, engaged in the manufacture of iron & steel products, cement & clinker etc. also produced electricity. This was partly used within the factory for manufacture of their final products and remainder sold to residential colony, contractors engaged in the factory for various works and Chhattisgarh State Electricity Board for ₹ 218.75 crore during April 2005 to March 2008 without payment of any excise duty. Since separate accounts were not maintained, the credit taken on inputs/input services used for producing electricity were not neutralised in any way.

Some other cases are illustrated in the following table: -

**Table no. 2:**

**(Rs. in crore)**

| Sl. No. | Assessee | Commissionerate | Non-excisable product | Value of sold non-taxable product | 10% of the sale value |
|---|---|---|---|---|---|
| 1 | Six assesses | Bhubaneshwar -I & II | Electricity | 335.25 | 33.52 |
| 2 | M/s Grasim Industries Ltd. | Indore | Electricity | 228.27 | 22.83 |
| 3 | M/s New Swadeshi Sugar Mills Ltd. | Patna | Rectified Spirit & electricity | 26.97 | 2.70 |
| 4 | M/s RPG Transmission Ltd. (New Name: M/s KEC Transmission Ltd.) | Bhopal | Zinc Dross & Burnt Zinc | 7.84 | .79 |

When we pointed this out in February 2009, the department intimated (June 2010) that SCNs had been issued to the assessees mentioned at sl. No. 2 and 4 of the above table.

***Recommendation No. 3***

- *Rule 6 of the Cenvat Credit Rules, 2004 provides for compensatory payments when manufacturers produce dutiable and exempted products but do not keep separate account of the inputs and input services used for manufacturing dutiable/exempted goods. The rule is silent in respect of manufacturing of dutiable and non-excisable goods. Suitable compensatory payments may be included in Rule 6 for not maintaining separate accounts for dutiable and non-excisable goods.*

In the exit conference, the Board agreed that the Rule was silent in respect of non excisable goods and stated that appropriate clarification would be issued in this regard.

## 2.4 Double benefit of credit of special additional duty (special CVD) availed on imported inputs

By customs notification dated 1 March 2006 issued under section 3(5) of the Customs Tariff Act,1975, an additional duty of customs 'Special CVD' in lieu of state taxes/VAT has been imposed at 4 per cent on all imported goods with effect from 1 March 2006. By amendment in rule 3 of the Cenvat Credit Rules, 2004, benefit of cenvat credit has been extended to the special CVD paid on imported goods.

However, the rules and provisions do not clearly specify whether Cenvat credit can be availed for special CVD which is not paid in cash but adjusted against licenses issued under various schemes like DFEC, Target plus, DEPB, etc.

We observed that 17 test checked assessees in Hyderabad I, III, IV, Tirupathi and Vizag commissionerates, engaged in the manufacture of excisable goods, availed cenvat credit of special additional duty on imported inputs (Special CVD) even though duty to this extent was not paid in cash but was adjusted against import incentive schemes like DEPB, Target Plus, etc. In terms of the above rule, the total credit of ₹ 27.88 crore of the special additional duty was availed and utilised during the period 2006-07 and 2007-08 on imported inputs needed to be recovered.

When we pointed this out (April 2007 to March 2009), the department intimated (January 2009 to August 2010) that protective SCNs had already been issued in all the cases. In the case of M/s Amara Raja Batteries Ltd., it was stated that the Board had clarified in October 2006 that CVD levied under section 3 of the Customs Act could be availed as cenvat credit irrespective of the fact whether it was paid in cash or debited to schemes. Further development was awaited.

The reply of the department was not acceptable. The clarification related to CVD levied under section 3 whereas Special CVD (SAD) was a distinct duty

levied under section 3(5). There was nothing in the clarification to indicate that it was also applicable for Special CVD.

***Recommendation No. 4***

- *The Government may examine and clarify whether Cenvat credit can be availed for special CVD paid for imports where all customs duties are adjusted against import incentive schemes.*

In the exit conference, the Board agreed to issue a clarification on admissibility of Cenvat credit for the special CVD debited to schemes.

## 2.5 Absence of provision for proportionate reversal of credit in respect of inputs written off partially

Rule 3 (5B) of the Cenvat Credit Rules and clarification of the Board provide that if the value of any input or capital goods, on which credit has been taken, is fully written off or provision to write off fully is made before being put to use, then the manufacturer shall pay an amount equal to the credit taken on the said inputs or capital goods. The rules do not stipulate any time limit for use of the inputs.

We found that 21 assessees in 14 commissionerates wrote off a major portion of the value of inputs that had not been used. However, they kept small residual amounts in their books for these inputs. Consequently, they did not reverse cenvat credit of ₹ 12.18 crore availed on these unutilised inputs. In the absence of any time limit for use, they were in a position to retain the residual value for an indefinite period and avoid reversing the cenvat credit. Therefore, the provision of reversal had become virtually non-operational due to the criteria of 'fully' writing off and absence of time limit. Two illustrative cases are given below: -

**2.5.1** M/s NALCO (M & R Division) Ltd., in Bhubaneshwar I commissionerate wrote off 95 per cent value of non moving stores and spares of ₹ 13.49 crore lying unused for more than 5 years. M/s SAIL, Rourkela Steel Plant under Bhubaneshwar II commissionerate wrote off 90 per cent cost of obsolete, surplus and non-moving stores and spares not used for 15 years and more amounting to ₹ 30.78 crore. Though the goods were unfit for use, the cenvat credit of ₹ 7.08 crore attributable to all these materials was not paid back by these assessees because the value was not fully written off. This was recoverable with interest of ₹ 99.12 lakh from the assessees.

When we pointed this out (April 2009 and May 2009), the department intimated in the first case (October 2009) that in view of sub rule 3 (v) (b) of Cenvat Credit Rules and as per Board's circular dated 16 July 2002, the assessee need not reverse the cenvat credit availed on such goods, as in those cases the spare parts were available in the factory premises and could be used in future. In the second case the department stated that as per accounting policy followed, the assessee wrote off 90 per cent of value of stores and spares which were not used for 15 years and more. There were instances when such material was used again. As rule 3 (v) (b) of Cenvat Credit Rules

envisaged for reversal of cenvat credit availed only in cases where the value was fully written off, no reversal of cenvat credit was warranted.

**2.5.2** M/s Toyota Kirloskar Auto Parts Pvt. Ltd, in Bangalore LTU commissionerate, wrote down the value of non-moving inputs from ₹ 270.24 lakh to ₹ 2.55 lakh, during the year 2007-08. By retaining this miniscule value in the books of account, the assessee postponed the reversal of cenvat credit of ₹ 32.60 lakh for an indefinite period.

When we pointed this out (March 2009), the department stated (November 2009) that as the assessee had not written off the inputs completely, the credit need not be reversed.

The replies underlined the absence of a provision for reversal on partial write off.

***Recommendation No. 5***

- *The Government should consider changing the stipulation of 'fully writing off' to a proportionate reversal of credit in case of partial writing off.*

In the exit conference, the Board agreed that it would examine the feasibility of an amendment for a proportionate reversal of credit where inputs were partially written off.

## 2.6 Non-recovery of cenvat credit on destroyed capital goods

Rule 3(5A) of the Cenvat Credit Rules (effective from November 2007) requires reversal of pro rata credit after allowing abatement of 2.5 per cent per quarter from the credit in respect of capital goods cleared in good working condition after being put to use. Rule 3(5B) provides that where capital goods are written off before use, the cenvat credit availed thereon will have to be reversed.

However, the Rules do not contain provisions for recovery of duty on capital goods destroyed in explosion, fire, flood etc.

**2.6.1** We found that capital goods on which cenvat credit of ₹ 37.78 lakh had already been availed, were damaged in an explosion in the factory of M/s Aurobindo Pharma Ltd. (Unit-V), Isnapur, in Hyderabad I commissionerate. Though the assessee received compensation from insurance company for the damage, yet it did not pay proportionate credit of ₹ 33.23 lakh after allowing the permissible abatement of 2.5 per cent of credit for every quarter of use from the date of installation to the date of destruction. The assessee paid duty of ₹ 1.73 lakh on scrap value of clearances which was not correct as the capital goods had neither been used for full life period in assessee's factory nor did they become scrap after prolonged use in normal course. Thus credit of ₹ 31.50 lakh was recoverable.

On the observation being pointed out (September 2008), the department stated (October 2009) that a protective SCN for ₹ 33.23 lakh had been issued to the assessee to safeguard revenue.

**2.6.2** Similarly, in M/s Merchem Ltd., Udyogmandal, in Cochin commissionerate, a fire accident occurred in January 2007 wherein plant and machinery valuing ₹ 37.30 lakh was destroyed on which credit had already been availed. Though, the assessee received the insurance claim of ₹ 55.53 lakh in February 2008 on damaged goods, inclusive of duty suffered, yet duty on damaged plant and machinery amounting to ₹ 5.42 lakh was not paid.

When we pointed this out (January 2009), the department replied (October 2009) that SCN had been issued to the assessee and demand confirmed. Further development regarding recovery of the amount was awaited (December 2010).

***Recommendation No. 6***

- *Feasibility of insertion of a provision under rule 3 of the Cenvat Credit Rules, 2004 may be examined to provide for recovery of credit in case of capital goods not fully used for any reason.*

In the exit conference, the Board agreed that there was no provision to write off credit in the cases of destruction of capital goods in fire or otherwise and stated that the matter would be examined.

## SECTION B: CREDIT AVAILED ON INELIGIBLE INPUTS, CAPITAL GOODS AND INPUT SERVICES

We found instances where assessees availed cenvat credit of ₹ 530.15 crore on inputs, input services and capital goods that had been specifically disallowed in the rules or through notifications.

### 2.7 Credit on tower and parts of tower by service providers

According to the Cenvat Credit Rules, 2004 and clarification issued by Board in February 2008, towers, parts of tower such as angles, channels, beams of steel etc. and pre fabricated shelter/panels used by cellular phone service providers for erecting towers, making house, storage units etc. are not specified capital goods for availing cenvat credit.

We found that 25 service providers, in 18 commissionerates, had availed of cenvat credit of ₹ 377.69 crore on towers and tower parts, fabricated building material/shelter, electric arrestors etc., by treating them incorrectly as capital goods during the period between April 2004 and May 2009. The department had admitted (December 2010) audit observations in five cases involving cenvat amount of ₹ 57.62 crore. In two cases, the assessees M/s. Lambda Therapeutic Research and M/s Bloomberg Data Services Ltd., in Ahmedabad ST and Mumbai ST commissionerates respectively had paid ₹ 39.38 lakh. In five cases (one accepted for ₹ 45.05 crore and four not accepted), the department issued SCNs for ₹ 86.77 crore. Reply was awaited in other cases (December 2010).

Two illustrations are given below: -

**2.7.1** M/s Reliance Telecom Ltd., Silliguri, in Silliguri commissionerate and M/s Reliance Telecom Ltd., Kolkata, in Kolkata service tax

commissionerate, availed of cenvat credit on various types of towers and tower parts treating the same as capital goods. Since, these items were not covered under definition of capital goods, availing of credit on the same treating them as capital goods was incorrect. The credit availed of ₹ 12.37 crore during the period from April 2005 to March 2008 was recoverable with interest.

On this being pointed out (January 2009), the department accepted (February 2009) the audit observation in one case involving credit of ₹ 11.89 crore.

**2.7.2** M/s Vodafone Essar Cellular Ltd., Erranakulam, in Kochi commissionerate, availed of cenvat credit on towers and parts thereof treating them as capital goods. The credit availed on them during the years 2005-06, 2006-07 and 2007-08 amounting to ₹ 6.32 crore was not admissible and had to be recovered.

When we pointed this out (April 2008), the department replied (October 2009) that SCN had been issued to the assessee in July 2008. Further development was awaited (December 2010).

## 2.8 Cenvat credit on ineligible inputs

Rule 2(K) of the Cenvat Credit Rules, 2004, defines 'input' as all goods except light diesel oil, high speed diesel oil and motor spirit commonly known as petrol, used in or in relation to the manufacture of final products and capital goods used in the factory, whether directly or indirectly and whether contained in the final product or not. It also specifies that cement, angles, channels, etc. used for construction of sheds, buildings and structures for support of capital goods do not quantify as inputs.

We found that 22 assessees in 14 commissionerates had availed cenvat credit of ₹ 21.64 crore on goods which were not covered by definition of inputs and did not relate to manufacture of products or capital goods. The department had accepted audit observations in four cases involving duty of ₹ 4.67 crore and issued SCN of ₹ 1.28 crore in one of these cases. Two illustrative cases are given below: -

**2.8.1** M/s HINDALCO Industries Ltd., Muri, in Ranchi commissionerate, engaged in the manufacture of calcined alumina, alumina hydrate etc. (chapter 28), purchased inputs such as MS plates, beams, channels, angles, welding electrodes etc. for the purpose of erection of structures, the expansion of the factory, for general use etc. This resulted in incorrect availing of cenvat credit of ₹ 5.47 crore during the period from September 2001 to December 2007 which was recoverable with interest and penalty.

When we pointed this out (June 2009), the department did not convey the action but mentioned that the issue was raised by their internal audit wing in 2004-05. This was not acceptable as it was first raised by CERA in September 2002 and the paragraph was updated as no action had been taken. Even now, the department had not intimated the action taken (December 2010).

**2.8.2** M/s IOCL (RD), Haldia, in Haldia commissionerate, brought in contaminated superior kerosene oil from its Marketing division for production of fresh superior kerosene oil and availed of cenvat credit thereon. As per Supreme Court judgement in the case of Ujagar Prints, this process does not amount to manufacture since no new commercial product arises out of it. Hence, contaminated superior kerosene oil was not an input for production of fresh superior kerosene oil in terms of Cenvat Credit Rules. This resulted in irregular availing of cenvat credit of ₹ 1.28 crore**.**

This was pointed out in July 2006. The department accepted the audit observation and intimated (November 2008) issue of show cause notice in October 2008. Further development was awaited (December 2010).

## 2.9 Cenvat Credit on ineligible capital goods

In the cases of M/s Nava Bharat Ferro Alloys Ltd., {2004 (174) ELT 375} and M/s Vivek Alloys Ltd., {1998 (98) ELT 156}, the Tribunals held that HR coils, channels, plate, hard plates, steel, MS angles, MS rounds etc., are not eligible for cenvat credit as capital goods because these goods, being general purpose items having multifarious use, are not covered by the definition of capital goods.

We found that 43 assessees in 24 commissionerates had availed cenvat credit of ₹ 50.49 crore, in contravention of the rules and judicial decision, on structural items like angles, plates, channels, beams, joists, plates, TMT bars, MS bars, lighting fittings, furniture, cement used for construction of warehouse, shed, distillery division, erection of machinery etc. and also on ladle car and rails (between April 2003 and March 2009). The department had accepted audit observations (August and November 2008) in 18 cases involving amount of ₹ 4.81 crore and reported recovery of ₹ 62.51 lakh including interest. The department has also issued SCNs of ₹ 19.67 crore in eight accepted cases and one case not accepted. Two illustrative cases are given below:

**2.9.1** M/s GMR Hyderabad International Airport Ltd., in Hyderabad II commissionerate, engaged in rendering services like airport services, business auxiliary services, renting of immovable property, etc., availed of cenvat credit on cement, TMT bars etc. treating these items as capital goods. Since the goods were building materials and were used in construction work, these were not eligible capital goods. The cenvat credit of ₹ 8.61 crore availed during the period from April 2005 to March 2008 had to be recovered with interest.

The observation was communicated to the department in March 2009. Reply was awaited (December 2010).

**2.9.2** M/s Kansai Nerolac Paints Ltd., in Kanpur commissionerate, engaged in the manufacture of paints, utilised cenvat credit of ₹ 53.42 lakh during the year 2006-07 and 2007-08 on unspecified capital goods such as angles, channels, PF beam, TMT bar, MS bar etc., which was not admissible. The credit of ₹ 53.42 lakh was recoverable with interest of ₹ 3.32 lakh.

On the observation being pointed out (January 2008/July 2008), the department replied (August 2008) that the assessee had deposited ₹ 56.74 lakh including interest in February 2008.

## 2.10 Cenvat credit of service tax paid on transportation beyond the place of removal

The Board vide their circular (August 2007) had clarified that a manufacturer/ consignor can take cenvat credit of service tax paid on outward transportation of finished goods up to the place of removal only and not beyond.

We found that 123 assessees in 44 commissionerates had availed cenvat credit of ₹ 50.38 crore for service tax paid on transportation of finished goods beyond place of removal and the entire amount was recoverable with interest. Twenty commissionerates had admitted audit observations involving cenvat credit of ₹ 6.69 crore in 47 cases, of which an amount of ₹ 1.48 crore in 14 cases had been recovered. In 33 cases SCN for ₹ 8.91 crore were also issued by 17 commissionerates. Two illustrative cases are given below: -

**2.10.1** Nine assessees, in Raipur commissionerate, engaged in the manufacture of various excisable goods cleared their final products from factory gate to the premises of various buyers on payment of transportation/freight charges. These assessees paid service tax on transportation/freight charges and availed of credit of such service tax paid on freight for outward transportation of goods by road from factory to party's premises. The availing of credit of ₹ 6.22 crore during the period from April 2005 to March 2008 of service tax on transportation charges beyond the place of removal was irregular.

On this being pointed out (May 2008 to March 2009), the department reported (March 2009) recovery of ₹ 1.18 lakh in one case and in other two cases it stated that matter would be examined. In two cases show cause notices had been issued to the assessees for ₹ 2.16 crore. In another case department issued SCN for ₹ 0.30 lakh and demand was confirmed in March 2010. In three other cases, it stated (between April and September 2008) that as clarified in the board's circular dated 23 August 2007 the credit could be availed in cases where value of the goods included the transportation charges up to the place of delivery.

The reply of the department did not indicate whether it had verified in the three cases that the assessable value included the transportation charges.

**2.10.2** Eight assessees, in Vapi, Ahmedabad-I, Surat-II and Vadodara-II commissionerates, availed of cenvat credit of ₹ 1.65 crore of service tax paid towards outward transport freight beyond the place of removal between January 2005 and May 2008. As credit was admissible for outward transport up to the place of removal only, the credit availed of was not regular and was recoverable with interest.

On the observation being pointed out (between January 2005 and May 2008), the department accepted all the audit observations and recovered ₹ 17.30 lakh

(including interest of ₹ 1.52 lakh) in three cases (between May 2008 and October 2008) and issued show cause notices for ₹ 1.32 crore in other three cases (between July 2008 and September 2008). Further developments had not been intimated (December 2010).

## 2.11 Cenvat credit on inputs/capital goods and input services used in exempted goods

Rule 6(1) of the Cenvat Credit Rules, 2004, stipulates that cenvat credit should not be allowed on inputs/input services which are used in the manufacture of exempted goods or services. Further, rule 6(4) provides that no credit shall be allowed on capital goods which are used exclusively in the manufacture of exempted goods or in providing exempted services.

We found that 28 assessees in 12 commissionerates had availed cenvat credit of ₹ 26.27 crore on inputs, input services and capital goods which were used exclusively in the manufacture of exempted goods or services. The department has accepted audit observations in 13 cases involving revenue of ₹ 19.58 crore and has reported recovery of ₹ 17.20 crore in nine cases. Two illustrative cases are given below: -

**2.11.1** M/s Gagal Cement Works Barmana - A.C.C. Ltd., (Units I and II), in Chandigarh commissionerate, manufacturing clinker and cement, availed credit on Goods Transport Agency (GTA) outward services in respect of service tax paid on transportation of cement (finished goods) which was totally exempt from payment of central excise duty under area based exemptions. Since final product was exempt from duty, the assessee was not eligible for GTA outward service credit of ₹ 15.72 crore taken in December 2008 for the period from April 2005 to December 2008.

The same assessee, M/s Gagal Cement Works Barmana-ACC Unit-II, bought duty paid capital goods for enhancing the installed capacity of the plant and availed credit on it. Since the plant and machinery was used to manufacture / grinding / packing of cement which attracted nil rate of duty, the availing and utilisation of credit amounting to ₹ 2.16 crore in the years 2005-06 and 2006-07 was not correct.

On the observations being pointed out (April 2007 and February 2009), the department accepted the first case and stated (April 2008) that credit of ₹ 15.72 crore had been reversed. Reply in respect of second case of credit availed on capital goods had not been received (December 2010).

**2.11.2** M/s Bharat Forge Ltd., in Pune III commissionerate, engaged in the manufacture of excisable goods, availed of cenvat credit of service tax for rubberisation of wheel which was used in goods supplied to defence at nil rate of duty. As this service was used exclusively for the manufacture of exempted goods, cenvat credit was not admissible. During the years 2006-07 and 2007-08, the assessee incorrectly availed of cenvat credit of ₹ 54.24 lakh which was recoverable with interest.

On the observation being pointed out, the assessee debited the amount of ₹ 55.56 lakh and paid interest of ₹ 5.01 lakh. Reply of the department had not been received (December 2010).

## 2.12 Simultaneous availing of cenvat credit and depreciation under the Income Tax Act, 1961

Rule 4(4) of the Cenvat Credit Rules, 2004 provides that cenvat credit in respect of capital goods shall not be allowed in respect of that part of the value of capital goods which represents the amount of duty on such capital goods, which the manufacturer or provider of output service claims as depreciation under section 32 of the Income Tax Act, 1961.

We found that five assessees in five commissionerates claimed depreciation under section 32 of the Income Tax Act, 1961 and also availed cenvat credit of duty paid on capital goods amounting to ₹ 35.31 lakh during the years 2000-01 to 2006-07. This was required to be recovered with interest.

On the observations being pointed out (between November 2007 and April 2009), the department accepted audit observations in three cases involving credit of ₹ 16.71 lakh and reported recovery of ₹ 13.48 lakh in respect of M/s Cold Steel Corporation, M/s. Citizen Ispat (P) Ltd. and M/s Shah Alloys Ltd. In one accepted case of ₹ 16.26 lakh the department issued SCN. Reply was awaited in one case (December 2010).

## 2.13 Cenvat credit of tax/duty paid on inputs/input services/capital goods received prior to 10 September 2004

Before 10 September 2004, manufacturers were not entitled to take cenvat credit of service tax paid on input services and service providers were not entitled to take cenvat credit of excise duty paid on inputs and capital goods. The Cenvat Credit Rules, 2004 introduced from 10 September, 2004 allowed this facility.

We found that 14 assessees, in nine commissionerates, had wrongly availed cenvat credit of ₹ 2.86 crore which was recoverable. This included manufacturers who had availed credit on input services and service providers who had availed credit on inputs and capital goods on service tax/ excise duty paid by them before the crucial date of 10 September 2004. The department had accepted audit observation in six cases involving credit of ₹ 24.31 lakh and in seven cases reported recovery of ₹ 25.22 lakh including interest. Two cases are illustrated below: -

**2.13.1** M/s Airtel Ltd., in Chennai service tax commissionerate, engaged in providing mobile phone services, availed credit of ₹ 2.04 crore on capital goods received prior to 10 September 2004. The amount was recoverable.

On the observation being pointed out (July 2008), the department stated (October 2009) that the items claimed by the assessee were received in their premises on or after 10 September 2004. Since our observation was based on invoices dated 9 January 2004 to 9 September 2004 the departmental reply appeared to pertain to some other claim.

**2.13.2** M/s Paradeep Port Trust and M/s Bharti Airtel Ltd.(service providers) in Bhubaneshwar-I commissionerate, availed cenvat credit of ₹ 66.19 lakh during January and February 2005 and again in April 2005 and May 2006 on

inputs and capital goods received prior to 10 September 2004. The amount was recoverable.

On the observations being pointed out (January and April 2009), the department while accepting the audit observation in the case of M/s Paradeep Port Trust intimated that the assessee had reversed ₹ 20.28 lakh in March 2009. Reply of the department had not been received in respect of second case (December 2010).

## 2.14 Credit on inputs used for trial run

Rule 2 (k) of the Cenvat Credit Rules, 2004 defines 'inputs' as goods used in or in relation to the manufacture of final products whether directly or indirectly. CESTAT in the case of M/s Reliance Industries Ltd, Surat (2004 173 ELT 106) held that inputs used in trial run production are not eligible for modvat/cenvat credit.

We found that five assessees in four commissionerates availed cenvat credit of ₹ 46.91 lakh on inputs used for trial run. Two of the cases are illustrated below:

M/s Honda Motorcycle and Scooter India Ltd., and M/s Whirlpool of India Ltd., in Gurgaon and Faridabad commissionerates, engaged in the manufacture of scooters, motor vehicles, refrigerators and their parts, used various inputs valued ₹46.03 lakh for trial run of production during the period 2006-07 to 2007-08. The assessees availed of cenvat credit of ₹ 7.55 lakh on such inputs and expenditure incurred thereon was capitalised. In terms of the above legal position, the availing of cenvat credit of ₹ 7.55 lakh was irregular and needs to be reversed along with interest.

## SECTION C: NON REVERSAL OF CREDIT

We found instances where cenvat credit of ₹ 1,356.30 crore was not reversed as required by the rules and led to accumulation of credit with the assessees.

## 2.15 Credit on goods sent to the job workers

Rule 4(5)(a) of the Cenvat Credit Rules, 2004 allows availing of cenvat credit where inputs or capital goods are cleared as such or after being partially processed, to a job worker for further processing, testing, repairs, recondition or for manufacture of intermediate goods necessary for manufacture of final product or for any other purpose. The rules provide that where inputs or capital goods sent to job worker are not received back within 180 days, the manufacturer shall pay an amount equivalent to the cenvat credit attributable to such inputs or capital goods.

We found that 38 assessees in 22 commissionerates had sent excisable goods involving cenvat credit of ₹ 2.72 crore to job workers for processing but they were not received back after lapse of stipulated period of 180 days. Therefore,

₹ 2.72 crore was recoverable with interest. The department had accepted audit observations involving credit of ₹ 1.79 crore in 24 cases and reported recovery of ₹ 1.62 crore in 25 cases. In 14 cases interest of ₹ 2.22 lakh was also paid by assessees. Two illustrative cases are given below: -

**2.15.1** M/s Bharat Heavy Electrical Ltd., and M/s Denison Hydraulics India Ltd., in Hyderabad I and M/s Puzzalona Machine Fabricators, in Hyderabad IV commissionerates, did not receive back goods sent to the job workers even after lapse of permissible period of 180 days. However, the assessees did not pay ₹ 1.28 crore (inclusive of interest) equivalent to the cenvat credit attributable to these input goods.

When we pointed this out (August 2008), the department accepted (August 2009 to August 2010) the audit observation in all the three cases and intimated recovery of ₹ 1.28 crore including interest.

**2.15.2** M/s Ultratech Cement Ltd., Bhatapara, in Raipur commissionerate, sent various inputs and capital goods to job-worker but they were not received back after 180 days. The cenvat credit of ₹ 43.60 lakh attributable to these inputs and capital goods was recoverable.

On this being pointed out (September 2008), the department stated that the matter would be examined and appropriate action taken (December 2010).

## 2.16 Credit taken on inputs not utilised for manufacture in the factory

The Cenvat Credit Rules, 2004 provide that the manufacturer of final products has to maintain proper records of the receipt, disposal, consumption and inventory of the inputs and capital goods. The inputs or capital goods not used in the manufacture of final goods are not eligible for credit and any credit, if availed, is to be reversed or paid back.

We found that 15 manufacturers, in 12 commissionerates, had availed cenvat credit of ₹ 14.69 crore in respect of inputs which were not used for manufacture. The department has accepted audit observations in three cases involving duty of ₹ 17.74 lakh and reported recovery of ₹ 1.11 lakh in one case. Two such cases are highlighted below:

**2.16.1** We found that the annual statements (ER-4) of M/s. Tata Steel Limited, Bistpur, in Jamshedpur commissionerate, engaged in the manufacture of pig iron, hot metal, billets, H.R. coil, CR coil, wire rod, etc. showed that it had purchased 174.91 lakh tone of iron ore during 2006-07 and 2007-08 and availed cenvat credit of duty paid on inputs. However, on totaling the monthly reports of receipt and consumption of iron ore (ER-6 return), the total quantity of iron ore received during the period worked out to 161.53 lakh tonne. The difference of 13.38 lakh tonne of iron ore was not utilised in manufacture as evident from ER-6 return. Therefore, Cenvat credit of ₹ 9.64 crore on 13.38 lakh tonne of iron ore was recoverable with interest.

When we pointed this out (December 2008) the department intimated that SCNs were being issued.

**2.16.2** M/s Hindustan Unilever Ltd., (formerly known as Hindustan Lever Ltd.,) Chhindwara, in Bhopal commissionerate, engaged in the manufacture of soap and detergent, took cenvat credit of duty paid on certain inputs. The material was directly delivered to M/s Khurana Olio Chemicals, Nallagarh, Solan, Himachal Pradesh who was working on behalf of the assessee. Thereafter, the invoices were received by the assessee from Solan (HP) and used only for taking cenvat credit of duty paid on the said inputs. Since, the assessee had not received the inputs, records of receipts, consumption, inventory etc. were not maintained. Thus, the assessee had taken the cenvat credit of duty paid on inputs material not received in the factory of production and without maintaining the proper records. This resulted in incorrect availing of cenvat credit of ₹ 1.32 crore during the period March 2006 to November 2007 which was required to be reversed.

On this being pointed out (August 2008), the department stated (February 2009) that a show cause notice was under issue. Further development in the matter was awaited (December 2010).

## 2.17 Non-recovery of credit on reduction of value of goods

Under the Cenvat Credit Rules, 2004, the credit of duty *actually* paid on inputs, input services and capital goods is to be availed by the manufacturers.

We found that five assessees, in Gurgaon commissionerate, had not reversed cenvat credit of ₹ 54.09 crore although it received refunds from supplier due to retrospective reduction in prices of raw material, failure of warranty etc. The entire amount was recoverable with interest. Two illustrative cases are given below: -

**2.17.1** M/s Hero Honda Motors Ltd., Gurgaon, M/s Maruti Suzuki India Ltd., Gurgaon and M/s Hero Honda Motors Ltd., Dharuhera (Rewari), in Gurgaon commissionerate, purchased inputs/raw materials from various vendors and availed of cenvat credit on these inputs during the period from 2005-06 to 2007-08. Due to retrospective reduction in price of these raw materials, the assessees recovered the excess amount of ₹ 324.79 crore including duty from the parties/vendors through debit notes. However, the assessees did not pay back the corresponding cenvat credit availed of ₹ 53.35 crore on the amount recovered.

**2.17.2** M/s Jai Bharat Maruti Ltd., Gurgaon, in Gurgaon commissionerate, purchased SS blanks from M/s Neel Metal Products, Gurgaon during April to August 2005 and availed of cenvat credit of duty paid on the value of SS blanks. The assessee raised debit notes on 31 August 2005 for recovering ₹ 3.64 crore excess charged. The value so recovered was inclusive of excise duty. However, the cenvat credit of ₹ 59.43 lakh availed on the inflated value was not paid back.

When we pointed this out (between October 2006 and March 2009), the department issued show cause notice to M/s Jai Bharat Maruti Ltd for ₹ 59.43 lakh in August 2007. In the case of M/s. Hero Honda Motors Ltd., Gurgaon the department did not accept the audit observation and intimated (November 2010) that protective demand for ₹ 15.68 crore had been issued in June 2009

covering the period up to December 2008. Reply in the remaining two cases had not been received (December 2010).

## 2.18 Inputs or manufactured goods destroyed in fire

Rule 3(5)(c) of Cenvat Credit Rule, 2004 read with Rule 21 of the Central Excise Rules, 2002 provides for reversal of cenvat credit taken on inputs used in goods that have been lost or destroyed by natural causes or accidents.

We found that five assessees, in five commissionerates had not reversed credit of ₹ 1.68 crore on inputs/finished goods destroyed in fire. The department had accepted audit observations in four cases involving credit of ₹ 23.06 lakh and reported recovery of ₹ 24.01 lakh including interest in four cases. Two illustrative cases are given below: -

**2.18.1** M/s Uflex Limited, Noida, in Noida commissionerate, engaged in the manufacture of films had a fire in the factory premises and there was loss of inputs, semi finished goods, finished goods, capital goods etc. valuing ₹ 6.03 crore on which cenvat credit had already been taken. The assessee had also received compensation of ₹ 3.92 crore from insurance company in respect of the value of inputs and goods destroyed in fire in April 2007. However, cenvat credit of ₹ 96.63 lakh attributable to goods destroyed was not paid.

When we pointed this out (October 2008), the department replied (December 2009) that the assessee had reversed cenvat credit of ₹ 8.96 lakh on raw material destroyed in fire and there was no need to reverse the balance cenvat credit on other goods destroyed in fire.

The reply of the department was not acceptable. All the inputs and other goods were utilised in connection with manufacturing of final product and cenvat was availed on such goods. Therefore, the assessee was liable to reverse all the cenvat credit availed on those goods.

**2.18.2** M/s NED Energy Ltd., Medchal, in Hyderabad-IV commissionerate, engaged in the manufacture of VRLA batteries had fire in its store during February 2008. Stock of raw material and packing material valued of ₹ 100.59 lakh (inclusive of cenvat of ₹ 12.95 lakh) were damaged. The assessee received compensation of ₹ 75.89 lakh against insurance claim in April 2008. However, cenvat credit of ₹ 12.95 lakh availed on destroyed inputs was not reversed by the assessee on the ground that cenvat was excluded while claiming insurance. This view was not tenable as irrespective of the receipt of insurance claim, cenvat credit had to be reversed as inputs lost in fire were no longer available for use in the manufacture.

On the observation being pointed out, the department reported (December 2008) recovery of credit of ₹ 12.95 lakh and interest of ₹ 0.95 lakh.

## 2.19 Capital goods cleared without reversing credit or paying duty

In terms of rule 3 (5) of the Cenvat Credit Rules, 2004, when capital goods on which cenvat credit has been taken, are removed as such from the factory or the premises of provider of output service, the manufacturer or the provider of output service shall pay an amount equal to the credit availed in respect of such capital goods and such removal shall be under the cover of an invoice referred to in rule 9 of the said Rules.

We found that 13 assessees, in 8 Commissionerates, had cleared capital goods on which cenvat credit of ₹ 889.17 crore was availed, from the factory or premises without reversal of credit or payment of duty. The department had admitted the objections in four cases involving credit of ₹ 60.85 lakh and had recovered ₹ 12.39 lakh in two cases. Two illustrations are given below: -

**2.19.1** M/s Bharti Airtel Ltd., Shimla, in Chandigarh commissionerate and other offices of the same company engaged in providing "cellular mobile telephony services", transferred capital goods valuing ₹ 6,558.21 crore to "M/S Bharti Infratel Ltd." and also sold capital goods valuing ₹ 3.12 crore without paying duty or reversing credit and without raising any invoice for company transfer/sale, during the years 2004-05 to 2007-08. Since cenvat credit of excise duty paid on capital goods had been taken, the assessee was required to pay duty of ₹ 839.39 crore.

When we pointed this out (February 2009); the department intimated (September 2009), that SCN for ₹ 23.38 crore was being issued. It also stated that the case was being examined further in respect of the remaining amount. Further development was awaited (December 2010).

**2.19.2** Similarly, M/s Bharti Airtel Ltd., in Bhubaneshwar-I commissionerate, engaged in providing services like telecommunication, business auxiliary service etc., availed of cenvat credit of ₹ 47.25 crore on capital goods like D.G. sets, tele equipments, battery modular box etc. during the years from 2005-06 to 2007-08 and cleared the same from its premises to different field units without paying amount equal to the credit availed thereon. The same were neither returned back within the stipulated period nor was any permission obtained from the department to extend such period.

When we pointed this out (May 2009), the department intimated (October 2009) that as the goods were used by assessee at their field formations for providing its output service, question of reversal of cenvat credit did not arise. The reply was not acceptable as the items had been removed from one unit to another and the rules provided for reversal of credit in such circumstances.

## 2.20 Separate account of dutiable and exempted goods not kept

When cenvat credit is availed on common inputs which are used in the manufacture of exempted goods as well as in dutiable goods and separate accounts of their use are not maintained, then the manufacturer shall pay an amount equal to eight per cent (ten per cent from 10 September 2004) of the total price of exempted goods excluding taxes, charged at the time of its clearance.

The lump sum amount of 8/10 per cent is paid to reverse the cenvat credit which had been availed on for the inputs and input services which were used in manufacturing exempted goods but separate account for those inputs and input services had not been kept. We found that 58 manufacturers in 34 commissionerates had not paid ₹ 178.52 crore on clearance of exempted final products though cenvat credit on common inputs was availed without maintaining separate accounts. The department had admitted (between January 2008 and April 2009) audit observations in 25 cases involving amount of ₹ 28.74 crore and reported recovery of ₹ 1.76 crore in 19 cases besides issuing SCN of ₹ 42.84 crore in 13 cases. Two illustrative cases are given below:

**2.20.1** M/s Fertilizers and Chemicals Travencore Ltd. (Udyogamandal Division and Petrochemical Division), in Kochi commissionerate, cleared two major by products viz. lactum ammonium sulphate and oxime ammonium sulphate to Udyogmandal division for use in the manufacture of ammonium sulphate by a process of purification and crystallization. Ammonium sulphate was cleared as fertilizers under nil rate of duty. The assessee in petrochemical division availed credit on principal raw materials like benzene, caustic soda, furnace oil, water treatment chemicals, packing materials like HDPE bags etc. which were used while obtaining the said by products. Separate accounts were not maintained for the raw materials used for manufacture of by products which were further used to manufacture exempted goods viz. ammonium sulphate. The assessee cleared ammonium sulphate valued ₹ 363.33 crore during the period from 2005-06 to 2007-08 on which an amount of ₹ 36.34 crore (10 per cent of ₹ 363.33 crore) was recoverable with interest.

On the observation being pointed out (August 2006 and April 2008), the department stated (October 2009) that three protective show cause notices had been issued to the assessee. Further development was awaited (December 2010).

**2.20.2** M/s Bharat Heavy Electrical Ltd (Boiler Auxiliaries Plant), Ranipet, in Chennai-III commissionerate, imported certain raw materials on payment of additional duty of customs/countervailing duty and used them for manufacture of boiler auxiliaries which were cleared both by payment of duty and as exempted item when supplied to construction of power project covered under International Competitive Bidding (ICB). The assessee did not maintain separate accounts of use of inputs in exempted and dutiable goods. Therefore, an amount of ₹ 13.82 crore being 10 per cent of value of the exempted clearances valuing ₹ 138.21crore made during 2007-08 and 2008-09 (up to September 2008) under international competitive bidding, was recoverable along with interest.

The audit observation was communicated to the department in April 2009; its reply was awaited (December 2010).

## 2.21 Inputs cleared as such without reversing credit or paying duty

When inputs on which cenvat credit has been taken are removed as such from the factory, or premises of the provider of output services, the manufacturer of the final products or provider of output service is required to pay an amount equal to the credit availed and removal has to be made under the cover of an invoice.

We found that 77 assesses in 31 commissionerates had not paid duty of ₹ 15.80 crore (between April 2000 and March 2008) on clearance of inputs as such to their sister units or outside buyers. The department has accepted audit observations in 24 cases involving revenue of ₹ 2.08 crore and reported recovery of ₹ 1.07 crore in 16 cases. An illustrative case is given below:

M/s LR Alloys Ltd., in Chandigarh II commissionerate, cleared 17.21 tonne of raw material on which an amount equal to credit availed of ₹ 42.80 lakh was required to be paid at the time of removal. We observed that only a sum of ₹ 22 lakh was reversed by the assessee. The short reversal of ₹ 20.80 lakh was required to be recovered along with interest.

On the observation being pointed out (June 2008), the department stated (July 2008) that the assessee had paid ₹ 20.80 lakh from credit account besides paying interest of ₹ 0.90 lakh in cash.

## 2.22 Goods cleared to developer/contractor of SEZ

Where a manufacturer avails of cenvat credit on any inputs or input services used in the manufacture of exempted goods or services and does not maintain a separate accounts, an amount equivalent to 10 per cent of the value of the exempted final products is leviable under rule 6(3)(b) of the Cenvat Credit Rules. By virtue of rule 6(6) of the said Rules, the provisions of rule 6(3)(b) are not applicable to goods cleared to a unit of special economic zone (SEZ) or 100 per cent export oriented unit.

We observed that 9 assessees in 7 commissionerates had incorrectly availed exemption under rule 6(6) in respect of goods cleared to the developers, co-developers and contractors of SEZ. They were liable to pay amount of ₹ 36.51 crore i.e., 10 per cent of the value of exempted goods. The department had accepted the audit observation in the case of M/s. Mahavir Steel Limited and recovered ₹ 2.30 lakh. Reply of the department had not been received in other cases. Two such cases are illustrated below:

**2.22.1** M/s Thermax Ltd., in Pune I commissionerate, cleared finished products valuing ₹ 237.17 crore to co-developers of SEZ viz. M/s Reliance Utility Ltd and M/s Bio-Tech Services Pvt. Ltd., during the period between September 2007 and February 2009. As the goods were supplied to co-

developers of SEZ who were not engaged in manufacture of goods, exemption under Rule 6(6) was not admissible. The goods cleared should have been treated as exempted goods and amount of ₹ 23.72 crore (being 10 per cent of the value) was required to be recovered.

**2.22.2** M/s Kanishk Steel Industries Ltd., Gummidipoondi, M/s Electro Steel Castings Ltd. and M/s Viki Industries Pvt. Ltd., in Chennai II, M/s ELGI Equipments Ltd., in Coimbatore and M/s Lenovo India Pvt. Ltd., in Puducherry commissionerates, cleared their finished goods valuing ₹ 473.88 crore to the developers/ contractors of SEZ during the period from April 2006 to December 2007 without payment of duty. Since exemption under rule 6(6) was not admissible to the developers/ contractors of SEZ and the assessees had not maintained separate accounts, they were liable to pay an amount of ₹ 4.74 crore being 10 per cent of total value of clearances.

When we pointed this out (January 2009), the Department stated that SCN was being issued in the case of M/s Lenovo India Pvt. Ltd. for the period up to 30 December 2008. In the remaining cases, the Department stated (October 2009) that the supply from DTA to a SEZ unit or SEZ developer had been defined to constitute 'export' as per Section 2 (m) of the SEZ Act, 2005 and was covered by Rule 6(6)(v) of Cenvat Credit Rules, 2004.

The reply of the department was not acceptable because Rule 6(6)(v) covered actual exports made under Central Excise Rules, 2002 whereas Rule 6(6)(i) specifically covered export made to SEZ/SEZ developer with effect from 31 December 2008. Hence, for any clearance made to SEZ/SEZ developer prior to this date, exemption was not available.

## 2.23 Interest not levied on credit paid back

Rule 14 of the Cenvat Credit Rules, 2004 stipulates that where cenvat credit has been taken or utilised wrongly, the same along with interest shall be recovered from the manufacturer or service provider of output services and the provisions of section 11AB of the Central Excise Act, 1944 and sections 73 and 75 of the Finance Act, 1994 shall apply mutatis mutandis for affecting such recoveries.

We found that 37 assessees, in 12 commissionerates, had availed cenvat credit of ₹14.30 crore wrongly and later reversed or paid back the amount of credit but interest of ₹2.85 crore for delayed payment was not paid. The department had accepted audit observation in 11 cases involving amount of ₹ 13.47 lakh and recovered ₹ 5.90 lakh in seven cases and SCNs were also issued for ₹ 11.13 lakh in three cases. An illustrative example is given below: -

M/s Rana Sponge Ltd., M/s NALCO(SP), M/s Vedanta Aluminium, M/s Jindal Stainless Ltd., and M/s Visa Steel Ltd., in Bhubaneshwar I commissionerate, and M/s HINDALCO Industries Ltd., in Bhubaneshwar II, engaged in the manufacture of iron and steel, aluminium ingot, calcined alumina etc. reversed credit of ₹ 5.61 crore between February 2005 and March 2008 towards wrong or excess availing of credit on inputs, input services and capital goods availed between May 1999 and March 2008. Interest of ₹ 57.77 lakh payable thereon was not paid by them.

On the observations being pointed out (January and February 2009), the department stated (October 2009) in respect of five cases (Bhubaneshwar I) that interest was not realisable as those assessees had not utilised credit.

The reply was contrary to the rules. The utilisation of credit was not a precondition for imposing interest and Rule 14 also provided for interest where credit had been "taken" wrongly. Further in respect of case of M/s. HINDALCO Industries Ltd., the department stated (September 2009) that action was being taken to realise the interest. Further development was awaited (December 2010).

## 2.24 Sale of capital goods as waste and scrap

Waste and scrap generated during the course of manufacture attract duty on transaction value at the rates prevalent on the date of clearance under appropriate heading of the schedule to the Central Excise Tariff Act, 1985. Rule 3(5A) of the Cenvat Credit Rules, 2004 stipulates charging of duty on transaction value of the capital goods cleared as waste and scrap.

We found that five assessees, in five commissionerates, had not paid excise duty of ₹ 1.12 crore on the sale of capital goods as waste and scrap. The department intimated that credit of ₹ 16 lakh had been reversed in the case of M/s. Abdos Oils Pvt. Ltd. Two illustrative cases are given below:

**2.24.1** M/s Indian Oil Corporation Ltd., (Guwahati Refinery), in Guwahati commissionerate, engaged in the manufacture of petroleum products, sold waste and scrap of capital goods such as boiler, kerosene treating plant, compressor of KTU etc. but did not pay duty on their clearance. During the years 2006-07 and 2007-08, the assessee realised an amount of ₹ 1.51 crore on sale of such waste and scrap against which excise duty of ₹ 24.12 lakh (at 16 per cent on transaction value) was recoverable.

The observation was pointed out in May 2009, reply of the department had not been received (December 2010).

**2.24.2** M/s Bihar Sponge Iron Ltd., in Jamshedpur commissionerate, engaged in the manufacture of iron and steel products, cleared capital goods as waste and scrap valuing ₹ 3.04 crore during the period from April 2006 to March 2007. Since cenvat credit was availed on such scrapped capital goods, excise duty of ₹ 54.27 lakh was leviable which was not paid by the assessee.

When we pointed this out (October 2007), the department intimated (December 2010) that show cause notice for ₹ 65.00 lakh had been issued in June 2010 to the assessee. Further development in the case was awaited (December 2010).

## 2.25 Non-taxable service

Rule 6 (3) (c) of the Cenvat Credit Rules, 2004 provides that a service provider who provides both taxable and exempted services has to maintain separate account of input services used in taxable and exempted services so that he does not avail credit on input services used for providing non-taxable output services. If he chooses not to maintain separate accounts, he shall utilise credit only to extent of an amount not exceeding twenty per cent of the amount of service tax payable on taxable output service. From 1 April 2008 the provision was changed and the provider of the output service opting not to maintain separate accounts shall pay an amount equal to eight per cent of the value of exempted service.
As per Rule 2(e) exempted service includes service on which no service tax is leviable.

We found that three service providers, in Chennai service tax commissionerate availed cenvat credit on common inputs, capital goods and input services and provided taxable and non-taxable services but credit of ₹ 159.15 crore attributable to non-taxable service was not reversed. One illustrative case is described below:

**2.25.1** M/s Air Tel Ltd., in Chennai service tax commissionerate, rendered mobile phone service (taxable) and non-taxable telecommunication service[2] and availed of cenvat credit on inputs, capital goods and input services during the period from September 2004 to September 2007. The assessee did not maintain separate accounts for the inputs and input services used for taxable and non-taxable services. The assessee utilised the entire cenvat credit for payment of service tax but did not reverse any credit attributable to inputs/input service used for providing non-taxable service. This resulted in undue benefit of cenvat credit of ₹ 64.29 crore during 2005-06 to 2007-08 which was recoverable with interest.

On the observation being pointed out (March 2008), the department replied that rule 6(3) had since been amended with effect from 1 April 2008 and it was a lacuna in the Rule. Since non-taxable services are included in the scope of exempted service, the amount was recoverable under Rule 6(3) of Cenvat Credit Rules.

## SECTION D : PROCEDURAL SHORTCOMINGS

We found instances of non-compliance to prescribed procedures and record keeping including availing of credit on improper documents which had a total revenue implication of ₹ 256.73 crore.

## 2.26 Irregular availing of cenvat credit

We found that 65 manufacturers of excisable goods/service providers in 33 commissionerates had wrongly availed cenvat credit of ₹ 38.14 crore. The

[2] International in-bound roaming services up to 15 January 2007, interconnection services up to 31 May 2007 and services provided to special economic zone.

irregularities included taking credit twice for the same invoices on different dates, inflating the amount of credit balance and by availing credit of the value of goods/services instead of amount of duty/tax paid. The amount of ₹ 38.14 crore was to be recovered with interest. The department had accepted audit observations in 47 cases involving amount of ₹ 12.82 crore and intimated recovery of ₹ 3.34 crore in 41 cases and issued SCNs of ₹ 7.44 crore in five cases. Two illustrative cases are given below:

**2.26.1** M/s Gagal Cement Works, Barmana (ACC Units I and II), in Chandigarh commissionerate, engaged in the manufacture of clinker and cement, availed cenvat credit of duty paid on inputs, capital goods and input services aggregating to ₹ 18.33 crore twice during the period from January 2008 to December 2008 (Unit I ₹ 8.36 crore and Unit II ₹ 9.97 crore). This was recoverable with interest and penalty.

This observation was pointed out to the department in February 2009, its reply was awaited (December 2010).

**2.26.2** M/s Lenova (India) Pvt. Ltd, in Puducherry commissionerate, engaged in the manufacture of personal computers and laptops, availed cenvat credit of ₹ 78.81 lakh twice or excess of eligibility during the years 2006-07, 2007-08 and 2008-09 based on the same invoices. This resulted in double / excess availing of cenvat credit of ₹ 78.81 lakh which was recoverable with interest of ₹ 10.25 lakh and penalty of ₹ 78.81 lakh.

On the observation being pointed out, the assessee paid back the incorrect / excess credit of ₹ 78.81 lakh during April 2009.

However, the department did not charge interest and stated (October 2009) that the assessees were continuously having balance much more than the amount required to be reversed for the period April 2007 to March 2009.

The reply of the department was not acceptable. The clarification issued by CBEC vide circular dated 3 September 2009 had specified that interest would be recoverable when credit had been wrongly taken, even if it had not been utilised.

## 2.27 Suo moto availing of cenvat credit

Section 11B of the Central Excise Act, 1944 envisages that any person claiming refund of any duty of excise shall apply to the jurisdictional Assistant/Deputy Commissioner of Central Excise before the expiry of one year from the date of payment of duty. The CESTAT in the case of M/s Jai Bhawani Concast (P) Ltd. Vs CCE, Jaipur {2007 (213) ELT 195 (Tri-Delhi)} held that if duty was paid erroneously from cenvat credit account at the time of clearance of goods, the assessee could not take re-credit of the same without a refund order under section 11B.

We observed that 14 assessees, in nine commissionerates, had availed credit of ₹ 23.50 crore suo moto in contravention of above provisions. The department had accepted audit observations in three cases involving ₹ 68.92 lakh. Credit of ₹ 4.55 lakh had been reversed in one case. SCNs of ₹ 3.20 crore had also

been issued in five cases which included two accepted cases of ₹ 64.72 lakh. Two cases are illustrated in the following paragraphs:

**2.27.1** M/s Bharati Airtel Ltd., Shimla, in Chandigarh I commissionerate, engaged in providing cellular mobile telephony services, filed revised return in July 2007 for the half year ended March 2007 after rectifying mistakes in education cess account for the period from November 2005 to March 2007. Subsequently the assessee availed credit of ₹ 4.75 crore suo moto pertaining to the period from November 2005 to March 2007 without following the relevant procedure of obtaining a refund order. The amount is recoverable with interest and can be credited back only after obtaining refund orders.

When we pointed this out (February 2009), the department intimated (September 2009) that SCN of ₹ 4.75 crore was being issued shortly. Further development was awaited (December 2010).

**2.27.2** M/s NALCO Ltd., (Smelter Plant), in Bhubaneshwar I and M/s Bhusan Power and Steel Ltd., in Bhubaneshwar II commissionerate, engaged in the manufacture of aluminium ingot and iron and steel, availed of cenvat credit of duty of ₹ 1.06 crore during March 2006, May 2007 and January 2009, which had been paid by them in excess. Since the amounts had been paid from cenvat credit account, the assessees were required to file refund claims as per provisions cited above. The credit aggregating ₹ 1.06 crore was required to be recovered with interest.

When we pointed this out (January 2009 and February 2009), the department intimated (October 2009) in the case of M/s. NALCO that the assessee had debited the excess duty paid due to calculation error, hence there was no need to apply for refund. In the case of M/s Bhusan Power and Steel Ltd. the department intimated (May 2010) that SCN for ₹ 1.01 crore had been issued.

## 2.28 Improper distribution of cenvat credit by input service distributor

In terms of rule 7 of the Cenvat Credit Rules, 2004, the input service distributor (ISD) may distribute the cenvat credit in respect of the service tax paid on the input service to its manufacturing unit or units providing output service. The registration for input service distributor is mandatory for the purpose of distribution of input service credit. Rule 9 of the Cenvat Credit Rules, 2004 and rule 4A(2) of the Service Tax Rules, 2002 specify the documents on the basis of which credit can be availed.

We found that 38 assessees, in 22 commissionerates, had availed of credit of ₹ 92.45 crore on the basis of improper distribution by input service distributors. The availing of credit was not justifiable as credit was availed without documents or on the basis of non-specified documents like credit notes, challans, inter office memos etc. The department has admitted audit observations in nine cases involving revenue of ₹ 1.28 crore and reported recovery of ₹ 16.16 lakh. Further in 12 cases of ₹ 7.66 crore SCNs had also been issued. Two illustrative cases are given below: -

**2.28.1** M/s National Insurance Co. Ltd., M/s United Bank of India and M/s Allahabad Bank, in Kolkata service tax commissionerate, availed of cenvat credit on the basis of ineligible documents sent by their sub-ordinate offices which were not registered as ISD. The availing of credit of ₹ 66.87 crore during the period from 2005-06 to 2007-08 was irregular and was recoverable with interest.

When we pointed this out (January 2007 and April 2009), the department stated (between April 2007 and January 2009) in the first case that such practice was acceptable since the assessee paid duty on provisional basis. In the remaining two cases the department while not accepting the audit observation intimated (July 2009) that various branches of these banks prepared monthly statements incorporating details of invoices and sent them to the concerned regional office who in turn prepared a consolidated return and sent it to the headquarters centrally registered as this was their internal procedure being followed for getting information regarding cenvat credit.

The reply of the department in the case of M/s. National Insurance Co. Ltd. is not acceptable. The assessment being made on provisional basis could not be a reason for justifying irregular availing of credit. The reply in the remaining two cases was also not acceptable. Since the headquarters office of the bank was the registered ISD, it was required to obtain all invoices centrally, avail the cenvat credit on the basis of actual invoices and then distribute the same as ISD. Under the system being followed, it was impossible to get an assurance that the ISD had availed correct amount of credit as the invoices would have to be checked at every branch.

**2.28.2** M/s Gagal Cement Works Barmana - ACC Ltd., (Unit I and II), in Chandigarh commissionerate, engaged in the manufacture of clinker and cement, availed ineligible credit of ₹ one crore on the basis of credit notes during the period from November 2004 to May 2006.

The observation was pointed out in February 2009, reply of the department was awaited (December 2010).

## 2.29 Excess availing of cenvat credit on capital goods

The Cenvat Credit Rules, 2004, provide for availing of credit of specified duties on capital goods not exceeding 50 per cent of duty paid in the financial year in which capital goods are procured and remaining 50 per cent in any financial year subsequent to the financial year of procurement.

We found that 31 assessees, in 18 commissionerates, had availed cenvat credit of ₹ 24.26 crore in excess of 50 per cent in the same financial year in which capital goods were procured. The department had admitted audit observations in 11 cases involving credit of ₹ 1.88 crore and reported recovery of ₹ 15.75 lakh in nine cases. Three illustrative cases are given below: -

**2.29.1** M/s Bharti Airtel Ltd., Shimla and M/s Raja Forgings and Gears Ltd., Baddi, in Chandigarh I commissionerate, engaged in providing cellular mobile telephony services and manufacture of gears and shafts respectively, availed of 100 per cent credit of ₹ 2.87 crore on capital goods in the years 2004-05

and 2007-08 against the permissible limit of 50 per cent. The credit was also utilised in the same year. This resulted in availing and utilisation of cenvat credit in excess by ₹ 1.44 crore on which interest of ₹ 25.34 lakh was also payable.

When we pointed this out (October 2008 and February 2009), the department in the first case intimated (September 2009) that protective demand was being raised after obtaining the figures of excess utilisation of credit for the year 2008-09. In second case the department intimated that SCN of ₹ 1.39 lakh was being issued to the assessee very shortly. Latest development in both the cases was awaited (December 2010).

**2.29.2** M/s Kandhari Beverages Pvt. Ltd., Baddi, in Chandigarh I commissionerate, engaged in the manufacture of aerated waters, availed full credit of duty paid on empty bottles and shells which were used for carriage of aerated water. The accounts of the assessee indicated that these goods were treated as capital assets; as such cenvat credit not exceeding 50 per cent of the duty paid on such capital goods in the same financial year was to be allowed. The irregularity resulted in excess availing of credit of ₹ 1.03 crore during the years from 2003-04 to 2006-07.

The Department intimated (September 2009) that the matter would be taken up at the Ministry level. Further development was awaited (December 2010).

**2.29.3** M/s Alloy Steels Plant, Durgapur, in Bolpur commissionerate, availed cenvat credit of the full amount of education cess and secondary and higher education cess paid on capital goods received in its factory in the first year itself without restricting it to fifty per cent of the cess paid, as required under the Rules. This was in contravention of the statutory provisions and resulted in incorrect availing of cenvat credit of ₹ 45.98 lakh during the years from 2005-06 to 2007-08.

When we pointed this out (March 2009), the department stated that 50 per cent credit of the capital goods was available to the assessee in next year. Therefore, no recovery could be made but it had intimated the recovery of interest for the period in which the credit was availed in advance.

## 2.30 Premature/advance availing of cenvat credit

Rule 3(4) of the Cenvat Credit Rules, 2004, stipulates that cenvat credit shall be utilised only to the extent it is available on the last day of the previous month. As per rule 4(1) of the said Rules, credit on inputs shall be taken immediately on receipt of them in the factory of manufacture. Similarly, rule 4(7) provides that credit on input services shall be allowed on or after the day on which payment is made for the input service and the service tax thereon.

We found that 28 assessees, in 13 commissionerates, had availed cenvat credit of ₹ 3.39 crore on inputs and input services in advance of accrual of actual credit in their cenvat account which was irregular as per the above legal provisions and recoverable. The department had accepted audit observations in nine cases involving revenue of ₹ 66.07 lakh and reported recovery of

₹ 64.88 lakh in seven cases. Besides, ₹ 39.92 lakh has been paid by M/s Cadbury Ltd., Malanpur although reply of the department was not received. One illustrative case is given below: -

M/s Samtel Color Ltd., in Ghaziabad commissionerate, availed of cenvat credit of ₹ 1.63 crore on input services before paying for the services and the service tax thereon on 178 instances during the year 2005-06 to 2007-08. The credit was taken 10 days to 224 days before actual payment. This premature availing of credit of ₹ 1.63 crore was irregular and needed to be recovered along with interest of ₹ 3.71 lakh.

When we pointed this out in January 2009, the department replied (January 2010) that a show cause notice for ₹ 1.67 crore had been issued to the assessee in October 2009. Further development was awaited (December 2010).

## 2.31 Credit availed on the basis of invalid documents

The Cenvat Credit Rules, 2004, provide that cenvat credit shall be taken by a manufacturer or provider of output service on the basis of specified documents which include original invoices, certificates issued by an appraiser of customs, challans for payment of service tax and invoices/challans issued by input service distributors (ISD) that are serially numbered and contain a set of prescribed details.

We observed that 144 assessees in 32 commissionerates, had availed cenvat credit of ₹ 74.98 crore on the basis of invalid or ineligible documents such as xerox copies of bills, debit notes, demand notes, consignment notes, letters, estimates, invoices not in the name of assessee, inter office memo and invoices of ISD not containing the prescribed details. The amount of ₹ 74.98 crore was recoverable with interest. The department had accepted observation in 31 cases involving amount of ₹ 9.39 crore and reported recovery of ₹ 26.10 lakh in 22 cases. Some illustrative cases are tabled below: -

**Table no. 3:**

| Sl. No | Assessee | Commissionerate | Invalid documents used | Amount involved |
|---|---|---|---|---|
| 1 | M/s Television Eighteen India Ltd. | ST Mumbai | Statements by ISD instead of invoices containing prescribed details) | 18.01 crore |
| 2 | M/s Tata Steel Ltd., Bistpur | Jamshedpur | Incomplete invoices | 18.12 crore |
| 3 | M/s Idea Cellular Ltd. | Cochin | Debit Notes | 11.95 crore |
| 4 | M/s Central Cables Ltd., M/s Candico (I) Ltd. And M/s BILT Ashti Ltd. | Nagpur | Xerox copies of the bills | 26.27 lakh |