

CHAPTER III 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. A few cases of incorrect use of cenvat credit involving duty of ₹ 91.45 crore noticed during test check, are mentioned in the following paragraphs. These observations were communicated to the Ministry through 23 draft audit paragraphs. The department had accepted (till December 2010) the audit observations in three draft audit paragraphs with money value of ₹ 0.87 crore.

3.1 Separate account for common inputs used in dutiable/exempted goods not maintained

Rule 6 of the Cenvat Credit Rules, 2002/2004, enunciates that a manufacturer who avails of cenvat credit on common inputs/services and manufactures both dutiable and exempted goods, has to maintain separate accounts for receipt and use of inputs/services for both categories of final products. However, if he opts not to maintain such separate accounts, then he shall pay an amount equal to ten per cent of the price of the exempted final product.

3.1.1 M/s Simbhaoli Sugar Ltd., (Distillery unit), in Meerut II commissionerate, engaged in the manufacture of dutiable goods i.e. denatured spirit, carbon dioxide, fusel oil etc. and non-dutiable goods i.e. country liquor, rectified spirit etc., availed cenvat credit of service tax paid on input services (viz. courier services, telephone and mobile service, repair and maintenance service, commission agent, business auxiliary service, GTA, website maintenance service etc.) which were used in the manufacture of both dutiable and non-dutiable goods and separate accounts were not maintained. The assessee cleared non-dutiable goods worth ₹ 226.05 crore in 2007-08 but did not pay 10 per cent amounting to ₹ 22.60 crore. Hence, the same was recoverable with interest of ₹ 5.88 crore and penalty up to ₹ 22.60 crore.

When we pointed this out (August 2008), the department stated (June 2009) that two show cause notices covering the period from February 2005 to March 2009 had been issued (May 2010).

The reply of the Ministry had not been received (December 2010).

3.1.2 M/s Titagarh Wagons Ltd., and M/s Texmaco Ltd., in Kolkata III commissionerate, engaged in the manufacture of dutiable as well as exempted railway wagons and pressure vessels, availed cenvat credit of service tax paid on input services viz. manpower supply agency's services, insurance services, couriers services, chartered accountant services, business exhibition services, registrar to an issue services, customs clearing agent's services etc. used for manufacture of both categories of final products, without maintaining separate accounts in respect of the input services used in manufacture of exempted goods. The assessees did not pay ₹ 20.61 crore being the amount equal to ten

per cent of the total price of exempted goods cleared between April 2005 and May 2008 which was recoverable with interest.

When we pointed this out (between May 2007 and July 2008), the department stated (December 2008), that M/s Titagarh Wagons Ltd. had availed input service credit on insurance, courier service and chartered accountant services which were not utilised for manufacture of exempted final product.

The reply of the department was not tenable because the services like insurance, courier, auditing, issue registry services on which the assessee had taken full credit were used for the whole business and could not be claimed as having been used only for manufacture of dutiable products. In any case the assessee had not maintained separate accounts for the use of the input services.

In the case of M/S Texmaco Ltd. the department stated (August 2008) that although such credit was taken on common input services but such credits were utilised for payment of service tax on output services provided by the assessee.

The reply of the department was not acceptable since the rule calls for payment of ten per cent of price of the exempted goods whenever credit is taken on input services used in manufacturing of both categories of goods. The rule does not provide any relaxation regardless of whether the credit was subsequently used for discharging liability of service tax or excise duty.

The department, however, had issued show cause cum demand notices in both the cases.

The reply of the Ministry had not been received (December 2010).

3.1.3 M/s Jindal Steel and Power Ltd., Raigarh, in Raipur commissionerate, engaged in the manufacture of both dutiable goods (viz. iron and steel products) and exempted goods (viz. coal tar etc.), sold 8,884 tonne of coal tar valuing ₹ 13.45 crore during the period from April 2007 to January 2009 without payment of excise duty. We observed that the assessee availed cenvat credit of service tax on common input services like mining (coal) service, inward transportation service (coal), manpower recruitment services, security services, repair and maintenance service, cargo handling services etc., which were used for the manufacture of both dutiable and exempted goods but cenvat credit of service tax so availed was utilised for payment of duty on final products. Since, no separate account of input services used in the manufacture of coal tar (exempted) was maintained, the amount of ₹ 1.35 crore equal to ten per cent of the price of coal tar sold was recoverable.

When we pointed this out (March 2009), the department stated (March 2009) that show cause notice for ₹ 51.60 lakh for the year 2007-08 has been issued on 31 March 2009. Report on action taken for the remaining period was awaited.

The reply of the Ministry had not been received (December 2010).

3.1.4 Rule 6 (6)(i) of the Cenvat Credit Rules, provides keeping separate accounts is not necessary in case of excisable goods are cleared to a unit in a special economic zone. Notification dated 31 December 2008 extended this benefit to clearance to a developer in SEZ.

M/s Duraline (India) Pvt. Ltd., and M/s Putzmeister (India) Ltd., in Goa commissionerate, engaged in the manufacture of telecom ducts and concrete pumps/pipelines, availed of cenvat credit on common inputs and input services which were used in dutiable as well as exempted goods and no separate accounts were maintained. The assessee cleared goods valuing ₹ 2.99 crore to the developers of SEZ without payment of duty before 31 December 2008. The assessee did not keep separate accounts for inputs used in the manufacture of the goods cleared to developers. Since the exemption from keeping separate account was not available up to 31 December 2008, they were liable to pay an amount of ₹ 29.94 lakh being ten per cent of the value of goods cleared with applicable interest and penalty.

When we pointed this out (January and March 2010) the department stated (June 2010) that the goods cleared to SEZ developers under bond were to be treated as exempted goods and the clearance does not attract the provision of rule 6 of the Cenvat Credit Rule. Further, the inclusion of 'developer' by notification no 50/2008 CE (NT) dated 31 December 2008 was not a case where a new sub-rule had been inserted but it was merely clarificatory in nature.

The reply of the department was not acceptable. The clearance to the developer of SEZ was included as an exemption from rule 6(3) through a specific clause inserted in the notification and made applicable from 31 December 2008. The benefit was not admissible before the notification.

The reply of the Ministry had not been received (December 2010).

3.2 Availing of cenvat credit on ineligible capital goods

Under rule 2(b)/2(a) of the Cenvat Credit Rules, 2002/2004, the term 'capital goods' for the purpose of allowing credit of duty means (i) all goods falling under chapters 82, 84, 85, 90, heading 68.02 and sub-heading 6801.10 of first schedule of Central Excise Tariff Act, 1985, (ii) pollution control equipment, (iii) components, spares and accessories of goods specified at (i) and (ii) above, (iv) moulds and dies, (v) refractories and refractory materials, (vi) tubes, pipes and fittings thereto and (vii) storage tanks. In the case of M/s Nava Bharat Ferro Alloys Ltd., the Tribunal held {2004 (174) ELT 375} that (i) HR coils, channels, plates and hard plates are general purpose items having multifarious use and are not covered by the definition of capital goods and (ii) columns of heavy fabricated structures and bracings, used as supporting columns of a boiler, etc., are in the nature of construction material and are not eligible for credit as capital goods.

3.2.1 M/s Ultra Tech Cement Ltd., (AP Cement Works) Tadipatri in Tirupathi commissionerate and M/s Shalimar Alloys (P) Ltd., Kothur in Hyderabad III commissionerate, engaged in the manufacture of cement, clinker, iron and steel products etc., availed cenvat credit of ₹ 4.71 crore on items like MS angles, channels, beams, joists etc. during 2006-07 to 2008-09. We found that these goods were utilised for construction of plant, shed and as supporting structures. Therefore, cenvat credit of ₹ 4.71 crore was not admissible and recoverable with interest.

We pointed this out to the (August/October 2009), the department reported (October 2010) that in the first case, a show cause notice was under issue for ₹ 23.36 crore covering the period between September 2005 and August 2010. In the second case department accepted the audit observation and reported (June 2010) that a show cause notice was under issue.

The reply of the Ministry had not been received (December 2010).

3.2.2 M/s Jayswal Neco Industries Ltd., in Raipur commissionerate, engaged in the manufacture of pig iron, sponge iron billets rolled products etc., availed cenvat credit of duty of ₹ 3.84 crore paid on angles, channels, beams, plates, joists etc., during the period from May 2004 to March 2009. These goods were not used for the manufacture of final product but were used in the construction of heavy fabricated structures for supporting the plant and machinery. The credit of duty availed on the structural items was incorrect and was recoverable with interest.

When we pointed this out (between October 2004 and March 2010). the department stated (between July 2008 and March 2010) that a show cause notice disallowing cenvat credit of ₹ 1.76 crore covering the period from February 2004 to February 2005 had been issued and another show cause notice was being issued. We also observed that the demand of ₹ 1.76 crore was confirmed on 29 October 2008.

The reply of the Ministry had not been received (December 2010).

3.2.3 M/s Harinagar Sugar Mills Ltd., in Patna commissionerate, engaged in the manufacture of sugar, availed cenvat credit of ₹ 52.16 lakh on items like M.S. bar, channels, angles, HR plates, beams, TMT bars etc. in August 2008 and April 2009 and used in construction of distillery division of the sugar mill. Since cenvat credit on goods used for construction were not eligible, cenvat credit of ₹ 52.16 lakh was recoverable with interest.

We pointed this out to the department/Ministry in December 2009/October 2010; their reply had not been received (December 2010).

3.2.4 M/s Bulk Cement Corporation India Ltd, in Belapur commissionerate, engaged in the manufacture of cement, procured railway wagons falling under chapter 86, in April 2009 and availed cenvat credit (June 2009) of ₹ 54.68 lakh (i.e 50 per cent of duty paid on railway wagons). Since railway wagons were not specified under the definition of capital goods, the cenvat credit availed by the assessee was not admissible and was recoverable with interest.

When we pointed this out (January 2010), the department intimated (August 2010) that show cause notice for ₹ 1.09 crore had been issued.

The reply of the Ministry had not been received (December 2010).

3.3 Cenvat credit availed on inadmissible input services

Rule 3 of the Cenvat Credit Rules, 2004, provides that a manufacturer of final products may take credit of service tax paid on any input service received if such service is used in the manufacture of final products. Rule 2(l) of Cenvat Credit Rules, 2004, stipulates the ambit of input services.

3.3.1 M/s Scooters India Ltd., in Lucknow commissionerate, engaged in manufacturing activity, availed credit of service tax paid of ₹ 8.16 lakh on services like employee mediclaim insurance services, private car insurance services, rent a cab services for day to day administrative requirement during the year 2006-07 to 2008-09. 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 the final products. Therefore, assessee was liable to pay ₹ 8.16 lakh besides interest and penalty.

When we pointed this out (January 2010), the department stated (April 2010) that a show cause notice had been issued demanding ₹ 10.72 lakh for the period from 2005-06 to 2008-09.

The reply of the Ministry had not been received (December 2010).

3.3.2 M/s Birla Power Solution Ltd., in Meerut I commissionerate, engaged in manufacture of portable and fixed DG sets, availed cenvat credit of service tax paid on input services viz. financial services, internet services, workmen compensation policy, courier service etc. Since these services were not covered under input services the assessee was, therefore, liable to reverse credit of ₹ 5.07 lakh besides interest of ₹ 0.83 lakh as of March 2010.

When we pointed this out (November 2009), the department intimated (April 2010) that show cause notice was under issue.

The reply of the Ministry had not been received (December 2010).

3.3.3 In the case of Excel Crop Care Ltd., Ahmedabad, the CESTAT held that cenvat credit of service tax paid on cargo handling agency services availed for export did not have any nexus with manufacture and clearance of product from the factory and hence no credit of tax paid on such services was to be allowed.

M/s Glaxo Smithkline Consumer Health Care Ltd., in Hyderabad IV commissionerate, engaged in packing of milk food products, manufactured in other units of the same company, exported goods and paid service tax of ₹ 10.48 lakh to various shipping agencies towards export liner charges in respect of goods exported during the period from 2006-07 to 2008-09. The assessee availed of cenvat credit of service tax so paid. The availing of cenvat credit was incorrect as such services were not input service in respect of the goods manufactured and cleared by the assessee. The credit was recoverable with interest.

When we pointed this out (July 2009), the department stated (January 2010) that a show cause notice has been issued (October 2009) demanding ₹ 12.15 lakh for the period from January 2005 to March 2009, besides interest and penalty.

The reply of the Ministry had not been received (December 2010).

3.4 Cenvat credit availed of service tax paid on non-taxable service

A manufacturer or producer of final products or a provider of taxable service can take credit of the service tax paid on any input service received by the

manufacturer of final product or by output service provider in terms of Rule 3(1)(ix) of the Cenvat Credit Rules, 2004.

Mining of mineral, oil or gas service came to tax net with effect from 1 June 2007.

M/s Jindal Steel and Power Ltd., in Raipur commissionerate, engaged in the manufacture of iron and steel products, availed services relating to extraction of coal from their captive coal mines and paid ₹ 23.16 crore to various registered private service providers. The assessee availed credit of service tax paid amounting to ₹ 2.60 crore during the period July 2005 to May 2007. Thus, the credit was wrongly availed for service tax paid during a period when service tax was not payable. The cenvat credit of ₹ 2.60 crore was recoverable with interest.

When we pointed this out (February 2008), the department stated (April 2010), that a show cause notice had been issued.

The reply of the Ministry had not been received (December 2010).

3.5 Availing of credit on the basis of invalid documents

The cenvat credit can be taken by the manufacturer or the provider of output service or input service distributor on the basis of the documents specified in rule 9 of the Cenvat Credit Rules. Further Rule 14 envisages that where the credit has been taken or utilized wrongly, the same alongwith interest shall be recovered from the manufacturer.

3.5.1 M/s Berger Paints India Ltd., in Jammu & Kashmir commissionerate, engaged in the manufacture of paints, availed cenvat credit of ₹ 1.91 crore during the period between September 2004 and July 2006. We observed that the credit was availed by the assessee without having the invoices evidencing payment of duty on inputs/capital goods. Therefore, the cenvat credit had been wrongly availed and was recoverable with interest and penalty.

When we pointed this out (July 2009), the department stated (December 2009) that show cause notice had been issued to the assessee.

The reply of the Ministry had not been received (December 2010).

3.5.2 M/s Diamond Cement Unit I and II, in Bhopal commissionerate, engaged in the manufacture of cement, availed cenvat credit of service tax of ₹ 59.79 lakh between March 2006 and September 2008 on the basis of debit notes issued by different output service providers. Since debit notes were not the specified documents for availing of cenvat credit, the amount of ₹ 59.79 lakh was recoverable with interest.

When we pointed this out between August 2009 and January 2010, the department admitted the audit observation and stated (December 2009) that the demand was being raised.

The reply of the Ministry had not been received (December 2010).

3.5.3 M/s Bhandari Foils and Tubs Ltd., (unit III), in Indore commissionerate, engaged in the manufacture of S.S. coils/tubes availed cenvat credit of service tax of ₹ 27.74 lakh on the basis of the invoices not in

the name of assessee, debit notes, photocopies of bills of entry and TR-6 challans. Since these documents were not eligible for availing of cenvat credit the availing of cenvat credit was not correct and was recoverable with interest.

We pointed this out to the department/Ministry in October 2009/September 2010; their reply had not been received (December 2010).

3.5.4 M/s Indian Oil Corporation Ltd., (Drum Plant), in Chennai I commissionerate engaged in the manufacture of drums, barrels etc., availed cenvat credit on input services for ₹ 10.26 lakh during the period from May 2007 to March 2008 relating to two service providers on the basis of an entry in the claim bills of the assessee. Since claim bill is not an eligible document the credit availed was inadmissible and, therefore, recoverable with interest.

When we pointed this out (February and May 2009), the department reported (July 2010) issue of show cause notice for ₹ 19.19 lakh covering the period from April 2007 to December 2009.

The reply of the Ministry had not been received (December 2010).

3.6 Goods not received back from job workers

3.6.1 Under rule 4(5) (a) of the Cenvat Credit Rules, 2002 (as amended vide notification dated 10 September 2004), inputs or capital goods on which cenvat credit has been availed of can be sent to a job worker for further processing, provided the goods are received back within 180 days and if the inputs or capital goods are not received back within this period, the manufacturer shall pay an amount equivalent to cenvat credit attributable to such non-returned inputs or capital goods.

M/s Haldia Petrochemicals Ltd., in Haldia commissionerate, engaged in the manufacture of petroleum products, cleared 7259.100 tonne and 1464.250 tonne of PP and LLDPE respectively to various job-workers for conversion into fabrics/bags during the years 2003-04 and 2004-05. We observed that, out of the said quantities, 1206.100 tonne of PP and 108.078 tonne of LLDPE valuing ₹ 6.10 crore were not received back in the factory even after expiry of the prescribed period of 180 days. Thus, the manufacturer was required to pay duty equivalent to cenvat credit of ₹ 97.56 lakh on inputs not received back.

When we pointed this out (March 2007), the department stated (December 2009) that a show cause cum demand notice had been issued in May 2008.

The reply of the Ministry had not been received (December 2010).

3.7 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 may make an application for refund of such duty to the excise department before expiry of one year from the date of payment of duty in such form and manner as may be prescribed and the application shall be accompanied by such documentary or other evidence as the applicant may furnish to establish that the amount of excise duty in relation to which such refund is claimed was paid by him. Further as per the explanation under

Section 11B of the Act, for the purpose of the section, refund includes rebate of duty of excise on excisable goods exported out of India or on excisable materials used in the manufacture of goods which are exported out of India.

3.7.1 M/s Indian Seamless Metal Tubes Ltd., in Aurangabad commissionerate, engaged in manufacture of articles of iron and steel, cleared goods for exports without payment of duty under bond. On non-submission of proof of export within the statutory time periods, the assessee paid aggregate duty of ₹ 49.82 lakh through cenvat for the exports made on 24 invoices during October 2006 to December 2007. However, on receipt of the proof of export, the assessee took suo moto credits during July 2007 to March 2009, of the duty paid earlier without applying for refunds (rebate) under section 11B of the Act.

When we pointed this out (December 2009), the department replied (March 2010) that it was only a procedural lapse on the part of assessee.

The reply of the department was not acceptable as the assessee had paid the duty on goods exported and to get refund (rebate) of such duty, he should have applied under Section 11B. There is no provision in the Central Excise Act, 1944 or any of the rules thereunder regarding suo moto credit of duty paid earlier by the assessee.

The reply of the Ministry had not been received (December 2010).

3.7.2 M/s Century Denim Ltd., in Indore commissionerate, engaged in the manufacture of Denim Fabrics under heading 52.09 paid service tax of ₹ 22 lakh between 30 September 2005 to 5 May 2009 on the input services received from foreigners by utilising cenvat credit which was incorrect. When we pointed this out between May 2007 and August 2008, the department issued three show cause notices. Following adjudication and decision of Commissioner (Appeals) in May 2009 the assessee deposited service tax of ₹ 22 lakh in cash on 10 August 2009. We observed that the assessee subsequently credited ₹ 22 lakh in the cenvat account on 30 September 2009 to adjust the service tax paid earlier by wrongly utilising cenvat credit. This was incorrect as assessee should have claimed refund.

When we pointed this out (December 2009), the department stated (December 2009) that the matter was under examination.

The reply of the Ministry had not been received (December 2010).

3.8 Non/short payment of duty on inputs cleared as such

Rule 2(1) of the Cenvat Credit Rules, 2004 defines 'input service' to mean any service used by a manufacturer, whether directly or indirectly, in or in relation to manufacture of final products and clearance of final products up to the place of removal, and includes other specified services. Rule 3(1) *ibid* enunciates that a manufacturer shall be allowed to take credit of any input/input service received by the manufacturer for use in or in relation to the manufacture of final product.

M/s Tata Sponge Iron Ltd., in Bhubaneswar II commissionerate, engaged in the manufacture of sponge iron, availed cenvat credit of service tax paid on

goods transport service for procurement of coal from coal mines. We observed that the assessee sold 50,928 tonne of coal fines during 2008-09 and also there was back spillage of unusable coal and shortage of physical stock of coal of 6,441.82 tonne. Since the quantity of coal sold and found short was not used in the manufacture of final goods, the cenvat credit of ₹ 59.56 lakh attributable to such sale and shortage was recoverable with interest and penalty.

When we pointed this out (July 2009), the department stated (September 2010) that a show cause notice had been issued for ₹ 71.85 lakh for the period from 2008-09 to 2009-10.

The reply of the Ministry had not been received (December 2010).

3.9 Excess availing of cenvat credit on imported materials

Rule 3(1) read with proviso to rule 3(7)(a) of the Cenvat Credit Rules, 2004 provides that cenvat credit in respect of inputs or capital goods cleared on or after 1 March 2006 from a 100 per cent export oriented unit (EOU) paying excise duty under notification dated 31 March 2003, shall be admissible. The calculation of the amount admissible was based on the ad valorem rates of basic customs duty and additional duty of customs leviable on inputs or the capital goods respectively.

M/s Khanna Paper Mills Ltd., in Ludhiana commissionerate, engaged in the manufacture of paper and paper board purchased inputs namely petroleum coke from a hundred per cent EOU and paid duty under aforesaid notification. We observed that the assessee had availed cenvat credit of ₹ 619.96 crore against the admissible credit of ₹ 593.83 crore during the year 2007-08. The credit of ₹ 26.13 lakh availed in excess was recoverable with interest.

When we pointed this out (November 2008), the department stated (February 2009) that the assessee had been asked to deposit the amount with interest.

The reply of the Ministry had not been received (December 2010).

3.10 Cenvat credit on capital goods availed in excess of permissible limits

Rule 4(2)(a) and (b) of the Cenvat Credit Rules, 2004 enunciates that cenvat credit in respect of capital goods received in a factory or in the premises of the provider of output service 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 and the balance of credit may be taken in any financial year subsequent to the financial year in which the capital goods were received. Rule 14 *ibid* of the above rules provide that where the cenvat credit has been taken or utilised wrongly, the same along with interest shall be recovered. Penalty also shall be invoked under rule 15 *ibid*.

M/s SMC Power Generation Ltd., in Bhubaneswar II commissionerate, engaged in the manufacture of sponge iron, billets and TMT bars procured capital goods like pipes, tubes and water treatment plants/instruments during

the period April 2007 to March 2008 and took full (100 per cent) cenvat credit of ₹ 30 lakh during 2007-08 on such capital goods instead of taking credit of ₹ 15 lakh being fifty per cent of the duty paid. The excess credit of ₹ 15 lakh taken by the assessee was recoverable along with interest and penalty.

When we pointed this out (September 2008), the department reported (June 2010) that the show cause cum demand notice for ₹ 5.28 crore for the period from September 2006 to March 2008 had been issued in which all such other capital goods had been covered.

The reply of the Ministry had not been received (December 2010).