



## CHAPTER III CENVAT CREDIT

A manufacturer/service provider uses capital goods such as plants and machinery, inputs such as raw material and input services such as security services, management, maintenance or repair services, etc. to make a final product. The excise duty/service tax paid on any of these three items is credited and accumulated under a cenvat credit account. Whenever the manufacturer has to pay duty on finished goods and service tax on output services, it can utilise the accumulated cenvat credit for the payment subject to fulfillment of certain conditions. This ensures that the inputs are taxed only once.

During the course of this audit, we found 227 cases of incorrect availing of cenvat credit with duty impact of Rs. 91.79 crore. The department agreed with our observations in 140 of these cases, involving duty of Rs. 6.34 crore and recovered Rs. 3.00 crore in 130 cases. In another 23 cases the department has issued SCNs for Rs. 11.02 crore without specifically accepting the audit observations and has not furnished any reply in the remaining 64 cases. A few of these cases are elucidated in the following paragraphs.

### 3.1 Inputs for both dutiable and exempted final products

Rule 6(1) of the Cenvat Credit Rules, 2004, (CCR) stipulates that cenvat credit cannot be taken on inputs which are used in the manufacture of final products which are exempt or have 'nil' rate of duty.

Rule 6(3) (1) of the CCR provides that if cenvat credit is taken on inputs which are used in the manufacture of both exempted as well as dutiable goods, separate accounts of their use must be maintained failing which the manufacturer shall pay an amount equal to eight per cent (ten per cent from 10 September 2004) of the total price of the exempted goods excluding taxes.

We found many instances where the assessee did not keep such separate accounts and the penal amount of 10 per cent was not imposed. A few of these cases are narrated hereafter.

**3.1.1** We found that M/s Albert David (P) Ltd., in Ghaziabad commissionerate, did not maintain the stipulated separate accounts during the period April 2005 to September 2008. The assessee had cleared exempted medicines valued at Rs. 141.46 crore. Therefore, 10 per cent of the value of the exempted goods i.e. Rs. 14.15 crore and interest of Rs. 1.63 crore were recoverable.

**3.1.2** In another similar case, M/s Piramal Health care Ltd., in Raigad commissionerate, had not maintained separate accounts of exempted and dutiable final products. An amount of Rs. 6.78 crore, which was 10 per cent of the value of the exempted medicines cleared during the period April 2005 to March 2008, was recoverable with interest.

**3.1.3** M/s Wockhardt Ltd., in Aurangabad commissionerate, availed of cenvat credit on the services utilised for the manufacture of exempted as well as dutiable medicines at its corporate office which was the 'Input Service Distributor (ISD)<sup>5</sup>'. The credit was distributed to various manufacturing units. The corporate office did not keep separate accounts of the input services for the exempted products manufactured at its 'Chikalhana' plant located in Aurangabad. It had distributed the entire cenvat credit, including the portion pertaining to Chikalhana plant, to other manufacturing locations. The assessee had cleared Rs. 50.29 crore of the exempted medicine 'Wosulin' from the plant at Aurangabad during the period April 2005 to June 2008. Therefore, it had to pay ten per cent of the value of medicines cleared i.e. Rs. 5.03 crore alongwith interest of Rs. 1.32 crore (till March 2009).

**3.1.4** M/s Ahlcon Parenterals (India) Ltd. Bhiwadi, in Jaipur I commissionerate is manufacturing patent or proprietary medicines. We found that for the period from April 2005 to September 2008, the assessee maintained pro rata accounts (as certified by chartered engineer) for inputs (furnace oil) used for dutiable and exempted final products. This was irregular as the rules did not provide for pro rata accounting. Moreover, the assessee had not maintained separate accounts for the input services used for manufacture. The total value of exempted goods cleared between April 2006 and September 2008 was Rs. 17 crore. Therefore, ten per cent of this amount i.e. Rs. 1.70 crore was recoverable alongwith interest of Rs. 27 lakh (till March 2009).

**3.1.5** M/s. Concept Pharmaceuticals Ltd., in Aurangabad commissionerate, engaged in the manufacture of pharmaceutical products, had availed of cenvat credit of service tax paid on input services that were used in the manufacture of both exempted and dutiable goods but no separate accounts were maintained. The assessee was, therefore, liable to pay Rs. 1.24 crore, equal to ten per cent of the value of exempted goods cleared during the period from April 2005 to March 2008 alongwith interest of Rs. 31.55 lakh (till March 2009).

On this being pointed out (August 2008), the department stated (January 2009) that proportionate service tax credit of Rs. 1.64 lakh was reversed alongwith interest of Rs. 0.13 lakh in August 2008. The reply is not tenable. As separate accounts had not been maintained, there was no reliable basis for ascertaining the amount of input services on exempted goods and the penal rate of ten per cent was payable as per provisions.

**3.1.6** M/s Emcure Pharmaceuticals Ltd. (unit II), in Pune I commissionerate, had not kept separate accounts and had availed of service tax credit on the services utilised for the manufacture of exempted goods as well as dutiable goods. The assessee reversed the service tax credit availed to the extent of Rs. 18.80 lakh whereas he was required to pay 10 per cent of the total value of the exempted goods. While an SCN for Rs. 6.27 crore was issued, there was a delay of 18 months from the date of reversal of credit. The demand case has not been adjudicated.

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<sup>5</sup> The input service distributor is a unit which receives and takes cenvat credit on all the inputs, input services and capital goods. It distributes the total credit to other units of the same company which utilise the inputs, input services and capital goods for manufacture or for providing output service.

**3.1.7** M/s Cure Medicines (India) Pvt. Ltd., in Pune I commissionerate, had availed of service tax credit on the services utilised for the manufacture of exempted goods as well as dutiable goods. The irregular service tax credit availed on exempted goods during the period from August 2006 to October 2007 amounting to Rs. 11.97 lakh was reversed by the assessee in February 2008 which was in contravention of rule 6(3) (i) of CCR. The assessee was required to pay 10 per cent of total value of the exempted goods. However, the department failed to issue SCN in time which has resulted in loss of revenue of Rs. 69.73 lakh (10 per cent of value of exempted goods) and interest of Rs. 12.84 lakh (till March 2009). No action has been initiated by the department.

**3.1.8** M/s Maan Pharmaceutical Ltd., in Ahmedabad III commissionerate, engaged in manufacture of pharmaceutical products, cleared both dutiable and exempted goods but did not maintain separate accounts. The assessee was liable to pay Rs. 92.70 lakh on clearance of Rs. 9.27 crore worth of exempted goods from April 2006 to March 2008. On this being pointed out (March 2008), the department issued SCN (April 2008) for recovery of duty of Rs. 48.52 lakh for the period April 2006 to March 2007 and intimated (June 2008) the recovery of Rs. 3.53 lakh. Report on recovery of the remaining amount has not been received (March 2010).

**3.1.9** M/s Gland Pharma Ltd., in Hyderabad IV commissionerate, was availing of cenvat credit on certain common inputs without maintaining separate accounts for inputs used in dutiable and exempted products. It manufactured and cleared the exempted patent or proprietary medicine 'low molecular weight Heparin' by paying duty and passed on the incidence of the wrongly paid duty to customers. It did not pay 10 per cent on the value of the 'Heparin' cleared on the pretext that it had paid duty on this exempted product. This argument is not tenable because in terms of section 5A of the Central Excise Act, 1944, the assessee has no option to pay duty on exempted items. By paying duty in an irregular manner, he actually overcharged the consumers and simultaneously inflated his cenvat credit with the inputs used for manufacturing Heparin. Therefore, he was liable to pay the penal rate of ten per cent for not keeping separate accounts. During the period from January 2004 to March 2006, the assessee cleared the exempted medicine 'heparin' valuing Rs. 27.93 crore. Therefore, Rs. 2.79 crore was recoverable with interest. On this being pointed out (July 2006/May 2007), the department reported (February 2009) that the assessee has paid Rs. 5.89 lakh including interest in March 2009 and the department has issued (March/October 2007) SCN for Rs. 1.44 crore. Report on recovery of the balance amount has not been received (March 2010).

### 3.2 Excess availing of service tax credit by 'Input Service Distributor (ISD)'

Under rule 7(b) of the CCR, if any unit of an assessee is engaged in manufacturing exempted goods or providing output services which are exempted from payment of service tax, the share of that unit in cenvat credit cannot be distributed by the input service distributor to other units of that assessee. Such credits are to be deducted from the distributable credit and surplus credit reflected in ST-3 returns and reversed from cenvat credit account.

We found that some assesses distributed the share of cenvat credit attributable to manufacture of exempted goods and the excess credits were recoverable. The cases are narrated below.

**3.2.1** M/s Johnson & Johnson Ltd., in Mumbai ST commissionerate, availed of full service tax credit in their corporate office as input service distributor (ISD). The pro-rata credit pertaining to units at duty free zones (Baddi units) was not reduced from the closing balance of

input tax credit as per ST-3 returns<sup>6</sup> of the corporate office. The excess credit involved was Rs. 1.40 crore.

On this being pointed out in audit (January 2009), the department stated (October 2009) that SCN for Rs. 1.40 crore had been issued in August 2009.

**3.2.2** In another similar case, M/s. Wockhardt Ltd., in Mumbai (Service Tax) commissionerate Mumbai, availed of full service tax credit in their corporate office as input service distributor (ISD). The pro-rata credit of Rs. 1.09 crore pertaining to units at duty free zones (Baddi units under area based exemption) was not reversed from the cenvat credit account and incorrectly distributed to the manufacturing units at other locations.

On this being pointed out (January 2009), the department issued SCN for Rs. 1.09 crore in August 2009 and reported (October 2009) that the assessee had admitted the observation, reversed credit of Rs. 65.67 lakh and deposited interest of Rs. 3.37 lakh. Details of the recovery of the balance amount are awaited (March 2010).

### 3.3 Cenvat credit of service tax on inadmissible input services

The CCRs stipulate that cenvat credit can be taken for 'input service' which means any service used by the manufacturer whether directly or indirectly in or in relation to the manufacture of final products and storage of final products upto the place of removal and includes various specified services.

We found instances of assessee taking inadmissible cenvat credit for services that were not falling within the definition of 'input service' in the CCRs as they were not directly related to manufacturing activities and were also not specified categories of input services. The cases are as follows.

<sup>6</sup> ST-3 return is a form required to be filled by any person liable to pay the service tax. The return is required to be filled on a half yearly basis.

**3.3.1** M/s IPCA Laboratories Ltd., Ratlam, in Indore commissionerate, engaged in manufacture of pharmaceutical products, availed of inadmissible cenvat credit of service tax paid on services like rent-a-cab scheme operator, clearing and forwarding agent, courier, personal insurance, outdoor caterer services, outward freight charges, car maintenance charges, canteen service charges, telephone and cell phones charges etc. Thus, the cenvat credit of service tax of Rs. 63.63 lakh taken during the period 2006-07 to 2007-08, was recoverable.

On the matter being pointed out (March 2008), the department stated (January 2009) that SCN for Rs. 63.63 lakh for the period 2006-07 to 2007-08 had been issued (November 2008).

**3.3.2** Similarly, in seven other cases in Indore, Bhopal and Mumbai (LTU) commissionerates, the assessee had availed of cenvat credit of service tax paid on inadmissible input services. The cenvat credit of Rs. 1.17 crore taken during the period April 2005 to September 2008, was recoverable.

### **3.4 Default in payment of duty**

Rule 8 (1) of the CCR provides that duty is to be paid by the stipulated dates. As per proviso to rule 3(4) of the CCR, cenvat credit shall be utilised only to the extent it is available on the last day of the month, for payment of duty relating to that month. In the event of any failure, it shall be deemed that goods have been cleared without payment of duty.

M/s Mega International Pvt. Ltd., Gurgaon, in Delhi III commissionerate, engaged in manufacture of pharmaceutical products paid duty amounting to Rs. 1.82 crore during the period from October 2007 and September 2008 through cenvat credit account.

We found that the records of the assessee showed negative balances in its cenvat credit account throughout this period. Therefore, the entire payment through cenvat

account is to be treated as default in payment of duty. The entire amount of Rs. 1.82 crore is recoverable alongwith interest of Rs. 11.83 lakh (till March 2009). Additionally, a penalty of Rs. 1.82 crore is also leviable.

### **3.5 Simultaneous availing of cenvat credit on capital goods and depreciation under Income Tax Act**

According to Rule 4(4) of the CCR, if cenvat credit is taken for duty paid on acquiring capital goods, the amount of credit taken shall be deducted from the value of capital goods while calculating depreciation under section 32 of Income Tax Act, 1961.

Three assesseees, M/s Cassel Research Laboratories Pvt. Ltd., M/s. A to Z Life Sciences and M/s Fourtts (India) Laboratories Pvt. Ltd., in Chennai IV, Puducherry and Chennai III commissionerates respectively, took cenvat credit on capital goods but did not deduct them while claiming depreciation.

Credit of Rs. 46.21 lakh was taken incorrectly in this manner during the period from April 2005 to March 2008.

On this being pointed out (February 2009), the department accepted (March 2009) the audit contention in the cases of M/s A to Z Life Sciences, Puducherry and M/s Fourtts (India) Laboratories Pvt. Ltd. It intimated the recovery of Rs. 16.12 lakh with interest of Rs. 1.88 lakh in February - March 2009. Reply in respect of the third assessee was awaited (March 2010).