CHAPTER II
CENVAT CREDIT

Under cenvat credit scheme, credit is allowed for duty paid on 'specified inputs/capital goods' and service tax paid on 'specified input services' used in the manufacture of finished goods. Credit can be utilised towards payment of duty on finished goods subject to the fulfilment of certain conditions. We communicated to the Ministry, 17 cases of irregular availing/utilisation of cenvat credit involving revenue of ₹ 25.36 crore, as mentioned in the following paragraphs. The Commissionerate/Ministry had accepted (December 2011) the audit observations in two draft audit paragraphs involving revenue of ₹ 4.40 crore.

2.1 Suo-moto availing of cenvat credit

Section 11B of the Central Excise Act, 1944 provides that any person claiming refund of any duty of excise and interest, if any, paid on such duty, may make an application for such refund to the jurisdictional divisional officer before the expiry of one year from the relevant date. There is no provision for suo-moto availing of credit.

CESTAT in the case of M/s Comfit Sanitary Napkins (I) Ltd. {2004 (174) ELT 220} also held that the assessee could not take suo-moto refund/credit but should follow the procedure laid down under section 11B of the above Act. This view was also upheld by the larger bench of CESTAT in the case of BDH Industries Ltd. {2008 (229) ELT 364 (Tri - LB)}.

2.1.1 The Finance (No.2) Act, 2004, provided that, with effect from 1 April 2003, cenvat credit taken on payment of Additional Duties of Excise (Goods of Special Importance Act), 1957 {AED (GSI)} could be utilised for payment of basic excise duty, provided such AED (GSI) was paid on or after 1 April 2000. In terms of section 124 of the Finance Act, 2005 (amendment of Act 23 of 2004), wrongly availed and utilised credit of AED (GSI) was required to be recovered with interest in 36 equal installments.

M/s J.K. Tyre & Industries Ltd., in Indore commissionerate, had availed credit of ₹ 11.87 crore of Additional Excise Duty (AED) that had been paid prior to 1 March 2000. It utilised this entire credit towards payment of excise duty in the months of March 2003 and April 2004, which was irregular and translated to duty not paid. Thereafter, in compliance to the letter of the Assistant Commissioner, Central Excise, Division, Gwalior dated 26 May 2005, the assessee deposited the duty with interest in 36 equal installments through TR-6 challans from July 2005 to June 2008. However, in June 2008, it credited back ₹ 11.87 crore suo-moto, thereby neutralising the incorrectly utilised cenvat credit. This was not correct, as the assessee, instead of taking suo-moto credit, should have filed a claim for refund as provided in section 11B of

Central Excise Act. The irregular credit had to be regularised through a refund claim and interest was also payable.

When we pointed this out (April 2010), the Commissionerate stated (April 2010) that section 11 B of the Central Excise Act, 1944 was applicable only for refund of duty of excise, and not for restoration of any other claim of the cenvat credit wrongly debited.

The reply of the Commissionerate was not correct. This issue had been dealt with at length in the case of BDH Industries Ltd. {2008 (229) ELT 364 (Tri-LB)} where it held that the debit entry made in the accounts was towards payment of duty and therefore refund of these amounts had to be considered as refund of duty and it clearly emerged that all types of refund have to be filed under section 11B of the Central Excise Act and no suo-moto refund can be taken.

The reply of the Ministry had not been received (December 2011).

2.1.2 M/s GAIL (India) Ltd., in Indore commissionerate, engaged in the manufacture of L.P.G., Pentane, Propane, Naptha etc. paid excise duty (including cess) of ₹ 19.41 lakh in excess through Personal Ledger Account (PLA) in the month of March 2007. In the subsequent month of April 2007, the assessee adjusted the same suo-moto without following the procedure of filing a refund claim under provisions of section 11B of the Act. This resulted in non-payment of duty of ₹ 19.41 lakh for the month of April 2007.

When we pointed this out (August 2008 and December 2010), the Ministry stated (December 2011) that the excess was brought about by an incorrect debit entry in PLA due to clerical error and in the summary of the PLA, the assessee had shown the correct amount of debit.

The reply of the Ministry was not correct. After making the incorrect debit entry in the PLA, the closing balance was shown as "nil" in March 2007. The nil opening balance had also been carried forward in the PLA. Further in ER-1 for April 2007, the amount of ₹ 19.41 lakh was clearly shown as 'excess duty adjusted/paid during previous period'.

2.2 Separate accounts for common inputs used in dutiable/exempted goods not maintained

Rule 6 (2) of Cenvat Credit Rules, 2004 enunciates that a manufacturer who avails of cenvat credit of common inputs/services and manufacturers both dutiable and exempted goods, has to maintain separate accounts for receipt and issue of inputs/services for both categorization of final products. However, if the manufacturer opts not to maintain separate accounts, then he shall pay an amount equal to ten per cent (five per cent from 7 July 2009) of the price of the exempted final products or pay proportionate duty by exercising option under sub rule 3(A) of the rule ibid.

2.2.1 M/s Hi-Tech Carbon, in Allahabad commissionerate, engaged in the manufacture of dutiable product (Carbon Black) and non-dutiable product (steam), availed cenvat credit on a common input, Carbon Black Feed Stock oil. Separate accounts were not maintained for this common input. The assessee cleared non-dutiable goods worth ₹ 9.76 crore during April 2008 to March 2010 without paying 10/5 per cent duty amounting to ₹ 79.06 lakh. This amount was recoverable with interest of ₹ 15.17 lakh and penalty.

When we pointed this out (August 2010), the Commissionerate intimated (January 2011) that a show cause notice was issued.

The reply of the Ministry had not been received (December 2011).

2.2.2 M/s Tata Motors Ltd., in Pune I commissionerate, having manufacturing unit for exempted goods at Uttarakhand and dutiable goods at Pune, availed service tax credit at its corporate office to the extent of ₹ 13.36 crore on the common services utilised in manufacture of exempted goods as well as dutiable goods. The common services were also used in Engineering Research Centre (ERC), trading of goods and doing job work for others which were non-taxable services. The assessee had opted for proportionate payment specified under Rule 6(3A) in respect of the exempted clearance attributable to the Uttarakhand plant and reversed credit amount of ₹ 1.21 crore for the year 2008-09. However, the assessee did not reverse the proportionate credit on common input services utilised in respect of ERC, trading of goods and on job work which worked out to ₹ 2.06 crore.

When we pointed this out (March 2010), the Ministry admitted the audit observation and intimated (November 2011) that the show cause cum demand notice for ₹ 4.60 crore for the period April 2008 to March 2010 was under process of issue.

2.2.3 Board vide circular dated 28 October 2009 clarified that subsequent to the amendment in Section 2(d), of the Central Excise Act, 1944, bagasse, aluminum/zinc dross and other such products, termed as waste, residue or refuse, which arise during course of manufacture and were capable of being sold for consideration, would be excisable goods and chargeable to payment of duty.

Recovery of duty in respect of these goods was to be effected for the period after the budget of 2008. In case of nil rate of duty, or exemption from duty, cenvat credit taken on inputs used for manufacture of dutiable and exempted goods, was required to be reversed proportionately under Rule 6 of Cenvat Credit Rules, or 5 per cent of the sale amount was to be paid.

M/s SBEC Sugar Ltd., in Meerut I commissionerate and M/s K. M. Sugar Mills Ltd., in Allahabad commissionerate, engaged in the manufacture of sugar, molasses, chemicals (dutiable goods) and bagasse, rectified spirit (exempted goods) availed cenvat credit on common inputs but neither reversed proportionate credit on the clearance of bagasse and rectified spirit nor paid five per cent of the sale amount. Therefore, the assessees were liable to pay duty of ₹ 2.79 crore and interest thereon of ₹ 42.55 lakh.

When we pointed this out (February 2011), the Commissionerate intimated that a show cause notice was issued to M/s K. M. Sugar Mills Ltd. in July

2011. Reply in respect of M/s SBEC Sugar Ltd. was awaited (December 2011).

The reply of the Ministry had not been received (December 2011).

2.2.4 Rule 6(6) of the Cenvat Credit Rules, provides that sub-rule (1), (2) and (3) ibid shall not be applicable in case the exempted goods are cleared to certain specified categories.

M/s Schwing Stetter (India) Pvt. Ltd., in LTU Chennai commissionerate cleared five numbers of concrete mixing plants for ₹ 1.70 crore between February and March 2010 to M/s Punj Lloyd Ltd. Gurgaon without payment of duty in terms of notification dated 14 June 2006 pertaining to holders of "Served from India Scheme (SFIS)" Certificate. Since this scheme was not covered by exception in Rule 6(6) ibid, the assessee was liable to pay 5 per cent of the value of exempted goods amounting to ₹ 8.50 lakh alongwith interest.

When we pointed this out (November and December 2010 and July 2011), the Commissionerate stated (September 2011) that they were aware of the issue right from September 2008, the date on which tax payer sought clarification from the department and issued show cause notice for ₹ 11.90 lakh in February 2011 to protect the Government revenue.

The reply showed that the show cause notice was issued (February 2011) only after we pointed out the issue in November 2010.

The reply of the Ministry had not been received (December 2011).

2.3 Availing of cenvat credit on ineligible capital goods

Capital goods for the purpose of allowing credit of duty is defined in rule 2(a)(A) of the Cenvat Credit Rules, 2004.

The Board in their instruction dated 8 July 2010 clarified that cenvat credit on capital goods is available only on items which are excisable goods covered under the definition of capital goods under the Cenvat Credit Rules, 2004 and used in the factory of the manufacturer.

2.3.1 M/s NALCO, in Bhubaneswar I commissionerate, engaged in the manufacture of calcined alumina availed and utilised cenvat credit of ₹ 4.27 crore on various construction materials like HR Plates, HR Sheets in coil forms, PMP plates etc. treating them as capital goods during the period between 2008-09 and 2009-10. The cenvat credit availed of ₹ 4.27 crore was not admissible and recoverable with interest.

When we pointed this out (February 2011), the Ministry accepted the audit observation and stated (October 2011) that show cause notice was under process of issue.

2.3.2 M/s SAIL-ISP, M/s Phillips Carbon Black Ltd. in Bolpur commissionerate and M/s Rashmi Metaliks Ltd. in Haldia commissionerate, engaged in manufacture of iron & steel products, carbon black etc., availed

cenvat credit of ₹ 49.98 lakh between April 2006 and March 2009, on sleepers, towers and tippers, treating them as capital goods. We observed that

- M/s SAIL-ISP availed cenvat credit on mono block sleepers (sub-heading 68109990) and pre-stressed concrete sleepers (sub-heading 68101190), which were basically used for construction of railway tracks for movement of railway rakes, which extended beyond the factory premises.
- M/s Phillips Carbon Black Ltd. availed credit on lattice type towers (sub-heading 73089090) for transmission of electricity beyond the factory premises.
- M/s Rashmi Metaliks Ltd. availed cenvat credit on tipper/automobiles (sub-heading 87042319) for movement of materials.

Since these items were neither specified under the definition of capital goods nor were used for the manufacture of final product, the credit of duty availed was incorrect and was recoverable with interest.

When we pointed this out (between November 2009 and February 2010), the Commissionerate (September 2010) admitted the audit observation and stated that a show cause notice of ₹ 24.82 lakh, covering the period from January 2009 to June 2009 was issued to M/s SAIL-ISP (January 2011) and that of ₹ 8.91 lakh was issued to M/s Phillips Carbon Black Ltd. (June 2010).

In the case of M/s Rashmi Metaliks Ltd., the Commissioner, admitted the audit observation in January 2011. Subsequently, the Additional Commissioner, intimated (March 2011) that even if tipper was not covered under the definition of capital goods, the same would come under the purview of 'input'.

The reply was not correct since the tippers were neither covered under capital goods nor inputs as per the definitions under rule 2(a) and 2(k) of the Cenvat Credit Rules, 2004. Further, the Tribunal, in the case of M/s Ganta Ramanaiah Naidu {2010 (15) STR 10 (Tri-Bang)}, had held that cenvat credit on tipper (Chapter 87) was not admissible either as capital goods or inputs.

The reply of the Ministry had not been received (December 2011).

2.3.3 M/s Hindustan Zinc Ltd., in Jaipur II commissionerate, engaged in manufacture of zinc concentrates availed cenvat credit of ₹ 32.96 lakh on items like channel, Angle, HR Sheet & HR Plates etc. during the period from 2007-08 to 2009-10 by treating them as capital goods. Since these items were not covered under the definition of capital goods, the cenvat credit of ₹ 32.96 lakh was not admissible and recoverable alongwith interest.

When we pointed this out (December 2010), the Commissionerate stated (March 2011) that the matter of admissibility of cenvat credit on the items referred by us such as MS Angles, Channels, Steel plate etc had already been decided in favour of assessee by the Rajasthan High Court {2007 (214) ELT 510 (Raj.)}, holding that goods brought in factory for use in upkeep and maintenance of plant & machinery would be treated as capital goods. It was further stated that the Supreme Court also upheld the view of the Rajasthan

High Court by dismissing the SLP filed by the department against the judgement.

The case cited by the Commissionerate was not applicable since the items referred under the judgement were used for upkeep and maintenance of plant and machinery while the items pointed out by us in the instant observation were used in construction of fabricated structures. Hence, the availment of cenvat credit was irregular.

The reply of the Ministry had not been received (December 2011).

2.4 Non-reversal of cenvat credit

Rule 3 of Cenvat Credit Rules, 2004 stipulates that a manufacturer or producer of final products shall be allowed to take CENVAT credit of specified duties paid on any input or capital goods received in the factory of manufacture of final product. The term "input" is defined in Rule 2(k) of the said rules which inter alia includes goods used in or in relation to manufacture of a final product.

2.4.1 M/s IOC (AOD) in Dibrugarh commissionerate, wrote off the stock of indirect materials value of ₹ 2.44 crore during 2007-08 to 2009-10. As these materials were not used in or in relation to the manufacture of duty payable goods, the cenvat credit of ₹ 40.23 lakh taken on such materials was irregular, which was recoverable with interest.

We pointed this out to the Commissionerate/Ministry in March 2011/October 2011. Their reply had not been received (December 2011).

2.4.2 M/s National Engineering Industries Ltd., in Jaipur I commissionerate, engaged in manufacture of ball/tapper roller bearing, axle box and their components recovered cost of raw material amounting to ₹ 1.25 crore in 184 cases from job workers/suppliers during April 2007 to March 2009 as they had supplied defective material. The recovery was effected by issue of debit notes. Since the material costing ₹ 1.25 crore could not be used for final production as it had become defective and its cost recovered, the proportionate cenvat credit availed thereon amounting to ₹ 16.25 lakh was required to be reversed.

When we pointed this out (February/March 2010), the Commissionerate stated (July 2010) that the amount recovered by the assessee was not attributable to short receipt of material from the job worker but was a reduction of job work charges. The department further stated (April 2011) that to safeguard the revenue a show cause notice was issued to the assessee on November 12, 2010.

The reply of Commissionerate was not in consonance with the assessee's statement in the debit notes that due to receipt of defective items, the cost of raw material was being recovered from the job worker.

The reply of the Ministry had not been received (December 2011).

2.5 Non-reversal of un-utilised credits

Rule 3(1) of the Cenvat Credit Rules, 2004, stipulates that a manufacturer or producer of final products or a provider of taxable service shall be allowed to take cenvat credit and in terms of rule 3(4)(b), the credits so availed could be utilised for payment of duty/tax on dutiable goods/taxable services.

M/s Gagal Cement Works Barmana, ACC Unit I and II in Chandigarh I commissionerate, engaged in the manufacture of cement (sub-heading 2523.29) started clearing cement without payment of duty under area based exemption with effect from 3 May 2005 and 4 April 2006 respectively. These two units had accumulated credit of ₹ 40.41 lakh in their cenvat accounts from prior periods when they had been availing cenvat credit and paying duty on clearance of cement. Records revealed that these un-utilised balances had not been reversed.

When we pointed this out (April 2007 and January 2009) the Commissionerate stated (May 2007) that as per rule 3(4)(a) of the Cenvat Credit Rules, 2004, credits could be utilised for payment of duty on clinker.

The reply of the Commissionerate was not correct. Only that portion of the credit balance which related to inputs attributable to manufacture of clinker could be utilised for paying duty. The portion of the balance related to cement manufacture had to be reversed as cement had become an exempted item.

The reply of the Ministry had not been received (December 2011).

2.6 Non-reversal of cenvat credit on inputs/capital goods cleared as such

Rule 3(5) of Cenvat Credit Rules, 2004 prescribes that when inputs or capital goods, on which cenvat credit has been availed, are removed as such from the factory or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods.

M/s Amcor Pet Packaging Asia Pvt. Ltd., under Pune III commissionerate, took cenvat credit of ₹ 18.73 lakh on capital goods viz. cavity injection moulds and related spare parts imported in the year 2002. The cavity injection moulds, on which cenvat credit of ₹ 15.04 was taken, were removed from the factory in the year 2005 but amount equal to cenvat credit originally taken was not paid / reversed in full.

We pointed this out in September 2009. Reply had not been received from the Commissionerate. The Ministry stated (November 2011) that the matter was under examination.

2.7 Cenvat credit availed on inadmissible input service

Rule 3 of Cenvat Credit Rules, 2004, provides that a manufacturer of final products may take credit of service tax paid on any input service received by him if such service is used in the manufacture of final products. As per Rule 2(1)(ii) ibid, the term 'input service', for purpose of allowing credit inter alia, includes activities relating to business such as accounting, financing, credit rating, share registry, security and inward transportation of inputs etc. Welfare benefits such as health insurance coverage, outdoor catering, transportation under Rent-a-cab operator etc extended by employer to employees, air travel services, event management services do not come within the ambit of input service, as such services have no nexus to manufacturing operations.

M/s Hindustan Petroleum Corporation Ltd., Visakhapatnam in Visakhapatnam I commissionerate, engaged in the manufacture of petroleum products availed credit of input service tax for ₹ 29.12 lakh on services relating to waltair park, yarada park sodeso pass services etc. during the period 2009-10. The availing of cenvat credit on above input services was irregular, as these input services were not directly or indirectly related to the manufacture of final products. Therefore, assessees were liable to pay ₹ 29.12 lakh alongwith interest.

When we pointed this out (March 2011), the Ministry while not admitting the audit observation stated (November 2011) that the services pertinent to the employees were to be treated as indirectly being used in or in relation to the manufacture of final products as the employees were integral part of the assessee undertaking the excisable activity.

The reply of the Ministry was not correct since the services relating to parks, colonies and pass services were not covered under definition of rule 2(l) of Cenvat Credit Rules, 2004.

2.8 Improper distribution of cenvat credit

Rule 2(m) of Cenvat Credit Rules, 2004, defines the term 'input service distributor' as an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under rule 4A of the Service Tax Rules, 1994, towards purchases of input services and issue invoice, bill or challan for purpose of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be. As per rule 3 of Service Tax (Registration of Special Category of Persons) Rules, 2005, the ISD has to obtain a registration number under the said rule in addition to a registration under rule 4 of the Service Tax Rules, 1994.

M/s Poggen AMP, Nagarsheth Powertonics Ltd., Unit I, Vatva, in Ahmedabad I commissionerate engaged in manufacture of cleated stamping,

die cast rotor etc., availed cenvat credit of ₹ 14.82 lakh for service tax paid by the head office at Vatva for the services of general nature utilised in its own unit as well as utilised by unit II Vatva and Kheda during the period April 2005 to March 2008. We found that the head office was not registered with the department as ISD. Hence passing on the credit of ₹ 14.82 lakh by the head office to the assessee was irregular, which was required to be recovered alongwith interest.

When we pointed this out (February 2009), Commissionerate stated (November 2010) that a show cause notice had been issued.

The reply of the Ministry had not been received (December 2011).

2.9 Incorrect availment of cenvat credit

Rule 6(1) of the Cenvat Credit Rules, 2004 stipulates that no credit of specified duty shall be allowed on inputs, which are used in the manufacture of final product which are exempt or are chargeable to 'nil' rate of duty.

The Board circular dated 4 January 1991 clarified that an assessee had no option to pay duty on his own volition, where the goods were fully exempted. In case he paid any amount in the name of excise duty, which was not leviable by law, the amount so paid would be in the nature of deposit with the Government.

M/s Desai Cement Co Pvt. Ltd., in Goa commissionerate, engaged in the manufacture of portland slag cement was also selling ground slag after crushing granulated blast furnace slag. During the period April 2007 to June 2009, the slag procured as input was used both for manufacture of cement, which was dutiable and ground slag, which was non-dutiable as it had not been generated by a manufacturing process. Cenvat credit of ₹ 13.46 lakh was availed on input quantity of 25,706.71 tonne used exclusively for generation of ground slag. During this period, the assessee cleared ground slag on payment of duty. From July 2009, it discontinued the payment of duty on clearance of ground slag as the process did not amount to manufacture as defined under Section 2 (f) of the Central Excise Act, 1944.

Going back to the period April 2007 to June 2009, the assessee paid duty on the clearance of ground granulated blast furnace slag of his own volition although duty was not actually payable. Therefore, as per Board circular of 1991, the amount so paid was not excise duty and had to be treated as deposit and hence, the cenvat credit availed of ₹ 13.46 lakh had to be recovered with interest.

When we pointed this out (August 2010) the Commissionerate did not accept the audit observation and stated (September 2010) that ground granulated slag was an excisable commodity and it could not be treated as non-excisable merely because it was obtained out of a process not amounting to manufacture. It also opined that granulated slag was an input and the assessee had rightly availed credit on the same.

The reply of the Commissionerate was not correct. Although ground granulated slag was excisable, in the instant case it was non-dutiable and was to be cleared at nil duty. Therefore, the cenvat credit of inputs attributable to its manufacture was required to be reversed as per rule 6(1) of Cenvat Credit Rules, 2004.

The reply of the Ministry had not been received (December 2011).

2.10 Availing of cenvat credit on ineligible inputs

As per explanation 2 to Rule 2(k) of Cenvat Credit Rules, 2004, input includes goods used in the manufacture of capital goods, which are further used in the factory of the manufacturer but shall not include cement, angles, channels, centrally twisted deform bar or thermo mechanically treated bar and other items used for construction of factory shed, building or laying of foundation, or making of structures for support of capital goods.

M/s Triveni Engineering and Industries Ltd., (Alcho-chemical Division) in Meerut II commissionerate, availed cenvat credit of ₹ 10.31 lakh on items like M.S. angles, channels, shapes and sections, M.S. Plates etc., treating them as inputs. Since these structural items were not eligible to be treated as inputs, the cenvat credit of ₹ 13.11 lakh was recoverable from the assessee with interest and penalty.

When we pointed this out (April 2010), the Commissionerate accepted the observation and intimated (November 2010) that a show cause notice was under process of issue.

The reply of the Ministry had not been received (December 2011).