

## Chapter III

### Central Excise duty on Petroleum, Oil and Lubricant products

#### 3.1 Introduction

The Mineral fuels, Mineral Oils and products of their distillation, bituminous substances and mineral waxes covered under Petroleum sector are classified under Chapter 27 of Central Excise Tariff Act, 1985. These products are broadly categorised as, (i) Crude Oil, (ii) Liquefied Natural Gas (LNG) & (iii) Petroleum, Oil & Lubricants (POL) Products. While Crude oil and LNG are naturally obtained, the POL products are obtained by way of refining/manufacture. During FY 14, out of total net revenue receipts from Central Excise duties, the share of petroleum sector was more than 50 per cent.

#### 3.2 Duty structure on petroleum products

In the Finance Bill 2005, the duty structure with regard to MS and HSD was changed to a combination of specific and ad valorem rates of duties in lieu of earlier ad valorem rate of duties. With effect from March 2008, excise duty rates on petrol and diesel were made specific. Products like Naphtha, Furnace Oil, Low Sulphur Heavy Stock etc. are both dutiable and exempted depending upon the end use. Duties levied by Central Government on major petroleum products as on 31 March 2014 are given as under:

Table - 3.1

Sl. No.	Name of the Product	Custom Duty	Excise Duty
1	Crude Oil	Nil + ₹ 50/MT as NCCD	Nil + ₹ 50/MT as NCCD and ₹ 4,500/MT as Cess
2	Petrol	2.5 per cent	₹ 9.48/Litre
3	Diesel	2.5 per cent	₹ 3.56/Litre
4	Superior Kerosene Oil (PDS)	Nil	Nil
5	Superior Kerosene Oil (Non PDS)	5 per cent	14 per cent
6	Domestic LPG	Nil	Nil
7	Non Domestic LPG	5 per cent	8 per cent
8	Furnace Oil	5 per cent	14 per cent
9	Naphtha	5 per cent	14 per cent
10	ATF	Nil	8 per cent

#### 3.3 Pricing of petroleum products

Central government regulates the prices of sensitive petroleum products (diesel, domestic Liquefied Petroleum Gas (LPG) and Public Distribution System (PDS) kerosene). With effect from June 2006, based on the

Rangarajan Committee Report, the price of diesel is fixed according to the Trade Parity Price (TPP), which is 80 per cent of Import Parity Price (IPP) and 20 per cent of Export Parity Price (EPP). With effect from June 2010 as per the recommendation of Parikh committee, price of petrol is market determined. Further, with effect from 19 October 2014, the price of diesel is also market determined. The Government fixes the price of natural gas produced by national Oil Companies. The respective producers and sellers fix the prices of the remaining products other than sensitive products and natural gas under Administered Price Mechanism.

### **3.4 Audit objectives**

The audit objectives were to ensure

- i. the adequacy and compliance with rules, regulations, notifications, circulars/instructions/trade notices etc. issued from time to time in relation to levy, assessment and collection of excise duty relating to Petroleum sector;
- ii. whether the extant provisions of law are being complied with adequately;
- iii. whether there was an effective monitoring and internal control mechanism.

### **3.5 Scope of Audit and coverage**

For conducting audit, we selected 35 Commissionerates and some subordinate offices functioning under those Commissionerates. Audit examined whether the internal control mechanisms were in place and functioned effectively at the selected Commissionerates, Division and Range offices.

Effectiveness of compliance verification mechanism was test checked at the Range office level through the scrutiny of excise returns filed by the assesseees. Compliance with rules and regulations designed for proper assessments and levy and collection of duty was test checked both at the departmental offices and at the premises of some selected assesseees.

The period covered was 2010-11 to 2012-13. We issued the draft report to the Ministry in August 2014.

## **Audit findings**

We noticed cases of irregular availing of exemption, non-recovery of arrears, non-payment/short payment of duty, irregular availing of Cenvat credit etc. involving revenue of ₹ 7.12 crore. The department accepted (December 2014) the audit observations involving revenue of ₹ 4.44 crore and recovered the same. The major findings are discussed below:

### **3.6 Non-payment/short payment of duty**

#### **3.6.1 Levy of National Calamity Contingency Duty (NCCD) on crude oil at different points**

We observed that the quantum on which NCCD is levied is not uniform across the Commissionerates. In the case of M/s Cairn India Limited, in Jaipur II Commissionerate, NCCD was paid on the gross quantity dispatched from processing terminal whereas in the case of M/s ONGC in Tiruchirapalli Commissionerate, NCCD was paid on the net quantity received by the refineries and not on the gross quantity dispatched by the assessee from the oil field. This inconsistent practice of levy of NCCD at different point had resulted in excess/short levy of NCCD.

The inconsistency in levy of NCCD at different points in different Commissionerates was brought to the notice of the department for corrective measures.

We await the reply of the Ministry (December 2014).

#### **3.6.2 Excise duty on interface SKO in pipeline transfers**

Supply of petroleum products through pipelines is carried out by product to product method of pumping and in such an event, co-mingling of one product with another is inevitable. However, in the scheme of accounting of one product, the duty payable on the interface product (co-mingled products) will be different. The Board, therefore, in Circular No. 636/27/2002-CX dated 22 April 2002 clarified that in the event of intermixing of the products while pipeline transfer, the higher of the two duties i.e. duty payable on Superior Kerosene Oil (SKO) not used for intended purpose and duty payable on surge/gain in Motor Spirit or High Speed Diesel shall be payable for the intermixed/interface quantity. In other words, the duty of intermixed part of SKO and HSD or MS and Naphtha, as the case may be must be quantified and higher of the two values remitted.

**3.6.2.1** M/s. BPCL-Kochi Refinery furnished data relating to variation in quantities of dispatch and receipt of SKO (PDS) at the three installations (for

the period from July 2008 to December 2012 in respect of BPCL installation and from January 2008 in respect of IOCL and HPCL installations).

Audit noticed from the show cause notice dated 29 July 2013 that it pertained to interface quantities of SKO (PDS) dispatched from BPCL- Kochi Refinery to HPCL and IOCL installations for the period from July 2008. However, the same issue in respect of BPCL installations for the period from April 2010 to December 2012 involving ₹ 68.81 lakh was not taken into account in the show cause notice indicating non-raising of demand.

Further, the show cause notice was issued to M/s. BPCL-KR, relying on the assessee's calculation sheet in which the duty in respect of intermixed quantity was calculated based on HSD alone instead of quantifying the higher of the two duties with respect to HSD and SKO. This resulted in short demand of ₹ 14.55 lakh for the period from July 2008 to December 2012.

Due to belated identification by the Department, SCNs were issued for the period from July 2008 only to IOCL and HPCL installations. Duty, time barred for the six months from January 2008 to June 2008, in respect of IOCL and HPCL amounted to ₹ 7.91 lakh. Further, higher duty on interface Naphtha during pipeline transfer of Naphtha and MS, in respect of BPCL installation, was also not taken into consideration by the Commissionerate. Thus duty could not be demanded due to inaction on the part of the Commissionerate.

We had pointed these out in October 2013, the reply of the Ministry/Commissionerate's was awaited (December 2014).

**3.6.2.2** Scrutiny of records of M/s. Indian Oil Corporation Ltd. (IOCL), in Guwahati Commissionerate, revealed that at the time of intermingling of products MS and HSD, the SKO passes in between the two products as interface through pipeline delivery for different locations. Further, the SKO so used for interface purpose came through pipeline as PDS Kerosene from the different IOCL refineries situated at Haldia, Gujarat, Panipat, Mathura and Barauni.

Audit noticed that as the PDS Kerosene was used for non-PDS purpose, the assessee had paid duty for interface kerosene after availing the benefit of exemption notification dated 13 May 2002 (i.e. North East region exemption of payment of Central Excise duty of 50 per cent of normal rate) and paid duty at the rate of 7 per cent ad valorem (the prevalent rate) as non PDS kerosene.

Audit observed that as the kerosene was manufactured and cleared from different IOCL refineries situated outside North East region, the excise duty at full prevalent rate which was 12 per cent was to be paid by the said refineries

from where the kerosene was cleared as “NIL” rate of duty for use as PDS purpose but ultimately used as Non-PDS purpose.

When we pointed this out (January 2013), the Commissionerate replied (November 2013) that the said five refineries, from where SKO was initially cleared, paid Central Excise duty along with interest (in April – May 2013) amounting to ₹ 3.42 crore for the clearance made during 2011-12.

### **3.6.3 Duty on clearance of scrap**

Scrap generated from capital goods after use attracts duty. The fact that on import, the Cenvat on such goods was not availed does not alter the position as regards the levy of duty on scrap generated from the use of such capital goods.

M/s Oil and Natural Gas (ONGC) in Trichy Commissionerate, sold Miscellaneous Steel scrap (chapter 72) and waste Oil (chapter 27) during the period from 2010-11 to 2012-13 for a sum of ₹ 3.75 crore. However, duty amounting to ₹ 41.88 lakh, payable on such removals, was not paid as verified from the ER 1 returns for the three years. This amount needs to be levied and collected along with interest.

We had pointed this out in December 2013, the reply of the Ministry/Commissionerate’s was awaited (December 2014).

## **3.7 Availing of Cenvat credit**

**3.7.1** Rule 2(l) of Cenvat Credit Rules, 2004 defines input service as:-

“(a) used by a provider of output service for providing an output service and (b) Used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products up to the place of removal” but excludes services such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance etc.

M/s Indian Oil Corporation Limited, Panipat Refinery in Rohtak Commissionerate, availed and utilised Cenvat credit amounting to ₹ 11.39 lakh in 2012-13 on services like Hotel, Club, Guest house service, Running of canteen and General Housekeeping services which did not fall under the ambit of input services as per rule ibid. Hence, Cenvat credit availed/utilised on above services was irregular and should be reversed along with interest.

We had pointed this out in October 2013, the reply of the Ministry/Commissionerate’s was awaited (December 2014).

**3.7.2** Rule 2 (l) of Cenvat Credit Rules 2004, excludes from the ambit of 'input service', services as specified in sub-clause (p), (zn), (znl), (zzm), (zzq), (zzzh), (zzzza) of clause (105) of section 65 of the Finance Act, 1994 so far as they are used for construction of a building or a civil structure or a part thereof and laying of foundation or making of structures for support of capital goods.

According to Rule 2(1)(ii)(A) of Cenvat Credit Rules, 2004 service portion in the execution of a works contract and construction services including service listed under clause (b) of section 66E of the Finance Act, 1994 do not qualify as input service, in so far as they are used for (a) construction or execution of works contract of a building or a civil structure or a part thereof or (b) laying of foundation or making of structures for support of capital goods.

**3.7.2.1** M/s Indian Oil Corporation Ltd., Haldia Refinery in Haldia Commissionerate, had taken credit on input services used for civil construction works, contravening the above rule provision. This resulted in irregular availing of Cenvat credit to the tune of ₹ 41.83 lakh (including Education Cess & Secondary & Higher Education Cess) for the year 2012-13.

When we pointed this out (August 2013), the assessee, while admitting the fact, reversed ₹ 1.15 lakh only. The balance amount of ₹ 40.68 lakh payable by the assessee had not been recovered. The assessee was also liable to pay interest under Rule 14 of Cenvat Credit Rules, 2004 for such irregular availing of Cenvat credit.

The issue was pointed out (August 2013). Reply of the Ministry/Commissionerate's was awaited (December 2014).

**3.7.2.2** M/s. BPCL-KR in Cochin Commissionerate, during the years 2011-12 and 2012-13 had availed and utilised Cenvat credit amounting to ₹ 20.48 lakh on Service Tax paid for input services contravening Cenvat Credit (Amendment) Rules, modified with effect from 01 April 2011.

When we pointed this out (October 2013), the Commissionerate replied (March 2014) that Cenvat credit is eligible for civil jobs which are of repairs/renovation, modification category. It was also stated that out of the total amount ₹ 13.95 lakh was eligible and ₹ 0.83 lakh was reversed under rule 6 (3) of Cenvat Credit Rules, 2004. The Commissionerate further stated that an amount of ₹ 5.68 lakh was reversed in November 2013 and payment of interest was awaited.

We await the reply of the Ministry (December 2014).

**3.7.2.3** M/s. BPCL-KR in Cochin Commissionerate, availed and utilised Cenvat credit of ₹ 14.29 lakh for Services in relation to transport facilities given to employees, Insurance coverage to employees, housekeeping and repair works at Canteen, Welfare activities to employees, Amenities given to CISF staff, repair works at Jwalagiri and CR School etc in contravention to Cenvat Credit (Amendment) Rules, modified with effect from 01 April 2011.

When we pointed this out (October 2013), the Commissionerate replied (March 2014) that the assessee had reversed ₹ 8.97 lakh for the year 2010-11 and 2011-12 and an amount of ₹ 5.31 lakh was eligible for availing Cenvat credit for the year 2011-12 as the same is taken on AMC on water coolers which were directly in relation to manufacture and on canteen facilities which was mandatory as per Factory Act.

The reply of the Commissionerate is not acceptable as with effect from 1 April 2011 input services shall not include services used primarily for personal use or consumption of an employee.

We await the reply of the Ministry (December 2014).

**3.7.3** According to Notification dated 1 March 2011, works contract services, construction services and architectural consultancy services used for the construction of a building or a civil structure or a part thereof, or laying of foundations or making of structures for support of capital goods shall not come under the definition of input service and hence were not eligible for Cenvat credit from 1 April 2011.

Integrated Refinery Expansion Project (IREP) is carried out by M/s. BPCL-KR, by engaging Works Contract and Construction Service firms. A test check of 10 major project works revealed that in respect of 2 Works contract projects – (Project 4503490792 Site grading, roads, drains and other miscellaneous works for IREP. Contractor: Bridge and Roof Co (I) Ltd. & Piling works for IREP site-Contractor: DBM Geotechnics and Construction Private Limited) the assessee availed and utilised Cenvat credit on ineligible input services relating to Civil structural and architectural works for an amount of ₹ 39.88 lakh and Piling works for an amount of ₹ 46.59 lakh during 2012-13 contrary to the provisions of Cenvat Credit (Amendment) Rules, 2011.

When we pointed this out (October 2013), the Commissionerate replied (March 2014) that the assessee are eligible for availing and utilizing the Cenvat credit on the Service Tax paid on the works of Dismantling of quarters/water tanks, cutting of trees, construction of drains and retaining walls, RR masonry walls for security purposes. The Commissionerate further accepted the audit observation regarding piling work and reported recovery of ₹ 46.59 lakh.

The reply of the Commissionerate is not acceptable as all the activities mentioned above will come under civil construction hence not eligible for input service credit with effect from 1 April 2011.

We await the reply of the Ministry (December 2014).

**3.7.4** As per Rule 4(2)(a) of Cenvat Credit Rules, 2004 the Cenvat credit in respect of capital goods received in a factory at any point of time in a given financial year shall be taken only for an amount not exceeding fifty per cent of the duty paid on such capital goods in the same financial year.

M/s Indian Oil Petronas Pvt. Ltd. in Haldia Commissionerate had taken 100 per cent credit on capital goods (spares of machinery) in the same financial year (2012-13) in which it was received in the factory as against the admissible credit at 50 per cent of the value of capital goods. This resulted in irregular availing of Cenvat credit of ₹ 9.64 lakh for the period 2012-13. The assessee was also liable to pay interest under Rule 14 ibid for such irregularity.

The issue was pointed out (September 2013), the reply of the Ministry/Commissionerate's was awaited (December 2014).

**3.7.5** Rule 6(5) of the Cenvat Credit Rules, 2004 provides that notwithstanding anything contained in sub-rules (1), (2) and (3), credit of the whole of Service Tax paid on taxable service as specified in sub-clause (g), (p), (q), (r), (v), (w), (za), (zm), (zp), (zy), (zsd), (zsg), (zsh), (zzi), (zsk), (zsq) and (zsr) of clause (105) of section 65 of the Finance Act, 1994 shall be allowed unless such service is used exclusively in or in relation to the manufacture of exempted goods or providing exempted services.

Above sub-rule (5) was omitted vide Notification dated 01 March 2011 with effect from 01 April 2011.

M/s. Indian Oil Corporation Ltd. in Vadodara-I Commissionerate was clearing both dutiable and exempted finished goods. Test check of RG-23 of Cenvat credit of input services and invoices for the years 2011-12 and 2012-13 of the assessee revealed that the assessee availed 100 per cent Cenvat credit during the year 2011-12 in respect of services specified in Rule 6 (5) of Cenvat Credit Rules, 2004 as the period of providing service was prior to 01 April 2011. It was further noticed that in addition to above services, the assessee availed 100 per cent Cenvat credit in respect of services viz. Man Power Recruitment & Supply Agency service (k), Rent-a-Cab Scheme Operator's Service (o), Business Auxiliary Service (zsb), Services in relation to execution of Works Contracts (zzza) and Supply of Tangible goods service (zzzj) on the same ground. However, these services were not covered under Rule 6(5) of Cenvat

Credit Rules, 2004. Hence, the assessee was required to avail Cenvat credit attributable to the duty paid clearance of the finished goods only. As certified by the Chartered Accountant, the assessee was eligible for availing Cenvat credit at the rate of 91 per cent of the total Cenvat credit of input services during 2011-12.

We further noticed that during September and October 2012, the assessee availed 100 per cent Cenvat credit in case of three entries as against Cenvat credit of 91 per cent attributable to the duty paid clearance of finished goods. In addition, the assessee availed one more per cent Cenvat credit of same input service as if he had availed 91 per cent Cenvat credit (As certified by the Chartered Accountant, the assessee was eligible for availing Cenvat credit at the rate of 92 per cent of the total Cenvat credit of input services during 2012-13, hence, assessee was eligible to avail difference of Cenvat credit of one per cent in cases where he had availed 91 per cent credit). Total 101 per cent credit was availed as against correct credit of 92 per cent.

This resulted in excess availing of Cenvat credit of Service Tax of ₹ 16.12 lakh (including Cess). In addition, interest under section 11AB of the Central Excise Act, 1944 is also leviable.

When we pointed this out (August 2013), the Commissionerate accepted (February 2014) the audit observation and intimated that the assessee reversed ₹ 16.81 lakh along with interest of ₹ 5.69 lakh.

**3.7.6** In view of the decision of the Larger Bench in the case of CCE, New Delhi v/s Avis Electronics Pvt. Ltd., credit on the basis of the photocopy was impermissible.

The CBEC circular (Para 10(d)) dated 13 February 1995 also stipulated that in no circumstances photocopy shall be accepted.

We noticed that the Indian Oil Corporation Ltd, Barauni, in the Patna Commissionerate availed Cenvat credit of ₹ 13.52 lakh during the period 2010-11 to 2012-13 on the basis of photocopy of tax invoices which are ineligible documents. This resulted in availing and utilisation of Cenvat credit of ₹ 13.52 lakh on ineligible documents.

We have pointed this out in September 2013, the reply of the Ministry/Commissionerate's was awaited (December 2014).

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

M/s IOCL, Panipat, in Rohtak Commissionerate, engaged in the manufacturing of mineral oils/fuels, had generated electricity. This was partly sold to M/s Air Liquide Industries Belgium and Brussels, who had built and operated a Naphtha Cracker plant for IOCL and partly used in the plant but the assessee did not maintain separate account for electricity consumed in the factory and sold outside. M/s IOCL recovered power charges amounting to ₹ 302.89 crore during the years from 2010-11 to 2012-13. The Cenvat credit availed for the same was recoverable from the assessee along with interest and penalty as applicable under the rules.

We had pointed this out in October 2013, the reply of Ministry/Commissionerate's was awaited (December 2014).

### **3.8 Non-levy of interest**

According to Section 11AB of the Central Excise Act, 1944, where any person, liable to pay duty of excise had not paid or had made belated payment thereof, in addition to the duty, are liable to pay interest at the rate prevailing from time to time. Interest is payable for the period from the date next to the due date till the date of payment of such duty. The effective rate of interest is 13 per cent per annum up to 13 March 2011 and 18 per cent per from 1 April 2011 onwards.

Further, the Board vide circular dated 28 July 2003 clarified that where supplementary invoices on account of revision of prices raised and differential duty on the value of such supplementary invoices raised, interest is also payable under section 11AB on the differential duty.

Four assessees- M/s. Essar Oil Ltd., Vadinar (Rajkot Commissionerate), M/s. Tiki Tar Ind.(Baroda) Ltd. (Vadodara-II Commissionerate) M/s IOCL, Koyali (Vadodara-I Commissionerate) & M/s. Anamica Oil Pvt. Ltd., Jaipur (Jaipur Commissionerate) did not pay interest amounting to ₹ 16.78 lakh on the excise duty paid late/paid through Cenvat credit availed irregularly during the period 2010-11 to 2012-13.

When we pointed this out (August 2013 to October 2013), the Commissionerate reported (October 2013 & February 2014) recovery of ₹ 15.93 lakh in two cases relating to M/s. Essar Oil Ltd. and M/s IOCL and in remaining cases the Ministry/Commissionerate's reply was awaited (December 2014).