



सत्यमेव जयते

**REPORT OF THE  
COMPTROLLER AND AUDITOR GENERAL  
OF INDIA**

**FOR THE YEAR ENDED 31 MARCH 1988**

**No. 11 of 1989**

**UNION GOVERNMENT  
(REVENUE RECEIPTS—INDIRECT TAXES)  
MODIFIED FORM OF VALUE ADDED TAX (MODVAT) SCHEME**

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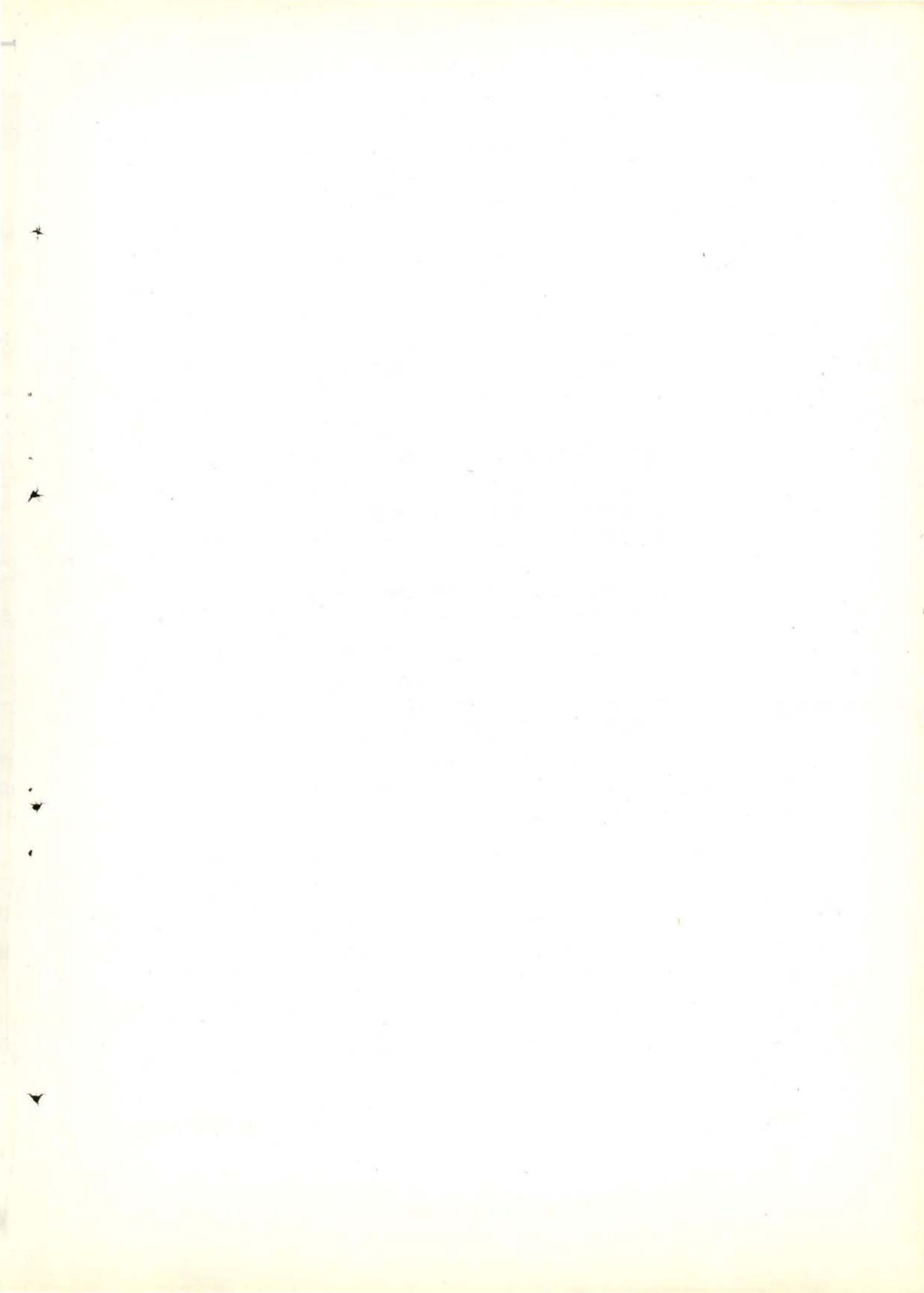
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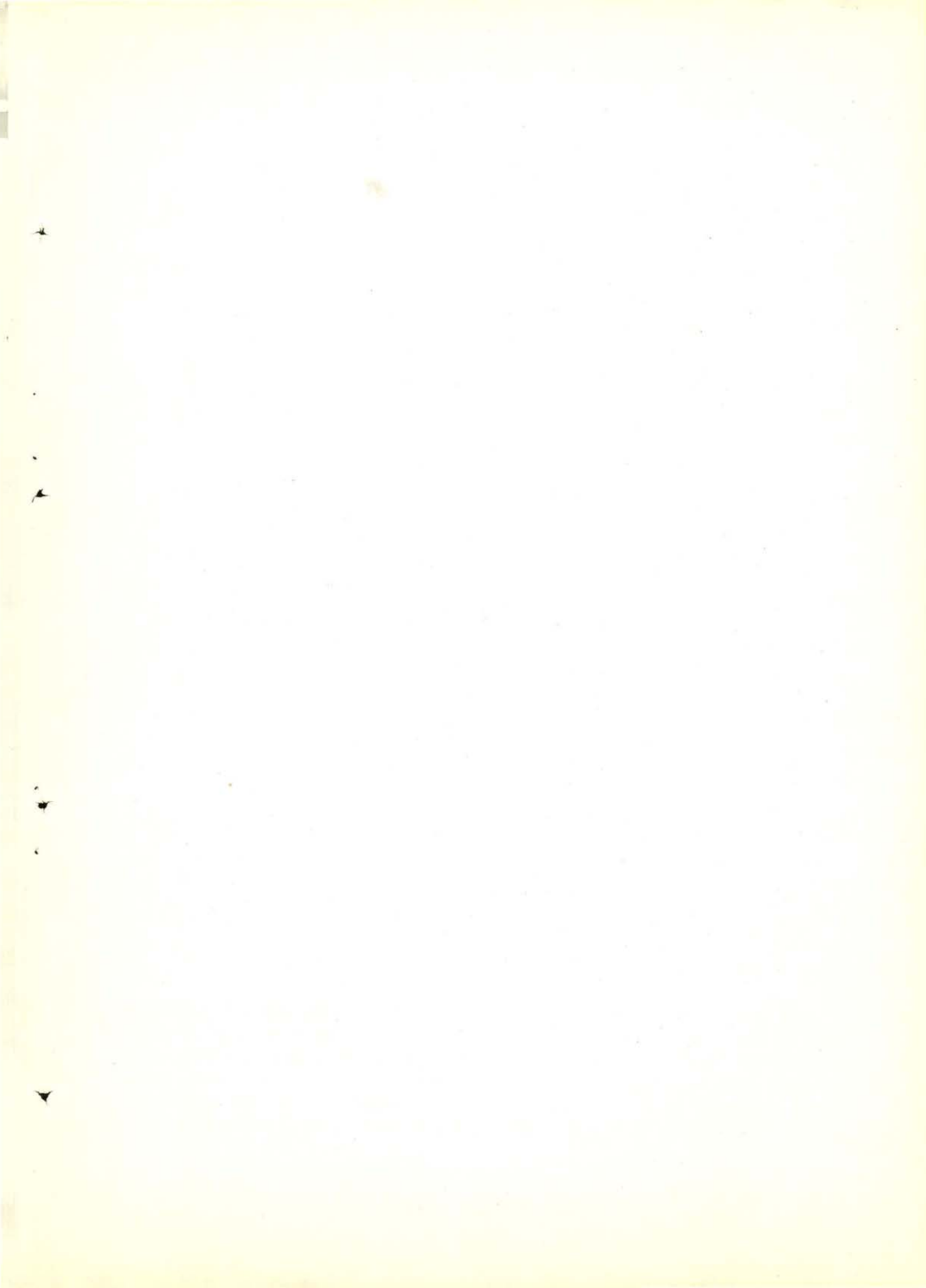
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## **PREFATORY REMARKS**

This Report of the Comptroller and Auditor General of India for the year ended 31 March 1988 containing an appraisal on Modvat (Modified form of value added tax) Scheme which is basically a central excise duty collecting procedure, has been prepared for submission to the President of India under Article 151 of the Constitution. The points mentioned in the review are those which came to notice in the course of test audit. The review highlights shortcomings in achieving the declared objectives of the scheme.





## OVERVIEW

### Modvat (modified form of value added tax) scheme

I) As one of the measures contemplated in the Long Term Fiscal Policy announced by the Government in December 1985, a new mode of Central Excise taxation procedure called 'Modified Value Added Tax (MODVAT)' was introduced with effect from 1 March 1986. This Scheme is basically a duty collecting procedure which is designed to allow relief to the manufacturer on the duty element borne by him in respect of the raw materials (inputs) used by him. The Scheme was also intended to be broadly revenue neutral. The aim was to shift the burden of excise taxation away from inputs on to the final products. The scheme was expected to boost the competitiveness of Indian industry and to tailor the excise duties in such a way that the well-off bear a higher proportion of the burden of taxation than the poor.

II) The scope of audit was designed to test check the level of efficiency with which the MODVAT Scheme was being implemented by the department. This was done by test checking the relevant records of the assessee and the Central excise collectorates, by the Central Excise Receipt Audit. The audit scope was also focussed on the impact of this Scheme on collection of revenue, in general terms.

III) An appraisal of the Modvat Scheme has revealed the following:

(a) The Modvat scheme was introduced on 1 March, 1986 with a view to allowing the manufacturers of excisable goods to obtain instant and complete reimbursement of the excise duty paid on the components and raw materials. As the scheme was to result in considerable reductions in the cost of final product, the rates of duty on the final product were suitably

adjusted to retain the collection of excise duties at the earlier level. It, therefore, follows that the Modvat scheme was intended to be revenue neutral. On a test check, thirty seven manufacturer of motor vehicles, detergents, televisions, etc; were found to have availed of much higher credit than those which were being availed by them previously (Para 6).

(b) The Modvat Scheme provides that a manufacturer who purchases raw material and component parts from a small scale unit on payment of duty at concessional rate, shall be allowed credit of duty at the normal rate. Test check of eight hundred and fifty-one cases revealed grant of additional credit of Rs.63.93 crores. This represented duty refunded, but not actually collected (Para 7).

(c) A manufacturer should file a declaration indicating the inputs intended to be used in the manufacture of the final products and obtain dated acknowledgement of the department for the same before availing of the Modvat credit. The manufacturers of different excisable goods were found to have taken irregular Modvat credit of Rs.5.41 crores in three hundred and eleven cases without filing the declaration.(Para 8).

(d) Government ordered (7 April 1986) that inputs of specified ferrous and non-ferrous metals including waste and scrap of iron and steel purchased from outside and lying in stock on or after 1 March 1986 with the manufacturers of the final products should be deemed to have paid duty and Modvat credit should be allowed at the specified rates. However, these orders expressly provided that no Modvat credit should be allowed if such inputs are clearly recognisable as non duty

paid or charged to nil rate of duty. Irregular deemed Modvat credit of Rs.9.63 crores was availed on wastes and scraps and other items which were clearly recognisable as non duty paid (Para 9).

(e) Modvat Scheme prohibits the availment of Modvat credit of duty paid on machinery, equipment, tools, appliances etc. In disregard to this provision Modvat credit of Rs.2.81 crores was taken irregularly in one hundred and eighteen cases (Para 10).

(f) Excisable goods manufactured in a factory as a job work and used in or in relation to the manufacture of final products are exempted from the whole of duty under certain conditions. Some assesseees sent inputs to small scale manufacturers for getting job work done on payment of labour charges. Though the job worker was not required to pay any duty on such job work, he, however, paid duty at concessional rate applicable to small scale manufacturers thereby enabling

those assesseees to take Modvat credit at normal rates. Additional modvat credit of Rs.2.05 crores on this account was taken in twenty four cases (Para 11).

(g) Modvat credit is not admissible in case the final product is exempt from duty or is chargeable to nil rate of duty. One hundred and eight manufacturers of excisable goods irregularly took Modvat credit of Rs.1.75 crores on account of duty paid on inputs used in the manufacture of final products which were either fully exempted or chargeable to nil rate of duty (Para 12).

(h) In forty one cases, duty of Rs.1.73 crores was not levied on waste generated in the course of processing of inputs in respect of which Modvat credit had been taken (Para 13).

(i) Other irregularities regarding irregular availment of Modvat credit amounted to Rs.10.64 crores (Para 14).

## MODVAT (MODIFIED FORM OF VALUE ADDED TAX) SCHEME

### 1. Introduction

The Long Term Fiscal Policy announced in December 1985 in pursuance to the commitment made by the Finance Minister in the budget speech of 1985-86, contemplated introduction of a new mode of Central Excise taxation procedure called Modified Value Added Tax (MODVAT). The Modvat is basically a duty collecting procedure which at the same time aims at allowing relief to manufacturer on the duty element borne by him in respect of the raw materials (inputs) used by him. The relevant extract of the proposal contained in the long term fiscal policy connected with the maintenance of revenue neutrality is reproduced hereunder:

“...the MODVAT programme is intended to be broadly revenue neutral. It is not the purpose to use MODVAT to give substantial net reliefs on excise. The loss of duty on inputs will be recouped through higher excise taxation of final products. Indeed, shifting the effective burden of excise taxation away from inputs and on to final products is at the heart of the proposed reform. Aside from reducing distortionary effects on production and thus increasing the competitiveness of Indian Industry, the shifting of excise to final products will help in tailoring excise duties in such a manner that the well-off bear a higher proportionate burden than the poor.”

### 2. Objective

The Modvat Scheme was introduced with effect from 1 March 1986 through Budget 1986 and initially covered inputs falling under 38 Chapters and outputs falling under 37 Chapters of the Central Excise Tariff Act 1985. It was extended later to further chapters. The present position of the inputs/final products covered under the Modvat Scheme is as follows:

Date of notification	Chapters covered		Outputs		Remarks
	Inputs No.	Total	No.	Total	
1 March 1986	38	38	37	37	Additional item relating to input is Chapter 48.
29 July 1986	1	39	1	38	Chapter 31 was added.
1 March 1987	37	76	38	76	Due to extension of the scheme.

The result is that with effect from 1 March 1987 all commodities except tobacco, minerals etc., matches, specified chemicals and textiles and textile articles are covered under the scheme.

### 3. Administration of the scheme

For administration of the scheme a new Section 'AA credit of duty paid on excisable goods' containing rules 57A to 57J, was introduced in Chapter V of the Central Excise Rules, 1944, with effect from 1 March 1986. This was followed by issue of notifications by the Government and directions by the Board.

### 4. Scope of audit

The scope of audit was designed to test check the efficiency of implementation of Modvat Scheme in the Central Excise Collectorates and to ascertain its impact on collection of revenue. In particular, the following aspects were seen:

- (i) whether the concept of “revenue neutrality” was achieved after the introduction of Modvat and if so, to what extent;
- (ii) factors which contributed to non-realisation of revenue neutrality and the extent of revenue losses;
- (iii) ambiguity in the wording of notifications which gave unintended benefit to assesseees;
- (iv) special concessions granted to small scale manufacturers which affected revenue

neutrality resulting in availment of notional higher credits by other manufacturers;

(v) failure in proper administration of Modvat Rules by Collectorates and consequential loss of revenue etc.

### 5. Highlights

An appraisal of the Modvat Scheme has been conducted. The results of appraisal are contained in the succeeding paragraphs which highlight the following:

The Modvat scheme was introduced on 1 March, 1986 with a view to allowing the manufacturers of excisable goods to obtain instant and complete reimbursement of the excise duty paid on the components and raw materials. As the scheme was to result in considerable reductions in the cost of final product, the rates of duty on the final product were suitably adjusted to retain the collection of excise duties at the earlier level. It, therefore, follows that the Modvat scheme was intended to be revenue neutral. On a test check, thirty seven manufacturer of motor vehicles, detergents, televisions. etc; were found to have availed of much higher credit than those which were being availed by them previously (Para 6).

The Modvat Scheme provides that a manufacturer who purchases raw material and component parts from a small scale unit on payment of duty at concessional rate, shall be allowed credit of duty at the normal rate. Text check of 851 cases revealed grant of additional credit of Rs.63.93 crores on this account(Para 7).

A manufacturer should file a declaration indicating the inputs intended to be used in the manufacture of the final products and obtain dated acknowledgement of the department for the same before availing of the Modvat

credit. The manufacturers of different excisable goods were found to have taken irregular Modvat credit of Rs.5.41 crores in 311 cases without filing the declaration (Para 8).

Government ordered (7 April 1986) that inputs of specified ferrous and non-ferrous metals including waste and scrap of iron and steel purchased from outside and lying in stock on or after 1 March 1986 with the manufacturers of the final products should be deemed to have paid duty and Modvat credit should be allowed at the specified rates. However, these orders expressly provided that no Modvat credit should be allowed if such inputs are clearly recognisable as non duty paid or charged to nil rate of duty. Irregular deemed Modvat credit of Rs. 9.63 crores was availed on wastes and scraps and other items which were clearly recognisable as non duty paid (para 9).

Modvat Scheme prohibits the availment of Modvat credit of duty paid on machinery, equipment, tools, appliances etc. In disregard to this provision Modvat credit of Rs. 2.81 crores was taken irregularly in 118 cases (Para 10).

Excisable goods manufactured in a factory as a job work and used in or in relation to the manufacture of final products are exempted from the whole of duty under certain conditions. Some assessee sent inputs to small scale manufacturers for getting job work done on payment of labour charges. Though the job worker was not required to pay any duty on such job work, he, however, paid duty at concessional rate applicable to small scale manufacturers thereby enabling those assessee to take Modvat credit at normal rates. Additional modvat

credit of Rs.2.05 crores on this account was taken in 24 cases (Para 11).

- **Modvat credit is not admissible in case the final product is exempt from duty or is chargeable to nil rate of duty. One hundred and eight manufacturers of excisable goods irregularly took Modvat credits of Rs. 1.75 crores of duty paid on inputs used in the manufacture of final product which were either fully exempted or chargeable to nil rate of duty (Para 12).**
- **In forty one cases duty of Rs. 1.73 crores was not levied on waste generated in the course of processing of inputs in respect of which Modvat credit had been taken (Para 13).**
- **Other irregularities regarding irregular availment of Modvat credit amounted to Rs.10.64 crores (para 14).**

#### **6. Revenue neutrality - expectation not fulfilled**

While presenting the Budget 1986 to the Parliament, the Finance Minister stated that 'the introduction of Modvat scheme will result in considerable reductions in the cost of final product and, therefore, to retain the collection of excise duties at the earlier level, the rates of duties on the final product have been suitably adjusted'. It, therefore, follows that the Modvat was supposed to be revenue neutral.

A test check in audit of records of thirty seven assesseees manufacturing motor vehicles, soap, chemical additives, televisions, electric wires and cables, tyres and tubes, prepared adhesives and electric fans and availing Modvat facility, was conducted to ascertain the revenue neutrality of the scheme. It was noticed that those units paid less duty to the extent of Rs 130.87 crores during the period from March 1986 to February 1988 than what they would have

paid but for the introduction of Modvat credit (after making adjustment for difference in quantum of clearances and rate of duty as a result of excess availment of Modvat credit), as per formula  $(B \times C / A) - D$  where:

A = assessable value in the year 1985-86

B = net duty realised in the year 1985-86

C = assessable value in the year 1986-87

D = net duty realised in the year 1986-87

The commodity-wise figures are given below:

Sl. No.	Commodity	No. of units	Loss of revenue (Rs. in crores)
1.	Motor Vehicles	14	59.42
2.	Tyres and tubes	4	19.37
3.	Soap, detergents and shampoo	6	18.81
4.	Chemical additives	1	14.84
5.	Televisions	7	9.50
6.	Prepared adhesives	1	4.11
7.	Electric fans	1	4.10
8.	Electric wires and cables	3	0.72
		37	130.87

Some of these cases are given below:

#### (i) Soap and detergent powder

(a) A manufacturer of detergent powder in Ahmedabad Collectorate was paying duty in cash at an average of Rs.76,94,926 per month during the period from August 1985 to February 1986. As the rate of duty was increased from 15 to 20 percent with effect from 1 March 1986 and as his production and clearances increased, his monthly average payment of duty increased to Rs.1,20,19,470 per month during the year 1986-87. Out of this, he paid on a monthly average of Rs.68,69,961 in cash and rest was adjusted against the credit of duty paid on inputs. The shortfall in revenue during the period from April 1986 to December 1987 amounted to Rs.8.95 crores.

(b) Another manufacturer of detergent powder in Ahmedabad Collectorate

was paying duty in cash at the monthly average of Rs.18,62,450 during the period from August 1985 to February 1986. As the rate of duty was increased from 15 to 20 percent with effect from 1 March 1986 and his production and clearance increased, his monthly average payment of duty increased to Rs.29,08,967 during the period from April 1986 to March 1987. Out of this, he paid Rs.12,48,961 on monthly average basis in cash and the rest was adjusted against credit of duty paid on inputs. The shortfall in revenue during the period from April 1986 to December 1987 amounted to Rs.3.84 crores.

(ii) Television

A leading T.V. manufacturer in Ahmedabad Collectorate had paid duty on the monthly average of Rs.45,88,750(98.21 per cent) in cash and the remaining Rs.1,00,390 (1.79 percent)from the proforma credit account under Rule 56A. After introduction of Modvat scheme, he paid duty on the monthly average of Rs. 78,49,900 in cash (93.80 percent) during the year 1986-87 and the rest 6.20 percent was availed as set off under modvat scheme. The short fall in revenue during the period from 1 March 1986 to 31 December 1987 amounted to Rs.4.47 crores.

(iii) Price escalation despite input relief

A leading manufacturer of soap and detergent in Calcutta-I Collectorate, availed modvat credit of Rs.1.30 crores in respect of duty paid on sodium silicate, titanium dioxide and packaging material during the period from May 1986 to July 1987. Nevertheless he increased the prices of soap and detergents after availing the said duty relief even though no duty relief on inputs was availed of by him in pre March 1986 period.

The Ministry of Finance have admitted (December 1988) that though the Modvat Scheme, at the time of its introduction in 1986, was estimated to be revenue neutral, it did not actually turn out to be so. They added that to make its impact revenue neutral, the

rate of duty on some of the final products were increased in the Budget of 1987 and again in the Budget of 1988. They have mentioned that the reasons for the escalation in prices of finished goods in Calcutta Collectorate as pointed in audit, are being ascertained.

**7. Unintended benefit to manufacturers on inputs procured from small scale units**

As per Rule 57A of the Central Excise Rules 1944, credit for duty paid on inputs used in or in relation to manufacture of final product is allowed to a manufacturer which can be utilised by him towards payment of duty leviable on such final products. As per Rule 57B of the said Rules, where duty on inputs has been paid under a notification exempting them from a part of duty on the basis of value of clearances of such inputs during any specified period credit shall be allowed at a rate otherwise applicable to such inputs but for the said notification. It, therefore, follows that if a manufacturer procures inputs from a small scale manufacturer, the former pays duty to the latter at the concessional rates, but takes credit of duty in his R.G.-23A account at the normal rates. This concession was sought to be withdrawn from 1 September 1987 vide a notification dated 4 August 1987 but the implementation of that notification was deferred till 31 March 1988. Thereafter, the concession has been continued with the stipulation that credit on such inputs shall be allowed at the rate of duty applicable under notification dated 1 March 1986 (for small scale units) plus an amount calculated at the rate of 5 per cent ad valorem or at the rate otherwise applicable but for the notification, whichever is less.

Eight hundred fifty one cases of higher (additional) Modvat credit of Rs. 63.93 crores (Rs.48.66 crores upto 31 August 1987 and Rs. 15.27 crores from September 1987 to December 1987) by the manufacturers on account of inputs under Rule 57B were no-

ticed in audit.

Few cases are given below:

Four big manufacturers of motor vehicles in Bombay II and Pune Collectorates took Modvat credit of Rs.9.51 crores against the actual payment of duty of Rs. 4.78 crores on inputs procured from small scale units during the period from 1 March 1986 to 31 December 1987 thereby availing excess credit of Rs.4.73 crores under Rule 57B of the Rules *ibid*. This included a credit of Rs.1.97 crores for the period from 1 September 1987 to 31 December 1987 *viz.* the period during which the concession was initially sought to be withdrawn.

The Ministry of Finance have not offered (December 1988) any comments on the grounds that the Modvat credit taken by the manufacturers under Rule 57B was in accordance with the rules provided under law and thus there is nothing irregular.

The fact, however, remains that Rule 57B has been promulgated by the Government under the powers delegated to them *vide* Section 37 of the Central Excises and Salt Act, 1944. This section empowers the Central Government to make rules to carry into effect the purposes of the act. Sub-Section (1) of that Section contains general provisions in this regard, whereas sub-section (2) thereof contains specific instances. Making of Rule 57B which permits to take credit of duty in respect of inputs in excess of the duty actually paid on such inputs is not covered under the provisions of Section 37 *ibid* inasmuch as it does not carry into effect the purposes of the Act.

#### **8. Irregular availment of MODVAT credit without filing a declaration or without obtaining the acknowledgement**

As per Rule 57G read with Rule 57H of the Central Excise Rules, 1944, a manufacturer intending to avail the input relief under Rule 57A should file a declaration indicating the description of the inputs in-

tended to be used in the manufacture of the final product and take credit of the duty paid on the inputs received by him after obtaining dated acknowledgement for such declaration. He could also take credit of duty paid on the inputs received by him before filing a declaration if such inputs were either lying in stock on 1 March 1986 or were received in the factory between 1 March 1986 and 31 March 1986.

Three hundred and eleven assesseees in twenty eight collectorates producing different excisable commodities irregularly availed themselves of Modvat credit of duty amounting to Rs.5.41 crores paid on inputs before filing declarations out of which Rs.51 lakhs have already been recovered. The Ministry of Finance have not denied the facts.

Some of these cases are given below:

(i) A public sector steel plant in Bhubaneswar Collectorate, filed the declaration on 26 March 1986 which was acknowledged by the Assistant Collector on the same date. It, however, availed credit of the duty amounting to Rs.20.30 lakhs paid on inputs from 1 March 1986 instead of 26 March 1986. The monthly return (RT 12) upto June 1987 were finally assessed, but the department did not disallow that credit.

The Ministry of Finance have stated (December 1988) that the assessee has paid the amount of credit wrongly availed.

(ii) A manufacturer of iron and steel products in Indore Collectorate, took credit of Rs. 14,95,298 during the period from December 1986 to July 1987 on account of duty paid on steel skull scrap (sub heading 7206.20) which was not declared as an input in the declaration submitted to the Jurisdictional Assistant Collector.

On this being pointed out in audit (November 1987), the department stated (March 1988) that steel skull scrap is waste and scrap falling under sub-heading 7203.20 and is, therefore, covered under the declara-

tion filed for availing modvat credit. It added that the declaration under Rule 57 G is not required to be given for a very detailed description of the product. The, fact however, remains that the word "skull" denotes solidified metal with some amount of slag and refractories remaining in the furnace or ladle after molten metal is poured out. Therefore, steel skull scrap is nothing but a lump of steel and is correctly classifiable under sub-heading 7206.20 . Further, in the duty paying documents also the classification of the goods, was given as sub-heading 7206.20.

Irregular availment of credit in respect of input not mentioned in the declaration furnished by the assessee was brought to the notice of Collector (March 1988). His comments have not been received (June 1988).

(iii) A manufacturer of excisable goods including starter motors, wiper motors, generators, dynamos. etc., (Chapters 72,82,83,85 and 87) in Madras Collectorate took credits of the duty paid on inputs before filing the declaration under Rule 57G and without the approval of the Assistant Collector as required under Rule 57H.

On this being pointed out in audit in March 1987, the department accepted the objection and recovered (July 1987) Rs.4,30,646 on account of availment of irregular credit.

(iv) Another manufacturer of goods (Chapter 72 and 73) in Madras Collectorate filed an additional classification list, effective from 1 October 1986 for the manufacture of "M.S. tie bars" (for railway track) falling under the sub-heading 7302.90, and took Modvat credit without filing declaration . The credit incorrectly availed during the period from December 1986 to February 1987 alone amounted to Rs.3,21,835. When this was pointed out (March 1988) in audit, the department issued a show cause notice to the assessee on 4 May 1988. Report on the adjudication of the case and on the recovery

of duty has not been received (June 1988).

(v) An assessee manufacturing electric supply meters (Chapter 90) and other electrical and electronic machinery, equipments and parts thereof (Chapter 85) in Trichy Collectorate took Modvat credit in respect of inputs for payment of duty on final products which were not included in the declaration. The irregular availment of Modvat credit during the period from March 1986 to May 1987 alone amounted to Rs.2,06,284. On this being pointed out in audit in August 1987, the department accepted the objection and reported (January 1988) the issue of show cause notice. Confirmation of demand and particulars of recovery of the said amount have not been communicated (June 1988).

The cases in sub paras (ii) to (v) were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

#### **9. Incorrect availment of deemed credit**

The Modvat scheme enables a manufacturer to obtain instant credit of excise duty or countervailing duty, as the case may be, paid on certain specified inputs used in or in relation to the manufacture of the specified final products and to utilise the credit for payment of excise duty on such final products. The scheme debars taking of credit unless the inputs are accompanied by a prescribed document evidencing payment of duty on such inputs. The second proviso to Rule 57-G(2) of the Central Excise Rules, 1944, however, empowers the Government to direct, having regard to relevant considerations, that with effect from a specified date, all stocks of specified inputs in the country, except those which are clearly recognisable as being non-duty paid, may be deemed to be duty paid and credit of duty may be allowed in respect of the said inputs at such rates and subject to such conditions as may be specified without production of any document evidencing payment of duty.



By an order dated 7 April 1986 Government directed that inputs of specified ferrous and non-ferrous metals including waste and scrap of iron (sub-heading 7203.10) and waste and scrap of steel (sub-heading 7203.20) purchased from outside and lying in stock on or after 1 March 1986, with the manufacturers of the final products may be deemed to have paid duty and credit allowed at the specified rates, without production of documents evidencing payment of duty. The aforementioned order, however, expressly provided that no credit shall be allowed if such inputs are clearly recognisable as non-duty paid or charged to nil rate of duty.

The facility of allowing 'deemed credit' in respect of wastes and scraps of iron as well as wastes and scraps of steel was withdrawn under an order dated 29 August 1986 because such wastes and scraps were exempt from Central Excise duty under notifications dated 1 August 1983 and 10 February 1986 respectively (and, therefore, were clearly recognisable as being non-duty paid or charged to nil rate of duty). Since the aforementioned exemptions were admissible even before 1 March 1986, the facility of allowing 'deemed credit' should not have at all been extended to wastes and scraps of iron and steel under the said order dated 7 April 1986.

One hundred twenty eight cases involving incorrect availment of deemed credit of Rs.9.63 crores on wastes and scraps and other items were noticed in audit.

Some of these cases are given below:

(i) Wastes and scraps:

(a) A manufacturer in Indore Collectorate was irregularly allowed deemed credit of Rs.44.25 lakhs between 1 March 1986 to 28 August 1986 on waste and scrap of iron and steel purchased by him from the market which was in contravention of instructions contained in Ministry's order of 7 April 1986. No action was taken by the de-

partment to disallow the credit taken wrongly and to recover the amount of credit already utilised by the manufacturer towards payment of duty on final products.

The irregular availment of credit was pointed out in audit in December 1986, January and April 1987. The department stated (June 1987) that the amount of Rs.5,60,148 which was clearly recognisable as non-duty paid, was disallowed.

The Ministry of Finance have confirmed the incorrect availment of credit to the extent of Rs.43.89 lakhs (August 1988).

(b) Four manufacturers in Calcutta II and Bolpur Collectorates, availed themselves of deemed credit of Rs.39,98,710 in respect of wastes and scraps of iron and steel purchased from market during the period 1 March 1986 to 28 August 1986, which were eligible for exemption.

On the issue being raised in audit (October 1986 and June and November 1987), the department in two cases stated (January 1988) that demands for Rs.5,53,099 and Rs.34,675 had been raised. In the third case it stated (February 1988) that the matter was under examination. Reply in the fourth case has not been received (August 1988).

(c) Two manufacturers of iron and steel in Chandigarh Collectorate using steel wastes and scraps as input in the manufacture of their final product of steel ingots, irregularly took Modvat credit of Rs.14.06 lakhs of duty deemed to have been paid on steel wastes and scraps during the period from June 1986 to August 1986 because the inputs were exempt from the whole of the central excise duty. Show cause-cum demand notices for Rs.14.06 lakhs were issued by the department and the demands were confirmed in March 1987, June 1987 and April 1988. Recovery particulars have not been intimated (August 1988).

(ii) Other inputs

A manufacturer of welding electrodes in Indore Collectorate (sub-heading 8310.10)

took deemed credits of Rs.11,48,081 on account of duty paid on inputs viz. M.S. wire rods and M.S. wire which were clearly recognisable as non-duty paid.

When this was pointed out (July 1987) in audit, the department recovered (24 July 1987 and 12 September 1987) Rs.14,73,105 on account of deemed credits availed during the period from 1 March 1986 to 31 May 1987.

The Ministry of Finance have stated (December 1988) that while issuing the order dated 7 April 1986, the underlying presumption was that the goods on which deemed credit would be allowed, had already suffered duty. The fact, however, remains that the waste and scrap of iron and steel were exempt from the whole of duty leviable thereon in terms of a notification dated 1 August 1983 which was issued long before the issue of said order.

#### **10. Incorrect availment of Modvat credit of duty paid on machinery, equipment, tools, appliances, etc.**

As per clause (b) of explanation below Rule 57 A inputs do not include:

- (i) machines, machinery, plant, equipment, tools, or appliances used for producing or processing of any goods or for bringing about any change in any substance in or in relation to the manufacture of the final products;
- (ii) packaging materials in respect of which any exemption to the extent of the Central Excise duty payable on the value of the packaging materials was availed of for packaging any final products;
- (iii) packaging materials, the cost of which was not included or had not been included during the preceding financial year in the assessable value of the final products under Section 4 of the Central Excises and Salt Act, 1944;
- (iv) cylinders for packing gases;

- (v) plywood for tea chests.

One hundred eighteen cases involving incorrect availment of Modvat credit of Rs.2.81 crores being the duty paid on goods which are not inputs under the Modvat rules were noticed in audit.

A few cases are given below:

- (i) Mercury

As per instructions issued by the Ministry of Finance on 23 September 1987, duty paid on mercury used as cathode in the manufacture of sodium hydroxide did not qualify for Modvat credit.

Three assesseees in Madras, Coimbatore and Madurai Collectorates, declared mercury as input which is used as Cathode in the manufacture of sodium hydroxide and availed Modvat credit of Rs.9,24,122 during the period from March 1986 to January 1988 on account of duty paid on mercury.

The irregularities were pointed out in audit in April, May and October 1987 and March 1988.

In one case the department reported (August 1987) issue of show cause notice for Rs.3,83,835; in the second case the department stated (February 1988) that a reference has been made to the Central Board of Excise and Customs for reviewing of the Ministry's aforesaid classification of September 1987. In the third case the department intimated (March 1988) that the jurisdictional Assistant Collector has been asked to take necessary action for expunging the Modvat credit.

In one case the Ministry of Finance have stated (December 1988) that an appeal against the order of the Collector of Central Excise (Appeals) holding mercury as input, has been filed. Their reply in the remaining two cases has not been received.

- (ii) Lining material for furnace

(a) Two manufacturers of steel billets, bars, ingots and castings (Chapter 72) in Madras and Trichy Collectorates, took

credits of duties of excise paid on inputs which were actually used as lining materials for the furnace and laddles forming part of the plant. As the inputs were not used in relation to the manufacture of the final products, the Modvat credits allowed were not in order. In one case total credits taken during March 1987 to July 1987 amounted to Rs.1,14,559 and in the other case credits taken during the period from March 1986 to June 1987 amounted to Rs.5,21,817.

These irregularities were pointed out in audit in August 1987 and September 1987, the department accepted the objection in the first case and reported (January 1988) the confirmation of demand. In the second case it reported (February 1988) that the assessee paid Rs.5,57,147 under protest in November 1987. The department, however, did not accept the objection in this case on the ground that the ramming mass which was being applied to the patches/spots in the lining chamber melts with the iron and steel melting metal, accompanies the finished products and slag and would be eligible for Modvat credit. The departmental view is not correct because the ramming mass being part of the equipment viz. furnace for melting iron and steel, is not eligible for Modvat credit.

(b) Four manufacturers of castings in Bangalore Collectorate, availed Modvat credit on certain foundry chemicals like sodium silicate, binders, ramming mass etc. as inputs. As these inputs were used in the manufacture of sand moulds which were subsequently used for steel castings, it was pointed out in audit that those foundry chemicals could not be considered as inputs for the manufacture of castings. The Ministry of Finance also clarified on 22 July 1987 that Modvat credit is inadmissible on foundry chemicals. A sum of Rs.5.86 lakhs availed as Modvat credit which was pointed out in audit as inadmissible, has been recovered in full.

(c) Two manufacturers of steel ingots in Delhi Collectorate, took Modvat

credit of Rs.6,40,953 on account of duty paid on refractories, ramming mass etc. which were used for lining in the electric furnace and as such did not qualify as inputs in terms of explanation below Rule 57A. The Central Board of Excise and Customs also clarified non-admissibility of credit on refractories vide question No.4 of Guide to Modvat (2).

The availment of inadmissible credit was brought to the notice of the department in June 1988; its reply has not been received (August 1988).

(d) Two other manufacturers of 'steel ingots' in Delhi Collectorate took credit of Rs.3,68,232 as duty paid on 'hot tops' which was also not admissible.

On this being pointed out in audit, one assessee paid Rs.1,990 in September 1987. Action taken to recover the remaining amount in respect of second assessee has not been intimated (August 1988).

(e) Another manufacturer of iron and steel products in Indore Collectorate applied (17 March 1987) to the Jurisdictional Assistant Collector for the grant of Modvat credits on the stock of inputs available with them on 1 March 1987. On 3 June 1987 the credits for Rs.1,05,378 on fire bricks were disallowed by the assistant Collector on the ground that fire bricks was not an input. Accordingly, further credits for Rs.1,28,243 on fire bricks received during the period from 1 March 1987 to 25 March 1987 were also disallowed by the Range Superintendent on 17 June 1987. Subsequently, the Assistant Collector vide his order dated 30 June 1987 reallocated the aforesaid credits for Rs.1,05,378 on the grounds that fire bricks were a consumable item. Thereupon all the credits of Rs.2,33,621 which were earlier disallowed by the department were taken in RG-23 A Part II register on 30 June 1987. When the irregularity was pointed out in audit the department stated (June 1988) that an appeal against the aforesaid order dated 30 June 1987 of the Assistant Collector, has been filed before Appellate

Collector, Central Excise and Customs, New Delhi. The decision in the appeal has not been received (August 1988).

The audit objections in sub paras (a) to (e) were communicated to the Ministry of Finance in September 1988. The Ministry have admitted (December 1988) the facts of the case in sub-para (b) and have stated that the case reported in sub-para (e) is pending decision with the Collector (Appeals). Their reply in the remaining three cases has not been received.

(iii) Thinners

As per explanation below Rule 57A inserted by a notification dated 14 March 1986 inputs included paints and packing materials but not thinners used for diluting the paints. The Central Board of Excise and Customs also clarified in September 1987 that thinners used as diluents of paints do not qualify for Modvat credit.

A manufacturer of motor vehicles in Madras Collectorate and eight manufacturers of different excisable goods in Delhi Collectorate were permitted to take Modvat credit of duty paid on 'thinners' which were used in diluting paints. This resulted in taking of incorrect credit of Rs.1,45,368 by the manufacturer in Madras Collectorate during the period from March 1986 to December 1987. The other eight units in Delhi Collectorate took irregular credit of Rs.7,80,277.

On this being pointed out in audit (February 1988 and June 1988), the department accepted the objection in respect of Madras Collectorate and reported (June 1988) issue of show cause notice demanding Rs.1,45,368 to the assessee. Recovery particulars have not been reported (August 1988). In another case in Delhi Collectorate the assessee paid Rs.13,821, whereas in remaining seven cases department's reply has not been received (August 1988).

The matter was reported to the Ministry of Finance in September 1988; their

comments have not been received (December 1988).

(iv) Packing materials

(a) A manufacturer of dyes in Baroda Collectorate, was availing Modvat credit of duty paid on packing materials like metal containers, fibre drums, paper drums etc. The said packing materials were partly used for packing of excisable goods and partly exempted goods like sodium salt, bulk drugs etc. However, Modvat credit of duty paid on packing materials used for packing exempted goods was not reversed. Such irregular credit during the period from April 1986 to June 1986 amounted to Rs.2,05,415.

On this being pointed out in audit (May 1986), the department accepted the objection (September 1987) and initiated action for recovery. Further developments have not been intimated (August 1988).

(b) An assessee in Chandigarh Collectorate manufacturing various fruit preparations (Chapter 20), filed a declaration under Rule 57G on 10 March 1987 and took credit of duty amounting to Rs.2,22,747 on that date (financial year 1986-87), in respect of stock of duty paid packing materials (metal containers) lying with him on the date of declaration, in terms of a notification dated 1 March 1987. The manufacturer had availed of exemption of duty on packing material (metal containers) under a notification dated 1 March 1983 during the financial year 1985-86 as the cost of packing material (metal containers) had not been included in the assessable value of final products during the preceding financial year (1985-86), the credit of Rs.2,22,747 on 10 March 1987 (financial year 1986-87) was not admissible.

On the mistake being pointed out (January 1988) in audit, the department contended (May 1988) that as the metal containers cleared by the assessee suffered duty on a part of their cost during April 1986 to June 1986 and on full cost after 30 June

1986, there was no mistake in allowing the credits.

The reply of the department is not acceptable because the assessee was allowed credit with effect from 10 March 1987 i.e. in the financial year 1986-87 for which the relevant preceding financial year was 1985-86, and not 1986-87 as contended by the department. As the cost of packing material was not included in the assessable value of final products during the previous financial year 1985-86 by virtue of a notification dated 1 March 1983, the credit was not admissible during the year 1986-87.

These objections were communicated to the Ministry of Finance in September 1988; their verification report has not been received (December 1988).

(v) Gases

A manufacturer of motor vehicles in Madras Collectorate, took credits of duties paid on oxygen and acetylene gases which were filled in an apparatus meant for producing oxy-acetylene flame which in turn was used for cutting steel sheets/plates for welding purposes. As the equipment/apparatus used for producing or processing any goods should not be treated as input, the duty paid on these two gases will not be available for taking Modvat credit. Further, oxygen and acetylene gases are to be treated as inputs of the equipment only. The irregular credit availed during April 1986 to July 1987 amounted to Rs.1.60 lakhs approximately.

When this was pointed out in audit (September 1987), the department justified (November 1987) the availment of Modvat credit on the ground that even though the gases were used in the oxyacetylene gun for cutting steel sheets, they satisfied the condition prescribed in Rule 57A; that the input should be used in or in relation to the manufacture of the final product.

In April 1988, the department further contended that the gases were used for

the fabrication of major sheet metal components and that the gases could not, therefore, be viewed as used for cutting of sheets but as were directly used in gas welding in or in relation to the manufacture of the final products. The contention of the department is not acceptable as they happened to be inputs of the equipments used for gas welding.

The objection was communicated to the Ministry of Finance in September 1988; their comments have not been received (December 1988).

**11. Misuse of Modvat scheme - Availment of higher credit of duty paid on intermediate goods manufactured through job worker**

As per Rule 57F(2)(b) of the Central Excise Rules, 1944 a manufacturer may remove the inputs obtained by him and on which Modvat credit was availed as such to a place outside his factory for the purpose of manufacture of intermediate products and get back the intermediate products in his factory for further manufacture of final products. As provided in Rule 57F(3), the credit already allowed on the inputs can be utilised towards payment of central excise duty on any of the final products in or in relation to the manufacture of which such inputs are intended to be used or on the inputs themselves if they are permitted to be cleared under Rule 57F(1). In terms of a notification dated 25 March 1986 as amended, goods manufactured in a factory as a job work and used in or in relation to the manufacture of final products is exempt from the whole of duty subject to the conditions specified therein.

Contrary to these provisions, some assesseees were allowed to send the inputs to one or more small scale manufacturers for the manufacture of intermediate products on job work basis. Although the job worker received labour charges only, yet he paid duty at the concessional rates in terms of a

notification dated 1 March 1986 as amended. In turn the supplier of the raw materials took credit for the full effective rate of duty under Rule 57B. Because under the Section 2(f) of the Central Excises and Salt Act, 1944 the term 'manufacturer' includes, a person who employs hired labour in the production of excisable goods, the assessee who got the manufacture of excisable goods done on job work basis would be the manufacturer and duty at the full effective rate should have been levied on the intermediate products got manufactured by him from the job worker. In the alternative the job worker should have removed the goods without payment of duty under the notification dated 25 March 1986 as amended. In the former case the amount actually paid as duty by the job worker would have been taken as Modvat credit by the assessee and in the latter case no credit would be admissible. In either case no additional credit could accrue to the assessee.

Twenty four cases of availment of additional Modvat credit of Rs.2.05 crores due to misuse of the provisions of Rule 57F were noticed in six Collectorates in the course of test audit.

Four of these cases are given below:

(i) A manufacturer of ceiling fans in Delhi Collectorate, availing Modvat credit of duty paid on electric stampings, copper wire etc. supplied/distributed the entire inputs received in the factory, to thirteen 'job work units' for assembling into various parts of ceiling fans and those units were asked by the principal manufacturer of ceiling fans to pay duty as per notification dated 1 March 1986 instead of the principal manufacturer himself availing the full duty exemption under Rule 57F(2)/notification dated 25 March 1986. The irregular procedure adopted for payment of duty resulted in the irregular availment of additional higher Modvat credit of Rs.1.34 crores by the principal manufacturer.

On the irregularity being pointed out

in audit, the department contended that the assessee had correctly supplied the raw materials to the units under Rule 57F(1)(ii), the benefit of notional credit was permissible under Rule 57B and there was no unintended benefit. It was added that the facilities provided under the law cannot be withdrawn arbitrarily and the assessee cannot be compelled to work under a particular rule/notification (March 1988). The fact, however, remains that allowing the transfer of all inputs, on which Modvat credit was taken under Rule 57A and which were required for assembling the complete parts under Rule 57F(1)(ii) is not in conformity with the spirit of the Modvat scheme.

(ii) A public sector undertaking in Madras Collectorate, manufacturing boiler components was allowed Modvat credit on steel used as inputs in the manufacture of final products. The unit sent the input for the manufacture of intermediate products on job work basis to a number of small scale units enjoying the benefits of a notification dated 1 March 1986. Some of the small scale units returned the intermediate products after payment of duty at concessional rates and the undertaking took credit at normal rate for the products received back. The Modvat rules and notification dated 25 March 1986 do not contemplate the utilisation of the input credit by the principal manufacturer except in the manner specified in Rule 57F(3). The payment of duty at concessional rate by the job worker for the clearance of intermediate products as well as the action of the public sector unit in expunging the Modvat credit for the inputs transferred to job worker and subsequently taking Modvat credit at higher rate of duty as against the concessional rate of duty paid for the intermediate products by the job worker was irregular. The excess credit thus allowed from April 1986 to April 1987 alone amounted to Rs.16,04,395.

On this being pointed out in audit in July 1987, the department contended (No-

vember 1987) that the assessee could legally bring back into his factory duty paid goods for which raw materials were sent under Rule 57F(2) and that there was no bar either in Rule 57F(2) or in any other rule to the effect that a job worker shall not pay duty on the manufacture done at his end.

The proviso under Rule 57F(2) contemplates the payment of duty only in the case of waste not returned to the principal manufacturer, but the provisions of the rule do not contemplate the payment of duty on the intermediate products and waste returned to the principal manufacturer. The inclusion of this proviso was not necessary if the job worker would take Modvat credit for the inputs received from the principal manufacturer and thereafter could return the intermediate products to the latter on payment of duty at concessional rate.

Subsequently, the department intimated (December 1987/February 1988) that a sum of Rs.5,41,505 being the input credits taken on total steel sent under Rule 57F(2) from April 1986 to April 1987 has been expunged and that measures were being taken separately to expunge such credits for the subsequent period from May 1987 to November 1987. In March 1988, the department also intimated the issue of a show cause notice demanding Rs.23,73,588 on account of grant of irregular credit.

Since Rule 57F(2) read with the proviso thereunder does not provide for payment of duty on the intermediate products returned by the job worker to the principal manufacturer, the availing of higher credit as against payment of duty on the intermediate products at the concessional rate resulted in revenue loss of Rs.16.04 lakhs for the period from April 1986 to April 1987. Further loss from May 1987 has not been assessed (April 1988).

(iii) Another manufacturer of rear axle gear assemblies and differential gear assemblies in Madras Collectorate, supplied raw materials viz., forgings, steel plates/flats etc.,

to four job workers for the manufacture of intermediate goods on payment of labour charges only. The job workers paid duty on the intermediate products at concessional rates in terms of a notification dated 1 March 1986 applicable to small scale units. In turn the assessee availed additional higher credit at normal rates of duty under Rule 57B. The excess Modvat credit thus irregularly availed by the assessee during the period from November 1986 to August 1987 alone amounted to Rs.10,93,750.

When this was pointed out in audit (November 1987), the department held (February 1988) that according to the Madras High Court judgment in the case of P.M. Abdul Latiff and others V/s Assistant Collector, Trichy (1985(22) ELT 758 (Madras)) the convertor of raw material were the manufacturers of the product. Whenever the small scale units or job workers paid duty on the components made out of raw materials supplied by the principal manufacturer who did not take credit on such raw materials, became eligible to higher credit in terms of Rule 57B read with the notification dated 1 March 1986. The contention of the department is not correct in view of the Supreme Court judgment (ECR 381 SC) holding that any person who supplies raw materials for the purpose of manufacture and receives back such goods on payment of labour charges only is to be treated as manufacturer of such goods. It was pointed out to the department (February 1988) that the availing of additional higher credit by the supplier of raw materials amounted to unintended benefit to the principal manufacturer not contemplated in Modvat rules.

(iv) Yet another manufacturer of mild steel fabricated items and flexible cell coils in Madras Collectorate, sent metal sheets to a job worker who was a small scale unit, for the manufacture of intermediate products. The job worker paid duty at concessional rates as per a notification dated 1 March 1986 as amended and the supplier of raw

materials took higher credit under Rule 57B. The credit excessively taken under Rule 57B to the extent of Rs.6,32,826 during the period from May 1986 to July 1987 was pointed out in audit in September 1987 and again in November 1987.

The department maintained (March 1988) that the assessee was not availing any credit on raw materials, which were sent to the job worker. The fact, however, remains that the availing of higher credit by the supplier of raw materials amounted to unintended benefit. The Ministry of Finance did not admit the audit objection and stated (December 1988) that it was for the assessee to either clear the inputs on payment of duty for home consumption which also included sending of raw materials to job worker or to follow the provisions of Rule 57F(2) along with notification dated 25 March 1986. They added that the assessee had rightly supplied raw materials to the job worker's unit under Rule 57F(1)(ii) and the availment of benefit of notional higher credit when the goods were received by the Principal manufacturer under Rule 57B was legally correct. The reply of the Ministry is not acceptable to Audit as it is against the principles of Modvat scheme.

## **12. Irregular availment of Modvat credit on exempted goods**

As per Rule 57C of the Central Excise Rules, 1944 no credit of the duty paid on the inputs used in the manufacture of a final product shall be allowed if the final product is exempt from the whole of duty or is chargeable to nil rate of duty.

The Ministry of Finance clarified on 10 April 1986 that the credit of duty paid on inputs used in the fully exempted goods should be debited in the account before removal of those fully exempted goods.

One hundred and eight manufacturers producing different commodities in twenty five collectorates, availed Modvat credits of Rs.1.75 crores of the duty paid on inputs

used in the manufacture of final products, which were exempted from the whole of the duty or chargeable to nil rate of duty.

The Ministry of Finance/the Central Excise department have already accepted the incorrect availment of credit of Rs.39 lakhs in 32 cases out of which Rs.28.21 lakhs in 27 cases have been recovered.

Some of these cases are given below:

(i) An assessee was manufacturing slurry explosives (Chapter 36) and supplying it to a buyer in terms of a contract which was in force since 1978. The buyer who himself was a manufacturer of iron ore slurry was approved as an Export-oriented undertaking in June 1983 and consequently no duty was collected by the department on the slurry explosives cleared by the assessee in terms of a notification dated 2 June 1981. However, the credit of duty paid on the various inputs namely sodium nitrite, atomised aluminium powder etc., used in the manufacture of the slurry explosive was continued to be allowed which resulted in grant of erroneous credit of Rs.9,09,742 from June to September 1987.

On this being pointed out in audit (October 1987) the department stated (December 1987) that an amount of Rs.11,83,978 being the aggregate of the erroneous credit upto 18 December 1987 has been recovered.

(ii) (a) A manufacturer of aluminium in Belgaum Collectorate declared 'calcined alumina' (sub heading 2804.90) as final product and used it in the manufacture of aluminium. Since calcined alumina captively consumed is exempt from the whole of duty in terms of a notification dated 2 April 1986, and was declared as final product, the input credit availed on caustic soda lye etc., used in the manufacture of calcined alumina was not admissible. The irregular credit taken on a quantity of 1,048.796 tonnes of caustic soda lye used for the manufacture of calcined alumina between 2 April 1986 to May 1986



worked out to Rs.6,99,966.

On this being pointed out in audit (July 1986), the department issued a show cause notice and confirmed the demand (March 1988). Details of realisation have not been furnished (August 1988).

(b) A manufacturer of aluminium (in primary form) in Belgaum Collectorate, utilised duty paid on caustic soda lye, as input, towards payment of duty on calcined alumina which is the final product. During the course of manufacture of calcined alumina, an intermediate product aluminium hydrate was also manufactured and a quantity of 499.938 tonnes of 'aluminium hydrate' was exported without payment of duty. Aluminium hydrate (Chapter 2804.70/2818.00) was subjected to 'nil' rate of duty and credit of duty on input was thus not available. The department allowed the duty on input to be availed for clearance of calcined alumina for home consumption even though the intermediate product was exempt from the whole of duty. On this being pointed out in audit, the department accepted the objection and directed the Range Officer to recover the amount of Rs.1.51 lakhs (March 1988). Further developments have not been intimated (August 1988).

(iii) An assessee in Ahmedabad Collectorate manufactured polyethylene card cans, classified them under Chapter 84 and paid duty by utilising credit of duty paid on input, viz., H.D.P.E. sheets. As the polyethylene card cans were classifiable as article of plastics under Chapter 39 and were wholly exempt from duty under a notification dated 1 March 1986, the credit of Rs.2,71,400 of duty paid on inputs which was availed between March 1986 and August 1986, was not admissible. The department did not accept the objection on the ground that the card cans were classifiable under Chapter 84 as parts suitable for textile machinery, in terms of note 2 of Section XVI of Central Excise Tariff. This reply is not acceptable as the cans are merely receptacles for slivers pro-

duced in textile machines and other uses cannot be ruled out. As per note 1 to Section XVI *ibid*, bobbins, spools and similar supports of Chapter 39 are classifiable under that chapter.

(iv) A manufacturer of urea resin in the form of moulding powder in Delhi Collectorate, took credit of Rs.2,21,205 of duty paid on ammonia and methanol used captively in the manufacture of hexamine and formaldehyde (headings 36.06 and 29.12 respectively) which were cleared for captive use without payment of appropriate duty during the period 1 March 1986 to 1 April 1986 whereas exemption was applicable with effect from 2 April 1986 only. This resulted in clearance of excisable goods manufactured from inputs on which Modvat credit was availed of, without payment of appropriate duty of Rs.2,21,205.

(v) A manufacturer in Jaipur Collectorate availed credit of duty on inputs of pipes and tubes of copper and brass. But while clearing pipes and tubes at nil rate of duty, he reversed credit of duty, on copper and zinc contained in the final products instead of credit of duty paid on entire quantity of copper and zinc used in manufacture of such pipes and tubes. This resulted in short adjustment of credit of Rs. 1,55,875.

On the matter being pointed out in audit (September 1987), the department recovered the entire amount (November 1987).

(vi) A manufacturer of chemicals in Baroda Collectorate, took credit of duty paid on inputs, 'aniline oil', 'chlorosulphonic acid' and 'pyridine C.T.C.', and utilised them in the manufacture of goods liable to duty as well as fully exempted goods like sodium salt, sulphadiazine etc. It was pointed out in audit (April 1987) that since the inputs are utilised both for exempted and dutiable goods, the credit of duty paid on inputs and utilised in the manufacture of exempted goods would not be admissible.

The department replied in August 1987 that an amount of Rs.1,43,556 has been

recovered from the assessee, on account of utilisation of input 'aniline oil' in the manufacture of exempted goods. The details of further recovery on account of utilisation of chlorosulphonic acid and pyridine in the manufacture of exempted goods have not been received (June 1988).

The audit objections in sub paras (i) to (vi) were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

### 13. Non-levy of duty on wastes and scraps

As per sub-rule 4(a) of Rule 57F, any waste arising from the processing of inputs in respect of which credit has been taken, may be removed on payment of duty as if such waste is manufactured in the factory. Forty one cases involving non-levy of duty of Rs.1.73 crores on waste generated in the course of processing of inputs in respect of which credit has been taken were noticed in fourteen collectorates in the course of test audit.

A few such cases are given below:

(i) Seven manufacturers in Calcutta I & II Collectorates, obtained duty paid inputs viz aluminium rerolled stock sheets, imported steel sheets, steel, copper and aluminium ingots and cleared scrap arising in the manufacture of finished goods (viz. aluminium foils, steel drums, steel articles, copper articles and aluminium articles etc.) without payment of duty even though Modvat credit on inputs had already been availed. This resulted in non-levy of duty of Rs.1.16 crores on clearances of scraps during different periods from March 1986 to October 1987.

On the irregularities being pointed out in audit between February 1987 and June 1988, the department accepted (November 1987) the irregularities in 3 cases involving duty of Rs.3.80 lakhs. The department did not accept (January 1988) the objection in the fourth case involving amount of Rs.1.01 crores on the ground that: (i)waste

and scrap of aluminium are exempted from duty under a notification dated 1 August 1984; and (ii) as per Ministry's clarification issued on 13 October 1986 such scrap would be exempted even though Modvat credit on inputs was availed. The contention of the department in this case is not correct as under notification dated 1 August 1984 wastes and scraps are exempted if these have arisen from duty paid inputs. Credit having been taken on inputs under Modvat scheme, the inputs have lost their duty paid character. Besides the CEGAT's decision dated 27 May 1987 (1987 ECR-433) gives support to this contention. Moreover, notification dated 1 August 1984 was amended on 2 November 1987 to incorporate the condition that 'no credit has been taken on the inputs from which such scrap has been generated'.

The fifth case was reported (November 1987) to be under examination. Further progress in that case and the reply in the remaining two cases have not been received (August 1988).

(ii) Nine manufacturers in Delhi Collectorate, cleared scrap which arose from processing of inputs, without payment of duty of Rs.37,49,406 between February 1986 and February 1988. On this being pointed out in audit, the amount of Rs.5,07,251 was debited in the account of the assessee between August 1987 and April 1988. Action taken for recovery of balance amount has not been intimated (August 1988).

(iii) Four manufacturers of torches, iron and steel products, electric wires and cables and valves, steam traps, etc. in Allahabad and Meerut Collectorates were availing the Modvat credit in respect of inputs i.e. copper sheets and strips, zinc slabs, aluminium wire rods and steel sheets respectively. However, the wastes and scraps arising during the process of manufacture of final products were allowed to be cleared without payment of duty under tariff headings 74.02,79.02,76.02 and 72.03 respectively. This resulted in non levy of duty amounting to Rs.8,67,995 on

clearance of wastes and scraps during the period from 1 March 1986 to August 1987. This was pointed out in audit.

The department admitted the objection in one case and intimated (May 1988) that the demand amounting to Rs.5,84,100 was pending confirmation. Further report has not been received (June 1988).

In the second case the department did not agree with the audit objection and stated (February 1988) that the wastes and scraps in question did not arise from processing of inputs (aluminium wire rods) but out of manufactured conductors (wire and cables) and were exempt under a notification dated 1 August 1984. The reply is not acceptable because the unit was engaged in the manufacture of electric wires and cables (conductors) out of aluminium wire rod and no further manufacturing process was involved after the conductors had been fully manufactured and thus any waste of aluminium arising during the process was out of the inputs and not out of finished conductors.

In the third case the department contended (May 1988) that zinc dross and ash (sub-heading 7902.00) was exempt from the whole of the duty as per a notification dated 1 August 1984 till it was amended by a notification dated 2 November 1987, from which date duty is leviable on zinc dross and ash arising out of inputs on which Modvat credit has been taken, unless the proportionate credit taken on the inputs is refunded. The reply is not acceptable because even prior to 2 November 1987, as per provisions of sub-rule 4(a) of Rule 57 F, such waste and scrap was to be cleared on payment of duty.

In the fourth case the department has not given any reply (June 1988).

(iv) Two assessees under Madras and Madurai Collectorates, were availing Modvat credit of duty paid on iron and steel inputs viz tin plates, tin free steel and tin mill block plates. Both of them were clearing the wastes and scraps of iron and steel/unused tin punching waste generated during the course

of manufacture of the final product without payment of duty.

On this being pointed out in audit in October/December 1986, the department reported (March, September and November 1987) that credit of Rs.1,70,734 have been disallowed in both the cases.

In the above cases the Ministry of Finance have admitted the facts that waste, arising from processing of inputs in respect of which credit has been taken, are to be removed on payment of duty only but rate of duty has to be calculated with reference to the exemption notification. They have added that in view of the Attorney General's decision dated 3 October 1985 the input goods do not lose their duty paid character after availment of credit of duty paid thereon under Rule 56A; on the same analogy, input on which Modvat credit has been availed of, will not lose their duty paid character.

The Ministry's reply is not acceptable. On the one hand the Ministry hold that after availing Modvat credit the goods retain their duty paid character (which is however, contrary to the CEGAT decision in the case of M/S Atic Industries (1987-ECR-433), on the other hand they have made the concession in duty under notification dated 1 August 1984 inapplicable with effect from 2 November 1988 in case credit under Rule 56A or Modvat credit under Rule 57A is availed on inputs.

#### 14. Other irregularities

##### (I) Additional credit allowed subsequently

As per Rule 57E, if duty paid on any inputs in respect of which credit has been allowed under Rule 57A, is varied subsequently due to any reason resulting in payment of refund to the manufacturer or the importer of the inputs, the credit allowed shall be varied accordingly by adjustment in the credit account maintained in RG-23 A-Part II, and if such adjustment is not possible

for any reason, by cash recovery from the manufacturer. But there was no such provision upto 28 February 1987 for adjustment of credit where additional duty was demanded and paid later. Seventy manufacturers in fourteen collectorates, producing different commodities irregularly took credit of Rs.1.54 crores during the period from April 1986 to February 1987 arising due to payment of differential duty to the manufacturers of inputs.

Some of these cases are discussed below:

(a) Nine manufacturers in Ahmedabad and Baroda Collectorates received linear alkyl benzene which was classified under Chapter 27 of the Central Excise Tariff Act, 1985. Subsequently, based on Government of India instructions dated 15 May 1986 linear alkyl benzene was reclassified under Chapter 38 and was assessable to duty at 15 percent ad valorem under that chapter instead of Rs.450 per tonne under Chapter 27. The manufacturer of linear alkyl benzene paid differential duty and issued certificates to that effect to his buyers. Based on those certificates the buyer assessee took credit of differential duty of Rs.17,61,718 paid subsequently to the manufacturer of linear alkyl benzene, which was not admissible.

On the irregular availment of credits being pointed out in audit (between April 1987 and June 1987), the department accepted the objection and raised the demand of Rs.17,43,857 in eight cases. Further progress of those eight cases and the reply in the ninth case have not been received (June 1988).

(b) A manufacturer of laminated sheets (Chapter 39) in Baroda Collectorate took credit of differential duty paid on input (viz. paper) purchased by him on the basis of the certificate issued by the paper supplier. When the irregularity was pointed out in audit in December 1986, the department accepted the objection (May 1987) and raised de-

mand for Rs.10,85,100. Recovery particulars have not been reported (August 1988).

(c) A manufacturer of chloro benzene (sub-heading 2901.90) in the Baroda Collectorate brought benzene (input) on payment of duty of at Rs.472.50 per kilolitre under Chapter 27. Subsequently the suppliers of benzene classified it under Chapter 29 and demanded a differential duty at Rs.500.19 (Rs.972.69 minus Rs.472.50) per kilolitre. Accordingly, the assessee paid the differential duty at Rs.500.19 kilolitre and took additional credit of Rs.5,53,598 being the supplementary payment of duty during June and July 1986.

The above cases were reported to the Ministry of Finance in September 1988. The Ministry have stated (December 1988) that the matter is under examination.

**(II) Irregular transfer of credit balance from RG23 account to RG23A account without permission**

As per Rule 57 H(3) the Collector may permit a manufacturer who immediately before the commencement of Modvat scheme had been availing of the exemption for giving credit with respect to duty paid on the materials or component parts used in the manufacture of finished excisable goods, to transfer the unutilised credit in his RG-23 account to his RG-23A Account provided that the materials and component parts and the finished excisable goods are specified as inputs and final products respectively under the Modvat scheme.

Twenty one cases involving irregular transfer of credit balance of Rs.1.43 crores from RG-23 part II to RG-23A part II without permission were noticed in eleven collectorates in the course of test audit.

A few such cases are given below:

(a) On 1 April 1986 a manufacturer of tyres and tubes in Delhi Collectorate, transferred an amount of Rs.87,43,286 from RG-

23 account to RG-23-A account which was irregular because:

- no permission of competent authority under Rule 57-H for transfer of amount was obtained;
- notification dated 4 June 1979 was rescinded on 1 March 1986. Hence no credit under that notification was admissible during the month of March 1986;
- notification dated 1 March 1983 was amended on 1 March 1986 withdrawing therefrom the benefit of proforma credit on tyre, tubes, and flaps; and
- transfer of credit accumulated during 1 March 1986 to 31 March 1986 was not admissible under Rule 57-H(3).

(b) An assessee in Patna Collectorate, applied (31 March 1986) for transfer of unutilised credit of Rs.28,10,025 lying in his RG-23 account to RG-23A account. The Assistant Collector permitted the transfer on 5 June 1986. However, the assessee transferred the whole credit to his RG-23A Account on 1 March 1986 and utilised the same on 7 March 1986 towards payment of duty on the finished goods. The availment and utilisation of the credit prior to granting permission of the transfer was irregular.

It was also noticed in audit that the assessee had a credit balance of Rs.2,26,217 only in his personal ledger account (PLA) on 7 March 1986. Duty of Rs.28,10,025 payable on the finished goods cleared on 7 March 1986 was required to be made by debit to PLA. Thus the clearances on 7 March 1986 were irregularly allowed without realising the duty of Rs.25,83,807 in cash.

(c) A manufacturer of components of watches in Coimbatore Collectorate, was availing proforma credit under a notification issued on 4 June 1979 upto 28 February 1986 and Modvat credit from 1 March 1986 onwards. He transferred credit balance of Rs.3,64,300 to his RG-23A account, without

the specific permission of the jurisdictional Assistant Collector. On this being pointed out in audit (March/April 1987), the department accepted the objection (August 1987) and reported expunging of the credit from his RG-23A account on 11 April 1987.

In the case reported in sub-para (c), the Ministry of Finance have confirmed (December 1988) the facts. Their reply in the cases mentioned in sub paras (a) and (b) has not been received (December 1988).

### (III) Grant of irregular credit on goods consumed captively

As per an explanation inserted under Rule 57 A by a notification issued on 14 March 1986, a manufacturer may avail credit of the duty paid on the inputs manufactured and used within the factory of production in or in relation to the manufacture of the final products and utilise the credit towards payment of excise duty leviable on the final product. As the aforesaid explanation would have prospective effect only, the availment of credit on inputs manufactured and consumed within the factory during the period from 1 March 1986 to 13 March 1986 was not regular.

Thirty units producing different commodities in seventeen collectorates, irregularly availed Modvat credit amounting to Rs.1.25 crores on the duty paid inputs manufactured and captively consumed in their factories during the period from 1 March 1986 to 13 March 1986. The department has already accepted irregular availment of credit of Rs.10.68 lakhs in three cases.

A few cases are given below:

(a) A public sector undertaking manufacturing iron and steel products in Patna Collectorate, irregularly availed of credit of duty paid during the period from 1 March 1986 to 13 March 1986 on hot metal, hot rolled plate, sulphuric acid, acetylene gas, nitrogen gas etc. manufactured in the factory and used captively for the manufacture of

final products. The irregularity resulted in short payment of duty of Rs.11,20,249.

(b) A manufacturer of motor vehicles in Madras Collectorate, manufactured parts of motor vehicles and used them captively in the manufacture of motor vehicles. The availment of credit of duty paid on the goods manufactured and captively consumed during 1 March 1986 to 13 March 1986 amounted to Rs.11,05,960.

On the irregular availment of credit being pointed out in audit (September 1987), the department justified (November 1987) the availment of Modvat credit on the ground that the explanation inserted to Rule 57A on 14 March 1986 would have retrospective effect from March 1986. The contention of the department was not correct inasmuch as there was no mention in the relevant notification dated 14 March 1986 regarding its date of effect as in the case of notification dated 20 February 1982 issued to amend Rules 9 and 49 of the Central Excise Rules, 1944. Further in the absence of an Act of Parliament for retrospective effect, the said notification would have only prospective effect from 14 March 1986.

(c) A public sector undertaking in Bangalore Collectorate, engaged in the manufacture of electric motors and transformers had paid duty on copper wires and laminations during February 1986 and sought permission in terms of Rule 57 H on the goods lying in stock on 1 March 1986 and intended for captive consumption. Permission was given by the department for taking Rs.8,66,940 as credit during June 1987. As Modvat credit was available for goods captively consumed from 14 March 1986 such credit under Rule 57A could not be taken prior to that date. Grant of permission under Rule 57H enabled the assessee to enjoy undue credit of Rs.8,66,940.

(d) A manufacturer of synthetic organic dyes in Baroda Collectorate incorrectly availed Modvat credit of Rs.7,72,400 of the

duty paid on inputs manufactured and captively consumed in his factory during the period from 1 March 1986 to 13 March 1986.

On this being pointed out in audit (May 1987), the department accepted the objection (August 1987) and initiated action to recover the amount.

(e) An assessee in Coimbatore Collectorate, manufacturing P.V.C. resin from ethylene di-chloride first cracked ethylene di-chloride into vinyl chloride monomer (VCM) and hydrogen chloride. VCM was then polymerised into PVC. Thus, during the process of manufacture of PVC resin, VCM was obtained as an intermediate product which is stable and marketable and which was consumed captively in the factory. The intermediate product 'VCM' falling under sub-heading 2901.90 (2903.90 from 10 February 1987) attracted duty at 15 per cent ad valorem. Duty on VCM produced and captively consumed during the period from 1 March 1986 to 13 March 1986 was payable and credit of that duty was not available. The assessee utilised 1383.7 tonnes of imported ethylene di-chloride during this period in the manufacture of VCM valued about Rs.50.09 lakhs and the duty thereon worked out to Rs.7.51 lakhs.

On the omission to collect the duty being pointed out in audit (December 1987 and again in February 1988), the department stated (March 1988) that the intermediate product viz. VCM would be classifiable under erstwhile tariff item 15A as in the case of the final product PVC. It added that in view of the amended provisions of Rules 9 and 49, the assessee could utilise the intermediate product without payment of duty. But the fact remains that the intermediate product (VCM) being only a chemical and not a resin was correctly classifiable under erstwhile tariff item 68. Further, in the new Tariff also the product was being classified in Chapter 29 (Chemicals) and not in Chapter 35 (Plastics and articles thereof). Since provisions of Rules 9 and 49 were not appli-

cable in this case, the input relief was not available under the Modvat scheme.

The Ministry of Finance have stated (December 1988) that the matter is being examined in consultation with the Ministry of Law.

**(IV) Incorrect availment of set off credit**

As per a notification dated 4 June 1979, excisable goods on which the duty of excise was leviable and in the manufacture of which any goods falling under tariff item 68 were used as inputs, were exempt from duty of excise as was equivalent to that already paid on such inputs. Availment of exemption was subject to observance of procedure set out in appendix to the said notification. This notification was rescinded on 1 March 1986 and set off of duty paid on erstwhile tariff item 68 inputs became inadmissible from that date.

As per para 2 of appendix to the notification of 4 June 1979, a manufacturer was allowed to take credit for the duty already paid on inputs received by him and to utilise it towards payment of duty of excise leviable on the goods for the manufacture of which these inputs were brought into the factory. Para 8 of the said appendix, however, required that if any inputs for which credit had been taken were not disposed of in the prescribed manner, the manufacturer was liable to pay duty leviable on such inputs within ten days of the notice of demand. Therefore, the quantity of inputs for which credit had been taken and which were lying in stock with the manufacturer on 28 February 1986, cannot be considered to have been used as raw material or component parts for the manufacture of goods eligible for exemption under the notification of 4 June 1979. Accordingly, credit for duty paid on inputs lying unutilised on 28 February 1986, was inadmissible and thus recoverable from the manufacturer.

Seventy one cases involving incorrect availment of credit of Rs.1.20 crores under

set off notification of 4 June 1979 which was rescinded from 1 March 1986, were noticed in fifteen collectorates in the course of test audit.

Three cases are given below:

(a) A manufacturer of food colours preparation in Bangalore Collectorate, was clearing his goods after availing set off of duty paid on inputs in terms of notification dated 4 June 1979. It was seen in audit (December 1987) that a balance of Rs.25,578 was left in R.G.23 account on 1 March 1986. The licensee continued to avail the set off credit even from 1 March 1986 and the total amount of credit wrongly availed till 21 September 1986 worked out to Rs.11,07,000. The Range Officer requested (25 March 1987) the licensee to pay back the aforesaid amount. However, no show cause notice was issued in this regard.

This was brought to the notice of the department in audit in December 1987. The department stated (July 1988) that every effort would be made to send the compliance as early as possible. Further progress has not been reported (December 1988).

(b) Two manufacturers in Calcutta I and Bolpur Collectorates, utilised set off credit amounting to Rs.2,32,914 even though the finished goods were no longer eligible for the exemption under the notification dated 4 June 1979 from 1 March 1986 nor were they covered under the Modvat scheme.

This was pointed out in audit in June and August 1987. The department's reply has not been received (August 1988).

The Ministry of Finance have not given any specific comments on these objections (December 1988).

**(V) Irregular availment of duty paid on inputs not admissible under Modvat scheme.**

Twenty nine miscellaneous cases of irregular availment of credit of Rs.98.48 lakhs on account of duty paid on inputs not admis-

sible under the Modvat rules were noticed in audit.

Some of these cases are categorised below:

(i) Utilisation of inadmissible credits

(a) The exemption available under a notification issued on 1 March 1983 to specified inputs used in the manufacture of specified outputs was withdrawn with effect from 1 March 1986 except for certain commodities namely 'glucose dextrose and calcined petroleum coke'.

A unit in Bombay III Collectorate, availed set off of duty paid on electrical stampings and laminations used in the manufacture of electric motors during the period from March 1986 to June 1986 in terms of the said notification of March 1983; thereafter he availed Modvat credit in respect of duty paid on inputs. As the aforesaid notification of March 1983 was amended in March 1986 so as to exclude the electric motors from its purview, the grant of set off of Rs.13.91 lakhs after the said amendment was irregular.

On the mistake being pointed out in audit (June 1987), the department accepted (November 1987) the objection on technical ground. It added that the benefit was available as per another notification issued in March 1986 read with Rule 57A which was nothing but continuation of Rule 56A.

The contention of the department is not acceptable as the assessee did not comply with the provisions of Rule 57G(1) upto 19 June 1986 and was, therefore, not entitled to avail of the credit of duty paid on inputs under provisions of Rules 57 A.

(b) With the withdrawal of Modvat facility in respect of aerated waters (Chapter 22) from 1 October 1987 credit relating to the unutilised quantity of inputs, lying in stock on that date should have lapsed.

An aerated water factory in Calcutta II Collectorate had, however, already utilised credit amounting to Rs.10,13,200 re-

latable to the stock of inputs lying unused on 1 October 1987.

When this was pointed out in audit (October 1987), the department reported (December 1987 and March 1988) that a demand for Rs.10,06,052 has been raised. Particulars of realisation have not been intimated (August 1988).

(c) Another manufacturer of aerated water in Chandigarh Collectorate availed Modvat credit of Rs.1.93 lakhs on 3,86,920 bottles of aerated water cleared from 1 October to 29 October 1987. The department issued show cause-cum demand notice for Rs.1.93 lakhs on 17 November 1987 and the Assistant Collector confirmed the demand on 4 February 1988 upon which the licensee went in appeal on 7 March 1988 without pre depositing the amount of duty involved and without obtaining permission of the jurisdictional officer. Results of appeal have not been intimated (December 1988).

The cases at (a), (b) & (c) above were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

(ii) Delay in adjustment of credits disallowed

As per Rule 57 I the credit on inputs wrongly taken may be disallowed by the proper officer and the amount so disallowed is to be adjusted in the credit account or account current maintained by the manufacturer. If no such adjustment is possible for any reason, the amount is recoverable in cash from the manufacturer. Penal action under Rule 173(bb) is also attracted where the manufacturer violates the provisions of Modvat rules.

(a) In two cases in Cochin Collectorate, an amount of Rs.15.31 lakhs being the credits disallowed by the department, was not adjusted in the assessee's personal ledger account or recovered in cash. Penal



action was also not initiated.

The Ministry of Finance have stated (December 1988) that the duty from both the assesseees have been recovered.

(b) A manufacturer of hydraulic excavators declared (9 March 1986) chapter headings in respect of inputs and finished goods for availing Modvat facility. The declaration was amplified on 11 August 1986 by the manufacturer. The Assistant Collector of Central Excise concluded that the description of inputs given by the manufacturer was inadequate and issued a show cause notice on 8 October 1987.

The manufacturer contended that furnishing of chapter headings would be sufficient for availing Modvat credit. The case was adjudicated and a demand for Rs.20.41 lakhs on account of irregular taking of credit and its utilisation of credit during the period from February 1986 to May 1987 was raised. In addition the department also did not permit the utilisation of Rs.5.55 lakhs on account of irregular credit of duty taken in Modvat account. As the balance in Modvat account on 1 January 1988 was Rs.11.12 lakhs only, the manufacturer irregularly utilised excess credit of Rs.14.84 lakhs (Rs.20.41 lakhs + Rs.5.55 lakhs - Rs.11.12 lakhs).

The matter was reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

(iii) Irregular availment of credit on inputs lying in stock

Sub-rule (1) of Rule 57H as amended vide notification dated 1 March 1987 stipulates that the Assistant Collector may allow credit of duty paid on inputs received by a manufacturer before filing a declaration under Rule 57 G, if he is satisfied that:

- Such inputs are lying in stock or are received in the factory, on or after 1 March 1987, or
- Such inputs are used in the manufacture of final products which are cleared from the factory on or after 1 March 1987.

Moreover, on the analogy of the Government of India clarification dated 10 April 1986, to point no.6, if the inputs were lying in stock on or received after 1 March 1987 or the final products lying in stock, no credit shall be allowed if duty was paid on the inputs before 1 February 1987.

Two manufacturers of aerated water in Chandigarh Collectorate, took credit of Rs.25.51 lakhs from March 1987 to September 1987 of which Rs.12.33 lakhs represented credit in respect of duty paid on inputs lying in stock on 1 March 1987 without obtaining specific permission of the Assistant Collector. Moreover, credit of Rs.4.99 lakhs out of Rs. 5.39 lakhs taken by one manufacturer on 2 March 1987 was not admissible as that amount related to duty paid on such inputs before 1 February 1987. Similar details of credits of Rs.6.93 lakhs and Rs.13.19 lakhs taken in June and September 1987 respectively, were not made available to Audit. The irregularity remained undetected by the department (April 1988).

The Ministry of Finance have stated (December 1988) that Rule 57A does not contemplate any condition that for taking modvat credit on the inputs, the duty ought to have been paid on or after 1 February 1987. The fact, however, remains that the reply of the Ministry is contrary to their own clarification dated 10 April 1986.

(iv) Procedural irregularity with revenue implications

As per a notification issued on 1 March 1986, the effective rate of duty on copper sheets was Rs.1,200 per tonne provided no credit of duty paid on the inputs had been taken under Rule 56-A or Rule 57-A. Copper sheets were leviable to duty at Rs.4,500 per tonne if such credit on input had been availed.

There is no provision in the rules to permit an assessee to work with and without the benefits of Modvat scheme simultaneously.

An assessee in Ahmedabad Collec-

torate, who had opted for the Modvat scheme on 13 May 1986, was permitted to clear copper sheets on payment of duty at the rate of Rs.1200 per tonne instead of Rs.4,500 per tonne. Subsequently, from 27 October 1987 he cleared his product partly with Modvat benefits on payment of duty at the rate of Rs.4,500 per tonne and partly without Modvat benefits to duty at the rate of Rs.1,200 per tonne simultaneously. The irregularity resulted in short levy of central excise duty of Rs.6,87,298.

On this being pointed out in audit (January 1987), the department intimated (January 1988) that a demand has since been raised.

The case was sent to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

(v) Incorrect availment of Modvat credit of duty other than excise duty and counter-vailing duty paid on inputs

The Modvat scheme provides for taking credit of excise duty or the additional duty of customs paid on inputs and the utilisation of such credit towards payment of basic excise duty on final products in or in relation to the manufacture of which those inputs were used. No Modvat credit is allowed on account of any other duties paid on inputs.

(a) A manufacturer in Baroda Collectorate, used imported waste paper in the manufacture of paper and paper board. He irregularly took credit of customs basic duty amounting to Rs.4,86,812 paid by him on imported waste paper, out of which he utilised Rs.2,45,263 for payment of duty on paper and paper board.

On this being pointed out in audit (September 1987), the Collector accepted the objection and raised the demand (January 1988).

The case was reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

(b) A manufacturer of bubblegum in Madras Collectorate, availed Modvat credit of additional excise duty paid on sugar (input) from March 1987 to February 1988. This was irregular.

On this being pointed out in audit (March 1988), the department expunged the whole irregular credits of Rs.87,400 in March 1988.

The Ministry of Finance have confirmed the facts (December 1988).

(vi) Removal of inputs without permission

According to sub-rule (1) (iv) of Rule 57F, the input in respect of which a credit of duty has been allowed under Rule 57A may be removed subject to the prior permission of the Collector of Central Excise from the factory for home consumption or for export on payment of appropriate duty of excise or for export under bond without payment of duty, if such inputs have been manufactured in the said factory.

A manufacturer of iron and steel in Chandigarh Collectorate deducted 58.225 tonnes of ferro maganese and 33 tonnes of ferro silicone from the RG- 23A (PartI) account during the period from 1 April 1986 to 17 December 1986 of which credit had already been taken in RG 23A (PartII) account on respective dates and transferred it to another unit without payment of duty leviable thereon and without prior permission of the Collector of Central Excise. Since the inputs were used by the manufacturer other than the one who initially procured them in contravention of the provisions of the rule *ibid*, the credit of Rs.1.11 lakhs taken by the licensee who procured the inputs in the first instance, was not admissible to him and has not been objected to by the department (April 1988).

The Ministry of Finance have stated (December 1988) that a demand for Rs.1.11 lakhs was confirmed but on the appeal by the party, the Collector (Appeals) directed the party to make debit in RG23A of unit I and

take credit in RG23A of unit II of the same party. The reply of the Ministry is silent on the inadmissibility of the credit to unit II under the provisions of the rule *ibid*.

**(VI) Irregular availment of credit without production of proper duty paying documents**

Under the first proviso to sub-rule (2) of Rule 57G, credit of duty can be taken if the inputs at the time of their receipt in the factory are accompanied by any other documents besides G.P.I., A.R.I. or Bill of Entry as may be prescribed by the Central Board of Excise and Customs evidencing payment of duty. Third proviso to sub-rule (2) *ibid* provides that the manufacturer availing of Modvat credit should take all reasonable steps to ensure that the inputs received by him are goods on which appropriate duty as indicated in the documents accompanying the goods, has been paid.

Government have prescribed that a certificate in lieu of original gate pass (subsidiary gate pass) may be accepted as a document evidencing payment of duty on the inputs received by a manufacturer. The subsidiary gate pass may be issued by the concerned Range Officer where the original manufacturer retains the entire consignment covered by a gate pass in his own duty paid godown and thereafter sends parts of consignment to the manufacturers working under Modvat scheme.

The serially numbered subsidiary gate pass should contain inter-alia particulars of number and date of the original gate pass under which the goods were initially cleared from the factory on payment of duty. A note should also be recorded in the subsidiary gate pass that the fact of issue of subsidiary gate pass has been noted in the original gate pass. Non-indication of the above facts would render the document as not evidencing payment of duty.

Seventy six cases involving irregular

availment of Modvat credit of Rs.75.24 lakhs without production of proper duty paying documents were noticed in nineteen collectorates in the course of test audit. Out of these, Rs.18.67 lakhs have been recovered. The Ministry of Finance have not denied the facts (December 1988).

Some of these cases are given below:

(a) Twelve assesees in Nagpur Collectorate, availed credit of duty paid on inputs to the extent of Rs.18,17,182 but no supporting duty paying documents were produced to Audit. In three cases the demands for Rs.9,99,220 were confirmed.

(b) Two manufacturers of iron and steel products in Patna Collectorate, received steel scraps from a motor vehicle factory and availed credit of duty paid thereon on the strength of subsidiary gate passes issued by the Range Superintendent of the supplier factory, which did not contain number and date of original gate pass under which scraps were cleared from the suppliers factory on payment of duty. A note to the effect 'that the subsidiary gate passes have been issued has been made in the original gate pass', was also not recorded in the subsidiary gate passes which did not indicate payment of duty on the scrap.

(c) Five manufacturers in Madras Coimbatore and Trichy Collectorates, took credits amounting to Rs.7,20,471 during the period from July 1986 to December 1987 on the basis of documents evidencing no payment of duty.

On the irregularity being pointed out in audit (June, November and December 1987 and March 1988), the department accepted the objections in all the five cases and reported recovery of Rs.3,61,463 in three cases. Particulars of recovery in remaining two cases have not been given (August 1988).

(d) Five manufacturers in Allahabad Collectorate, took credit of Rs.4,88,210 during the period from March 1986 to September

1987 either on the basis of photocopies of duty paying documents or without any document, which was irregular.

On the mistake being pointed out in audit, the department recovered the irregular credits of Rs.2,66,364 in two cases in July and December 1987 and issued show cause-cum demand notice amounting to Rs.35,175 in May 1987 in the third case. Further progress in the latter case and department's replies in the remaining two cases have not been received (June 1988).

(e) Three manufacturers in Calcutta I and II Collectorates, took credit of Rs.3,88,820 where duty paying documents were not available.

On this being pointed out in audit (November 1986, March and November 1987), the department reported (May 1987 and February 1988) recovery of Rs.1,46,267 in two cases. Reply in the third case has not been received (August 1988).

(f) Three manufacturers in Indore Collectorate, availed Modvat credit of Rs.3,43,554 on the basis of documents evidencing no payment of duty.

On the mistake being pointed out in audit, the department accepted the objection and recovered the whole amount (February, August, September and November 1987).

(g) A manufacturer of wires and cables in Delhi Collectorate, purchased copper wire of 0.91 mm thickness as inputs during March-April 1986 without payment of duty, but took Modvat credit of Rs.1.82 lakhs thereon.

On this being pointed out in audit, the credit was reversed in November 1987.

(h) An assessee in Bhubaneshwar Collectorate, was purchasing polyethelene from M/s I.P.C.L. and taking Modvat credit on the basis of certificates issued by the M/s I.P.C.L. evidencing payment of duty. A comparison of the certificates and the credits taken in Modvat account revealed that the assessee took an excess credit for Rs.96,110

over the amounts certified by M/s I.P.C.L. during the period from 26 April 1986 to 1 February 1987.

(i) Another assessee in the Bhubaneswar Collectorate, took credit of Rs.2,13,774 on 20 September 1986. However, the documents evidencing payment of Central Excise duty were not produced to audit.

The cases at (a) to (i) were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

#### **(VII) Irregular availment of credit on inputs not covered under Modvat scheme**

As per Rule 57A credit of duty paid on specified inputs is permitted to be utilised for payment of duty on specified finished excisable goods. The inputs for which Modvat credit is admissible, was specified by a notification issued on 1 March 1986.

Fifty nine manufacturers in twelve collectorates, producing different commodities incorrectly availed during the period from 1 March 1986 to 31 December 1987 Modvat credits of Rs.64.48 lakhs on account of duty paid on inputs which were not specified under the Modvat scheme. Out of this, availment of incorrect credit of Rs.7.24 lakhs in twenty cases has already been accepted by the Ministry of Finance/the Central Excise department.

Some of these cases are given below:

(a) Fifteen manufacturers in Ahmedabad Collectorate, availing Modvat credit received linear alkyl benzene (Chapter 27). Since Chapter 27 was not specified as an input in the Modvat scheme, the credit of duty paid on input linear alkyl benzene was not admissible. Subsequently, the input was retrospectively reclassified under Chapter 38 (a chapter included for input credit under the scheme) and the manufacturers took credit of initial duty paid under Chapter 27 and the differen-

tial duty paid as a result of reclassification of input. The irregular Modvat credit allowed worked out to Rs.11,25,685. On this being pointed out in audit, the department initiated action to recover the amount.

Neither the Ministry of Finance nor the Central Excise department has intimated further developments of the case (December 1988).

(b) An assessee in Baroda Collectorate manufacturing dry battery cells, received ammonium chloride falling under Chapter 31 as input and took Modvat credit of Rs.2,04,175 during the period from 1 March 1986 to 28 July 1986, in his credit account maintained under Modvat rules. Chapter 31 was not covered by the Modvat scheme prior to 29 July 1986. The said Chapter 31 was added by a notification issued on 29 July 1986. The Modvat credit availed on input 'ammonium chloride' amounting to Rs.2,04,175 during the period from 1 March 1986 to 28 July 1986 was, therefore, irregular.

The objection was pointed out to the Central Excise department in March 1988 and to the Ministry of Finance in September 1988. Their reply has not been received (December 1988).

(c) A manufacturer of aerated waters, sweet drinks and fruit juices (Chapter 22) in Madras Collectorate was availing credit of duty paid on inputs for payment of duty on final products. On 1 October 1987 (the date of withdrawal of Modvat facility from their products) the input relief availed in respect of the stock of inputs on that date, amounted to Rs.1,97,684 whereas the balance of credit available in the credit account was only Rs.1,28,141. In addition to expunging this credit of Rs.1,28,141, the department should have demanded excess utilised amount of Rs.69,543 (Rs.1,97,684 minus Rs.1,28,141) also.

The omission to collect this amount was pointed out in audit to the Central Excise department in February 1988 and to the

Ministry of Finance in September 1988. Their reply has not been received (December 1988).

(d) A public sector steel plant in Indore Collectorate, irregularly availed Modvat credits to the extent of Rs.1,31,497 on iron ore pellets procured during the period from 18 February 1986 to 1 April 1986. The iron ore pellets (Chapter 26) were neither specified as input under notification dated 1 March 1986 at the time of procurement of pellets nor when the declaration was filed with the jurisdictional Assistant Collector on 31 March 1986.

On this being pointed out in audit (January 1988), the department stated that the assessee was not following the correct procedure and, therefore, entire credits were being disallowed. The fact, however, remains that the manufacturer derived undue financial accommodation by utilising the credits which were not at all admissible.

The Ministry of Finance have stated (December 1988) that the amount of Rs.1,31,497 has been recovered in February 1988.

#### **(VIII) Incorrect availment of Modvat credit due to errors, omission etc.**

In terms of sub rule (3) of Rule 57F credit of duty allowed in respect of any input may be utilised towards payment of duty of excise:

(i) On any of the final products in or, in relation to the manufacture of which such inputs are intended to be used in accordance with the declaration filed under sub-rule (1) of Rule 57G; or

(ii) On the waste, if any arising in the course of manufacture of the final products; or

(iii) On the inputs themselves if such inputs have been permitted to be cleared under sub rule (1). Sub rule (5) *ibid* further provides that no part of the credit of duty allowed shall be utilised save as provided in Sub rule(3)

Twenty cases of irregular availment of Modvat credit of Rs.49.97 lakhs due to errors and omissions etc. were noticed in eight collectorates in the course of test audit.

Some of the cases are given below:

(a) A manufacturer of tyres and tubes in Jaipur Collectorate took Modvat credit of duty paid on inputs received from 1 March 1986.

It was noticed in audit (November-December 1987) that the unit utilised the credits taken under Modvat Scheme for discharging pre-March 1986 duty liabilities amounting to Rs.18,25,925 on rubber, bladders, tyres and tyre cord fabrics.

On the irregularity being pointed out in audit (January 1988), the department stated (February 1988) that the entire amount was paid by the unit on 27 February 1988.

(b) A manufacturer in Belgaum Collectorate declared caustic soda, aluminium flouride, sulphuric acid and aluminium hydroxide as inputs for the manufacture of aluminium hydrate and calcined alumina. It was, however, seen in audit that the inputs relevant to alumina hydrate were caustic soda, lime, aluminium flouride and sulphuric acid; and to calcined alumina was alumina hydrate.

The Modvat credit in respect of caustic soda lye, aluminium flouride and sulphuric acid could not therefore, be utilised for payment of duty on calcined alumina as these inputs were not directly used in the manufacture of calcined alumina. But were used in the process of manufacture of alumina hydrate which was cleared at 'nil' rate of duty. The irregular credit so availed during April 1986 and May 1986 amounted to Rs.15,13,809.

On this being pointed out in audit (September 1986), the department reported (March 1988) the confirmation of the demand. Recovery particulars have not been intimated (August 1988).

(c) Two manufacturers in Delhi Collec-

torate, irregularly availed of Modvat credit of Rs.8,34,866 during June 1986 to December 1987 on rejected/defective final products received back into the factory.

On the irregularity being pointed out in audit (June 1987 and June 1988), the department issued (January 1988) show cause notice for Rs.60,385 in one case; action taken in the other case has not been reported (August 1988).

(d) A small scale unit in Madras Collectorate, manufacturing flexible films, sheets and foils availed of in April 1987 Modvat credit of Rs.2,83,419 on the imported input 'low density polythene granules' as against the countervailing duty of Rs.1,01,841 actually paid.

On the excess availment of credit being pointed out in audit in February 1988, the department accepted the objection and reported (March 1988) payment of Rs.1,81,577 by the assessee on account of excess credit.

(e) A manufacturer in Delhi Collectorate, availed Modvat credit of duty paid on motors, aluminium blades, down rods etc. brought into the factory for assembling them into ceiling fans. He cleared some of the damaged inputs as scraps after payment of duty under Rule 57F(4).

This was irregular as those inputs were received damaged and duty of Rs.1,73,665 (equivalent to the credit availed under Rule 57A) was correctly payable on them under Rs.57-F(1)(ii).

On this being pointed out in audit, the department contended (March 1988) that Rule 57F(1)(ii) was not applicable as the waste arose in the course of manufacturing electric fans, it was covered under Rule 57F(4). The fact, however, remains that damaged inputs can neither be treated as processing waste, nor is the case covered under Rule 57F(1) or Rule 57F(4). As such credit availed on the inputs was required to be reversed in full.

(f) A unit in Jaipur Collectorate, manufacturing chassis fitted with engine for motor vehicles took Modvat credit of Rs.1,28,700 in respect of the duty paid on tyres, tubes and flaps (inputs) twice, once on the basis of photo copy of the gate pass and again on the basis of its original copy.

On the irregularity being pointed out in audit (November/December 1987), the department admitted the objection and stated (May 1988) that the amount of Rs.1,28,700 has been adjusted on 23 December 1987.

(g) An assessee in Bombay-III Collectorate, procured inputs at 'nil' rate of duty, but irregularly availed Modvat credit of Rs.1,21,044 thereon during the period from March 1986 to June 1986.

On the irregularity being pointed out in audit (October 1987), the department admitted the objection and recovered the whole amount (May 1988).

(h) An assessee in Bombay II Collectorate, engaged inter alia in the manufacture of panels, cladding sheets, steel furniture etc., availed Modvat credit of specified duties paid on various inputs that were used in the manufacture of final products. In respect of two consignments of inputs received in July 1987 and August 1987, the assessee took the assessable values shown in the Gate Passes (Rs.1,12,570 and Rs.18,940) as credit amounts of duty paid instead of the actual amounts of the duties (Rs.22,514 and Rs.3,788) paid on the inputs. This resulted in availment of excess credit of Rs.1.05 lakhs.

On this being pointed out in audit (March 1988), the Collector intimated (July 1988) that the excess credit availed of by the assessee had been reversed in March 1988.

The cases from (a) to (h) were reported to the Ministry of Finance in September 1988. The Ministry have stated (December 1988) that the case in sub para (b) is pending decision with the CEGAT and the duty involved in the case in sub para (d) has been recovered. Their reply in the remaining cases

has not been received.

**(IX) Availment of higher credit on account of concessional duty paid by the big manufacturers to their own newly established units**

Rule 57B allows credit of duty which may be in excess of the duty actually paid on the inputs produced by S.S.I. units. This facility is available in respect of specified inputs manufactured by S.S.I. units covered under notification dated 1 March 1986. With a view to avail this facility of the maximum advantage many major units seem to have started after 1 March 1986 many small scale units for supply of inputs solely to their requirements. In some other cases major units entered into contracts with small scale units for supply of major quantity of inputs produced by them either by supplying raw materials on job work basis or otherwise thereby cornering the benefits for themselves.

(a) Thirty five new small scale units were started from 1 March 1986 or 1 March 1987 for supplying goods to twenty four major units in Hyderabad Collectorate alone. The test audit of accounts of four of those twenty four major units revealed availment of additional higher Modvat credits amounting to Rs.41.57 lakhs by them.

(b) A private limited company in Calcutta I Collectorate, procured bare aluminium wire during the period December 1986 to July 1987 from a small scale partnership firm by paying concessional duty amounting to Rs.6,75,657 and took credit of Rs.13,49,469 (at the normal rate). The partnership firm and the company had common head office. Further one of the partners of the firm was director of the company. The firm obtained Central Excise licence in December 1986 and surrendered it in December 1987 after supplying the entire quantity of bare aluminium wires manufactured by it, to the company. It seems the company obtained a benefit of Rs.6,73,810 in the shape of higher credit

by resorting to the means of setting up a small scale unit.

This was pointed out to the department in March 1988.

The Ministry of Finance have stated (December 1988) that the dummy units established by big units will not be eligible for benefits for small scale units if this fact can be established. The Ministry have, however, not intimated the action taken in the specific cases pointed out in audit.

#### (X) Transitional provisions

As per Rule 57H as amended read with Rules 57F and 57G, credit of the duty paid on inputs received by a manufacturer can be allowed to him before filing a declaration provided the Assistant Collector of Central Excise is satisfied that such inputs were lying in stock or were received in the factory on or after 1 March 1986 or such inputs were used in the manufacture of final products cleared from the factory on or after 1 March 1986. No credit shall be allowed if duty had been paid on the inputs on or before 31 January 1986.

(a) Irregular availment of Modvat credit on inputs which discharged duty prior to 1 February 1986.

It was noticed in audit that Modvat credit amounting to Rs.41.17 lakhs on account of duty which was paid on inputs prior to 31 January 1986, was availed in one hundred and one cases in fifteen collectorates. Out of this availment of irregular credit of Rs.9.39 lakhs in eleven cases has already been accepted by the Ministry of Finance in December 1988.

Four of these cases are given below:

(i) A unit in Jaipur Collectorate was irregularly allowed credit of duty amounting to Rs.6,82,155 paid on copper weighing 206.714 tonnes lying in stock as on 1 August 1984 for use in manufacturing print rolls and sections. On this being pointed out by Audit vide para 2.62(vi) of Audit Report 1985-86,

the amount was debited by the assessee in Personal Ledger Account in August 1986.

In August 1986, the unit again applied for taking credit of the same amount stating that they were holding the aforesaid balance in stock on 1 March 1986 and had not availed proforma credit earlier. The credit of Rs.6,82,155 was allowed by the department and was taken by the unit on 2 September 1986. This was irregular as the duty on inputs had been paid prior to 31 January 1986 and inputs were not in stock on 1 March 1986. The credit was also not allowable under any rule or notification which existed prior to 1 March 1986.

On the matter being pointed out in audit (May 1987) the department accepted the objection and confirmed the demand of Rs.6,82,155 in December 1987. Recovery particulars have not been intimated (August 1988).

(ii) A manufacturer of copper and aluminium rectangular conductors in Madras Collectorate, was irregularly allowed Modvat credit of Rs.3,61,218 on account of countervailing duty paid on inputs (erstwhile tariff item 68) prior to 1 February 1986. When this was pointed out in audit (June/September 1987), the department accepted the objection (July/October). Realisation particulars have not been intimated (June 1988).

(iii) Another manufacturer of machinery parts in Baroda Collectorate was permitted to avail of Modvat credit of duty paid on inputs on which duty was paid prior to 1 February 1986. The incorrect credit allowed amounted to Rs.2,60,446.

On this being pointed out in audit, the department recovered Rs.2,60,446 on 18 September 1987.

(iv) Two manufacturers in Calcutta I and Calcutta II Collectorates, availed credit of Rs.2,64,674 for inputs on which duty was paid prior to 1 February 1986.

On this being pointed out in audit (June and November 1987), the department



reported (January 1988) the realisation of Rs.1,87,030 in one case from the assessee (October 1987). Reply has not been received in the second case.

(b) Irregular availment of Modvat credit in respect of inputs not in stock on 1 March 1986.

(i) A manufacturer of lead oxide in Calcutta II Collectorate, took credit of duty paid on lead (input) received by him in February 1986 instead of on the quantity lying in stock on 1 March 1986, resulting in availment of excess credit of Rs.1,76,606.

On this being pointed out in audit (September 1987), the department stated (February 1988) that a show cause cum demand notice for Rs.1,76,606 had been served on the assessee in December 1987. Further progress has not been reported (August 1988).

(ii) The transitional provisions contained in Rule 57H did not also permit a manufacturer to take credit on inputs received on or after 1 April 1986.

A manufacturer of motor vehicle parts, filed a declaration for availing Modvat scheme on 29 March 1986. Subsequently, the assessee intimated (26 August 1986) that he had started working under Modvat scheme from 1 July 1986 and sought permission to take credit of duty paid on inputs lying in stock on 30 June 1986.

The department permitted the assessee to take credit of Rs.6,09,083 which included an irregular credit of Rs.2,93,101 on account of duty paid on inputs during the period from 1 April 1986 to 30 June 1986.

The cases at (a)(i) to a(iv) and b(i) to b(ii) above were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

**(XI) Simultaneous availment of Rule 56A credit and Modvat credit in respect of items not covered by Modvat**

In terms of Rule 56A(9) of the Central Excise Rules, 1944 as it existed prior to 15 April 1987, a manufacturer who opted for Modvat scheme, was not eligible for Rule 56A credit even in respect of items which were not covered under Modvat scheme.

It was noticed in audit that in twelve cases in six collectorates the assessee who opted for availment of Modvat credit, also simultaneously availed Rule 56-A credit of Rs.30.21 lakhs during the period from 1 March 1986 to 14 April 1987, which was not in order. Out of this irregular credit for Rs.1.29lakhs in two cases has been expunged. The Ministry of Finance have agreed with Audit in principle (December 1988).

Some of these cases are given below:

(a) A manufacturer of oxygen in Calcutta-I Collectorate, availed Modvat credit on inputs like soda, acetone and calcium carbide from 1 March 1986 and also availed credit of duty of Rs.18,21,179 paid on inputs like liquid oxygen dissolved acetylene under Rule 56A during the period 1 March 1986 to 25 November 1986. Similarly another manufacturer of plywood under Calcutta II Collectorate, simultaneously availed Modvat credit and credit under Rule 56 A amounting to Rs.2,99,947 on inputs like wood veneer during the period from 1 March 1986 to 14 April 1987.

When this was pointed out in audit (March and August 1987) the department contended (January 1988) in first case that simultaneous credit was allowable in terms of sub-rule (8) of Rule 56A which had overriding effect and to remove doubt sub-rule (9) was amended on 15 April 1987. The de-

partmental reply in the first case is not in conformity with clarification circulated by the Central Board of Excise and Customs in July 1986. In the second case, the department accepted the objection and intimated (March 1988) that the Superintendent concerned had been instructed to raise demand. Further developments of the case have not been intimated (August 1988).

(b) A manufacturer of coffee, metal cans, milkmaid, tomato ketchup in Chandigarh Collectorate who opted for availment of Modvat credit of duty paid on inputs used in the manufacture of metal cans from March 1986 onwards, also took Rule 56-A credit of Rs.4,49,984 on account of duty paid tomato pulp during the period from April 1986 to February 1987, and utilised it towards payment of duty on tomato ketchup. The utilisation of proforma credit of Rs.4,49,984 under Rule 56A was, inadmissible.

On the irregularity being pointed out in audit the department stated (March 1988) that the sub rule (9) cannot stop an assessee from availing credit of duty under Rule 56A. The same is not correct, in view of provision of Rule 57A.

(c) A manufacturer in Calcutta I Collectorate availed himself of full exemption on the clearances of copper winding wires from April 1986 to June 1986 under the notification dated 10 February 1986. Later on, the assessee started availing MODVAT credit on copper wire rods from July 1986 and cleared the same product in two ways viz. (i) on payment of concessional rate of duty under Small Scale exemption notification issued on 1 March 1986 by availing Modvat credit; and (ii) without payment of duty and not availing Modvat credit on copper wire rod.

It was pointed out in audit that there is no provision in the notification that for the same product full exemption can be taken for part of the production and other part can be cleared on payment of concessional rate of duty under small scale exemption. The

incorrect application of the notification resulted in short levy of duty for Rs.1.27 lakhs on the clearances of copper winding wires during the period from July 1986 to March 1987.

The department while not accepting the audit objection stated (October 1987) that it has not been stipulated anywhere in the notification dated 10 February 1986 as amended that only one rate of central excise duty should be made applicable to copper winding wires at a particular period of time when the other conditions are fulfilled. Even the inputs used in the manufacture of such goods are of two types i.e. one on which no Modvat has been taken and the other on which Modvat has been taken.

The stand of the department is not acceptable in view of the Ministry's clarification issued on 25 July 1986 on point 19 that since there is no one to one correlation between the inputs and final products under the Modvat scheme, it would not be possible to allow a manufacturer to avail of Modvat for some of the products and full exemption for others under the small scale exemption scheme simultaneously.

The above cases were reported to the Ministry of Finance in September 1988. The Ministry have stated (December 1988) that the facts of the case in sub para (b) was being ascertained. Their reply in the remaining cases has not been received.

#### **(XII) Credit irregularly allowed on goods other than declared goods or against wrong declaration**

As per sub-rule (3) of Rule 57F of the Central Excise Rules, 1944, credit of specified duty allowed in respect of any inputs may be utilised towards payment of Central Excise duty on any of the final products in or in relation to the manufacture of which such inputs are intended to be used. Clause (3) of sub rule (3) *ibid* prohibits utilisation of credit taken on inputs not indicated in the declaration.

(i) Twenty eight cases involving irregular availment of credit of Rs.19.23 lakhs of duty paid on inputs which were not mentioned in the declaration were noticed in six collectorates in the course of test audit. The Ministry of Finance have not denied the facts (December 1988).

Some of these cases are given below:

(a) A manufacturer of air filters, regulators, lubricators, filter-regulators combination units, filters with lubricators and oil removal filters (Sub-heading 8481.80) in Bangalore Collectorate, filed declaration to avail credit of duty paid on inputs on 31 March 1986. It was noticed in audit (December 1987) that the assessee had furnished a consolidated list of inputs and final products in the aforesaid declaration without indicating details of inputs used in each of the final products as required under Rule 57G.

It was pointed out (January 1988) in audit that as the declaration filed by the assessee was defective availment of credit of duty amounting to Rs.3,44,311 till the end of October 1987 was irregular. The department has not sent any reply (April 1988).

(b) A manufacturer of mopeds (heading 87.11) in Patna Collectorate irregularly utilised the credit of duty paid on internal combustion engine which was not indicated as input in the declaration submitted by him on 15 March 1986. This resulted in irregular availment of credit amounting to Rs.2,74,258 during the period from November 1986 to October 1987.

(c) A manufacturer of ink (sub heading 3215.00) and adhesive paste (sub heading 3501.90) in Bombay I Collectorate, declared aluminium and zinc chlorides (Chapter 28) as inputs for the manufacture of adhesive paste. However, for payment of duty on adhesive paste not only did the assessee utilised credit of duty paid on aluminium and zinc chlorides, but also utilised the credit of duty paid on carbon black and other inputs which were used for the manu-

facture of ink and not adhesive paste. This resulted in irregular utilisation of credit of Rs.2,06,437 during the period from May 1986 to August 1986.

This was pointed out in audit in July 1987. The assessee paid the amount in February 1988.

These cases were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

(ii) Eighteen cases of availment of irregular credit of Rs.55.47 lakhs of duty paid on inputs which were not actually used in the declared output were noticed in six collectorates in the course of test audit. The Ministry of Finance have not denied the facts (December 1988).

Some of these cases are given below:

(a) A manufacturer of PVC resins in Coimbatore Collectorate availed credit of countervailing duty paid on imported thermax transfer oil which was used to transfer heat from the boiler to other parts of the machinery producing PVC resin and not as an input in the manufacture of the final product. As the input 'thermax transfer oil' was intended for transfer of heat from the boiler to other parts of the machinery only and was not used as an input for the manufacture of PVC resin, the availment of Modvat credit of Rs.1,70,138 during the period from 1 March 1986 to 15 July 1987 was irregular. This was pointed out in audit during December 1986 and again through a statement of facts in April 1987. The Ministry of Finance have stated (December 1988) that the party has contested the objection. They have, however, not given any reasons and their views in this regard.

(b) Another manufacturer of fuse gear, fuse switches, etc. in Coimbatore Collectorate, availed a total credit of Rs.1,21,544 in December 1986 on the duty paid on 'fuse gears' manufactured by him and sent to his sister unit which were subsequently returned

to the first factory. As the goods were originally manufactured by the assessee as finished products and as they were neither used as inputs in any of the final products manufactured nor mentioned as inputs in the declaration filed under Rule 57G of the Central Excise Rules 1944, the availment of the credit was not in order.

When this was pointed out in audit (February 1987), the department accepted the objection (July 1987/October 1987) and got recovered Rs.1,21,544 on account of irregular credit on 30 December 1987.

The Ministry of Finance have confirmed the facts (December 1988).

(c) An assessee in Bombay III Collectorate, brought duty paid aluminium ingots into his factory, produced aluminium wire rods from them and cleared such rods (sub-heading 7603.10) on payment of duty of Rs.2,900 per tonne after availing of Modvat credit of duty paid on ingots. The assessee also manufactured wire rods on job work basis for a company which supplied aluminium ingots on delivery challans without accompanying of gate passes, in respect of which no credit either under Rule 56A or Rule 57A was taken and the finished goods were cleared on payment of duty of Rs.258.50 per tonne in terms of a notification issued in March 1986. Those wire rods which attracted duty at concessional rate of Rs.258.50 per tonne were cleared after utilising the credit of duty taken on aluminium ingots brought under duty paying document viz. gate passes. The utilisation of Modvat credit for clearances of such finished products in the manufacture of which duty free ingots on which Modvat credit was taken were used, was not in order. During the period from August 1986 to March 1987, the irregular utilisation of credit amounted to Rs.1.18 lakhs.

On this being pointed out in audit (November 1987), the collectorate accepted the objection and stated (March 1988) that the concerned Assistant Collector has been directed to regularise the case.

The matter was reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

**(XIII) Non expunging of Modvat credit on inputs which were either not received or which were not used in the final product**

As per Rule 57A credit of duty paid on specified inputs is allowed if such inputs are used in or in relation to the manufacture of specified final products and the same may be utilised towards the payment of duty of excise leviable thereon on the final product.

As per a clarification dated 1 July 1986 of the Central Board of Excise and Customs surplus Modvat credit, if any, will have to lapse.

Twelve cases of irregular availment of credit of Rs.20 lakhs due to non expunging of credit on inputs not actually received or not actually utilised were noticed in six collectorates in test audit. The Ministry of Finance have not denied the facts (December 1988).

Some of these cases are given below:

(i) Four manufacturers in Calcutta I & II Collectorates, utilised surplus credit of Rs.16,36,546 for payment of duty on finished products, in the manufacture of which the declared inputs were not used.

The irregularities were pointed out in audit (June, July, November and December 1987). In one case the department intimated (February 1988) that a demand for Rs.2,70,350 had been raised. In two other cases it contended (February and March 1988) that rule did not call for one to one correlation between the inputs used and the final products manufactured. The said contention is, however, against the aforementioned clarification. Reply in the fourth case has not been received (August 1988).

(ii) A manufacturer of scooters in Pune Collectorate, availed Modvat credit of

Rs.1,49,534 on account of duty paid on inputs which were found short. Since under Rule 57A, credit of duty paid on inputs was available only if they were used in or in relation to the manufacture of final product, the availment of credit of duty paid on inputs found short was irregular.

On this being pointed out in audit (November 1987), the department accepted the objection and stated (May 1988) that a show cause-cum demand notice for Rs.1,49,534 has been issued to the assessee. Further progress has not been intimated (August 1988).

Both these cases were reported to the Ministry of Finance in September 1988, their reply has not been received (December 1988).

**(XIV) Irregular availment of credit in excess of prescribed limits**

As per proviso to Rule 57A the Central Government may specify the goods or classes of goods in respect of which the credit of specified duty may be restricted.

As per a notification dated 20 May 1987, Modvat credit of duty paid on paper and paper board has been restricted to Rs.800 per tonne or the actual amount of duty paid whichever is less.

As per another notification dated 19 June 1987, Modvat credit of duty paid on vegetable products has been restricted to Rs.900 per tonne or the actual amount of duty paid whichever is less.

Seventeen cases of irregular availment of credit of Rs.10.47 lakhs in excess of the prescribed limit were noticed in four collectorates on test audit. Details of the sixteen cases are given below:

(i) Four manufacturers of transformers and biscuits in Allahabad and Karpur Collectorates who used paper and paper board and vegetable products as inputs, were allowed credits of Rs.3,73,431 in excess of the limits prescribed as above during the period

from June 1987 to December 1987.

On this being pointed out in audit (September, October, November 1987 and February 1988), the department admitted the objection and intimated (January and February 1988) the part recovery of Rs.3,41,363 from four manufacturers and raising of further demands of Rs.32,048 in one case in February 1988.

The Ministry of Finance have confirmed the facts (December 1988).

(ii) Similarly twelve manufacturers of different excisable goods in Delhi Collectorate took excessive/notional Modvat credit of Rs.6,59,083 notwithstanding the restrictions to effective rates of duty applicable to the concerned commodities.

On the irregularities being pointed out in audit (October, November, December 1987 and March 1988) the department recovered Rs.2,31,689 in five cases. Particulars of recovery in remaining seven cases have not been intimated (August 1988).

The matter was reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

**(XV) Irregular availment of higher (additional) Modvat credit during the period 25 March to 31 March 1986**

A notification dated 1 March 1986 provides for grant of higher credit under Rule 57B of the Central Excise Rules, 1944. As that notification was not in operation during the period from 25 March 1986 to 31 March 1986, goods cleared during that period were not entitled to higher credit under Rule 57-B.

Twenty three cases involving irregular availment of higher (additional) Modvat credit of Rs.5.60 lakhs during the period from 25 March 1986 to 31 March 1986 were noticed in four collectorates in test audit. Out of this, availment of irregular credit amounting to Rs.2.72 lakhs in ten cases has been accepted by the Ministry of Finance/Central Excise department.

Some of these cases are given below:

Fourteen manufacturers in Delhi Collectorate, took higher credit of duty of Rs.3,64,312 during the period between 25 March 1986 to 31 March 1986.

On the matter being pointed out in audit, the department recovered Rs.1,08,506 (September 1986 to January 1988) from three

assesseees, in respect of other three assesseees the department did not accept the objection and in respect of remaining eight cases the reply from the department has not been received (September 1988).

These cases were reported to the Ministry of Finance in September 1988; their reply has not been received (December 1988).

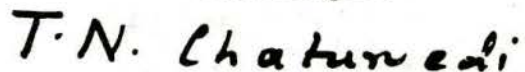
NEW DELHI  
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(R. RAMANATHAN)  
Director of Receipt Audit (INDT)

Countersigned



(T. N. CHATURVEDI)  
Comptroller and Auditor General of India

NEW DELHI  
The

16 मार्च 1989  
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