

## Chapter 2: System issues

### 2.1 Utilisation of Cenvat credit for payment of duty

**2.1.1** It is observed from Table 1 that central excise duty paid through Cenvat as a percentage of PLA payments is approximately 154 per cent over the period of review. Further it was found that in 13 out of 41 selected Commissionerates the central excise duty paid from Cenvat credit as percentage of PLA payment was more than double in comparison with national averages. Some other discrepancies in relation to availing and utilisation of credit were also observed. Three cases are illustrated below: -

- In Silvasa Commissionerate, duty payment through Cenvat as compared to PLA is as high as 1,300 per cent approximately during 2012-13 to 2014-15. This ratio is very high in comparison with all India figures of 154 per cent.
- In Hyderabad-III Commissionerate while the number of assesseees increased from 424 in the year 2012-13 to 457 in the year 2014-15 (eight per cent) the corresponding duty payment through PLA decreased from ₹ 961 crore to ₹ 771 crore (minus 20 per cent). In respect of Cenvat utilisation it increased from ₹ 1,182 crore to ₹ 1,207 crore (two per cent).
- In Ahmedabad-III Commissionerate during the years 2013-14 and 2014-15 though the number of assesseees increased from 2,012 to 4,452 (121 per cent) the corresponding duty payment through PLA increased from ₹ 838 crore to ₹ 920 crore (10 per cent) and in respect of Cenvat utilisation it increased from ₹ 3,051 crore to ₹ 3,170 crore (four per cent) only.

**2.1.2** It is observed from Table 2 that service tax paid through Cenvat as a percentage of PLA payments is approximately seven per cent over the period of review. Further it was found that in 14 out of 41 selected Commissionerates payment from Cenvat credit as percentage of PLA payment, was more than double in comparison with national averages. Two cases are illustrated below:-

- In Bengaluru LTU Commissionerate the utilisation of Cenvat credit during 2012-13 and 2013-14 were 58 and 61 per cent respectively which is more than seven times in comparison with all India average of 7.48 per cent.

- In Bhubaneswar-I Commissionerate the utilisation of Cenvat credit during the year 2012-13 and 2013-14 were 76 and 67 per cent respectively which is more than nine times in comparison with all India average of 7.8 per cent.

## **2.2 Absence of provision to reverse credit of service tax paid on input services used for inputs removed as such**

As per rule 2(l) of the Cenvat Credit Rules, 2004, “input service” includes services used in relation to procurement of inputs and inward transportation of inputs or capital goods and outward transportation upto the place of removal etc. Further, rule 3 (1) of the rules, *ibid*, provides that the manufacturer or producer of final products or provider of taxable service shall be allowed to take credit of service tax on input service received by the manufacturer of final product. Although rule 3(5) provides for reversal of credit taken on inputs or capital goods removed as such, there is no corresponding provision under the rules requiring payment of the amount equal to the credit of service tax paid on input services. These services could include custom house agent’s services, clearing and forwarding agents’ services, transportation availed for procurement/transportation of inputs or capital goods etc. Non-existence of such provision resulted in unintended benefit to the manufacturer.

During test check of records of 44 cases in 17 Commissionerates, we observed that the proportionate value of service tax credit on input services of ₹ 21.63 crore was not reversed due to absence of suitable provision in Cenvat Credit Rules, 2004. A few cases are illustrated below:-

**2.2.1** M/s. UPL Ltd. (Unit-V) in Bharuch Commissionerate, cleared inputs as such of ₹ 139.21 crore out of total inputs purchased during the period of review worth ₹ 1,459.10 crore. However, the assessee, due to absence of provision for reversal of Cenvat credit on input services involved in inputs cleared as such, did not reverse the same. This resulted in unintended benefit of ₹ 5.96 crore to the manufacturer during the aforesaid period.

**2.2.2** M/s. Toyota Kirloskar Motors Pvt. Ltd., in Bengaluru LTU Commissionerate, cleared inputs as such of ₹ 6.82 crore out of total inputs purchased during the period of review worth ₹ 950.36 crore. However, the assessee, did not reverse the credit of input services involved in inputs cleared as such. This resulted in unintended benefit of ₹ 3.60 crore to the manufacturer during the aforesaid period.

**2.2.3** M/s. Kirloskar Oil Engines Ltd. and M/s. Cummins India Ltd., in Pune-III Commissionerate, cleared inputs as such of ₹ 271.15 crore out of total

inputs purchased during the period of review. However, the assessee, did not reverse the credit of input services. This resulted in unintended benefit of ₹ 4.78 crore to the manufacturer during the aforesaid period.

**2.2.4** M/s. Asian Paints Ltd., in Mumbai LTU Commissionerate, cleared inputs as such of ₹ 76.91 crore out of total inputs purchased during the period of review. Due to absence of provision for reversal of Cenvat credit on input services involved in inputs cleared as such the assessee, did not reverse the same. This resulted in unintended benefit of ₹ 1.23 crore to the manufacturer during the aforesaid period.

When we pointed this out (between April and June 2015), the Ministry stated that this is a policy matter.

**Recommendation No.1**

*The Ministry may insert a provision in Cenvat Credit Rules, to reverse the proportionate Cenvat credit of input services at the time of clearance of input/capital goods as such.*

*During the exit conference, the Ministry stated that a survey will be undertaken to find out misuse, if any. The result of this survey will be shared with the CAG.*

**2.3 Lacunae in provision allowing credit on input services**

While amending Notification dated 17 March 2012, the notification dated 1 March 2015 allowed clearance of mobile phones with payment of duty at the rate of one per cent subject to conditions as specified therein which restricted availing of Cenvat credit in respect of inputs and capital goods only. The condition remained silent in respect of availing of Cenvat credit on input services. As the notification allowed concessional rate of duty in respect of mobile phones, allowing benefit of Cenvat credit in respect of input services does not appear to be in line with basic principles of Cenvat credit scheme.

M/s. Samsung India Electronic Pvt. Ltd., in Noida-I Commissionerate, engaged in manufacture of mobile handsets, cleared mobile phones with payment of duty at the rate of one per cent availing the benefit of the aforementioned notification and also availed Cenvat credit in respect of input services during March 2015. As the mobile phones were cleared at concessional rate of duty, availing of Cenvat credit in respect of input services by the manufacturer resulted in unintended benefit of ₹ 7.30 crore during March 2015.

When we pointed this out (June 2015), the Ministry stated that this is a policy matter.

## **Recommendation No.2**

*Government may consider making suitable amendment to the Notification to restrict credit on input services as well.*

*During the exit conference the Ministry stated that the issue is under examination of Tax Research Unit (TRU) and detailed reply will be furnished separately.*

### **2.4 Absence of provision for credit reversal for obsolete goods**

Rule 3 of Cenvat Credit Rules, 2004, provides that a manufacturer or a provider of output service shall be allowed to take credit of input or input services or capital goods for use in or in relation to the manufacture of final products or for providing output services.

Rule 3(5A) of Cenvat Credit Rules, 2004, provides that when the capital goods, on which Cenvat credit has been taken, are removed after being used, whether as capital goods or as scrap or waste, the manufacturer or provider of output services shall pay an amount equal to the Cenvat credit taken on the said capital goods reduced by the percentage points calculated by straight line method as specified in the rule for each quarter of a year or part thereof from the date of taking the Cenvat credit. But if the amount so calculated is less than the amount equal to the duty leviable on transaction value, the amount to be paid shall be equal to the duty leviable on transaction value.

According to rule 3(5B) of Cenvat Credit Rules, 2004, if the value of any input or capital goods before being put to use, on which Cenvat credit has been taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of account, then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the Cenvat credit taken in respect of the said input or capital goods. But, there is no provision for goods declared as obsolete but not written off in accounts. During test check we observed in three cases where goods were declared as obsolete but Cenvat credit was not reversed which are illustrated below:-

**2.4.1** M/s. Rashtriya Ispat Nigam Ltd., in Kakinada Commissionerate, had made the provision of ₹ 36.36 crore against the cumulative stock of obsolete material. In the absence of provision, the assessee had not reversed the Cenvat credit of ₹ 4.49 crore attributable to these obsolete material.

**2.4.2** M/s Toyota Kirloskar Motors Pvt. Ltd., in Bangalore LTU Commissionerate, declared some of the used capital goods as obsolete in the books of accounts and the same were kept in the factory without removal.

However, due to absence of provisions, the assessee did not pay the amount equal to Cenvat credit of ₹ 24.29 lakh on the ground that the said goods had not been removed from the factory.

**2.4.3** Similarly M/s. HMT Machine Tools Ltd., in Hyderabad-IV Commissionerates, had not reversed the Cenvat credit of ₹ 26.45 lakh attributable to obsolete material declared in the books of accounts.

When we pointed this out (between April and July 2015), the Ministry stated (February 2016) that it is a policy matter.

**Recommendation No.3**

*The government may consider inserting provision for reversal of Cenvat credit where the inventories were declared as obsolete but were not written off from the books of accounts and where capital goods after being used are written off but not removed from the factory.*

*The Ministry in its reply stated (February 2016) that the issue is under examination.*

**2.5 Absence of provision for charging interest on reversal of credit for non-receipt/delayed receipt of goods sent for job work within 180 days**

Inputs or semi finished goods sent to job worker under rule 4(5) (a) of Cenvat Credit Rules, 2004, should be returned to the factory within 180 days. For failure to do so proportionate Cenvat credit on inputs/semi finished goods not received back is required to be reversed. However, in case of delay in reversal of credit, there is no specific provision for charging interest on such delayed reversal. This results in loss of interest to the Government.

M/s. LanXESS India Pvt. Ltd., in Bharuch Commissionerate, had not received back inputs/capital goods involving credit of ₹ 19.78 lakh sent to job worker ever after expiry of 180 days. The assessee reversed the Cenvat credit on 1 June 2015. Due to absence of provision to charge interest on non-reversal or delayed reversal of Cenvat credit in respect of non-receipt/delayed receipt of goods sent to job worker resulted in loss of interest of ₹ 3.17 lakh.

When we pointed this out (June 2015), the Ministry stated (February 2016) that it is a policy matter.

**Recommendation No.4**

*The Government may consider inserting provision for charging interest in case of non/delayed reversal of Cenvat credit in respect of non/delayed receipt of goods sent to job worker.*

*During exit conference Ministry replied that Tariff Conference held on 28 and 29 October 2015 have already decided that the interest is liable to be paid after the expiry of period of 180 days from the date of issue of capital goods to job worker and same principle would also apply in case of inputs sent to job worker and there is no need for insertion of provision for charging interest.*

*On one hand Ministry stated that it is a policy matter (Para 2.5) and on the other hand it stated (Exit conference) that the tariff conference had already clarified the issue and no need for insertion of provision for charging interest.*

*Audit is of the opinion that to avoid ambiguity there is a need to insert specific provision in this regard.*