CHAPTER III

MODIFIED VALUE ADDED TAX
Chapter III
MODIFIED VALUE ADDED TAX

INTRODUCTION

Modified Value Added Tax has its origin in the system of VAT, (Value Added Tax) which is common in West European Countries. Generally any Tax is related to selling price of product. In Modern production technology, raw material passes through various stages and processes till it reaches the ultimate stage for example, steel ingot are made in steel mill. These are rolled into plates by re rolling unit, while third manufacturer makes furniture from these plates. Thus the output of the first manufacturer becomes input for second manufacturer who carries out further processing and supply it to third manufacturer. This process continues till a final product emerges. This product then goes to the distributor who sells to the retailer and then it reaches the ultimate consumer. If a tax is based on selling price of a product, the tax burden goes on increasing as raw material and final product passes from one stage to another. For example, the tax on a product, is 10% of selling price and manufacturer "A" supplies his output to B at Rs.100. B gets the material at Rs.110 (100 + Rs.10 tax). He carries out further processing and sells his output to (at Rs.165, i.e) (cost Rs.110+Rs.40 conversion cost, Tax at 10% on Rs. 15).

In fact, value added by B is only Rs.40, the proper tax would have been only Rs.4. But the tax is Rs.15. As stages of production or sales continue, each subsequent purchaser has to pay tax again and again on the material which has already suffered tax. This is called cascading effect.
Due to cascading effect,¹

a) it becomes very difficult to know the real tax content in the price of a product as a product passes though various stages and tax is levied at each stage. By this it is difficult to fix regulatory prices.

b) tax burden on various commodity will vary depending on the number of stages through which it passes in the chain from first producer to ultimate consumer.

3) the growth of small scale industries gets discouraged. Large units used to buy parts from small manufacturer and assemble in their plant and sell them. If a component is purchased from outside tax is payable. But if the same component is manufactured inside the factory no tax is payable, leading to vertical integration. Thus the manufacturers are tempted to manufacture parts by themselves instead of developing ancillary units. This is against national policy because it discourages growth of small industries.

4) the cost of production increases.

The cascading effect of excise duties had been the subject matter of debate since a long time. Excise duties may adversely affect resource

allocation and dislocate production. When the government imposes tax on a particular goods, some people will stop buying as they fail to obtain optimum satisfaction from the purchase. The production of other goods will increase while that of taxed goods will decrease. Thus, there is poor allocation of resources. When excise duty are levied, selling prices are marked up and consumers suffer. Prices are increased more than the tax amount. It is called 'Pyramiding' effect.\(^2\) When taxes are imposed, the prices are increased by the trader but when concessions are granted, they are not passed on to consumers in the form of reduction of price.

Excise duties are inflationary despite all predications of finance department. The total duty burden imposed on the country by the major indirect taxes (i.e) customs, excise, sales tax is of considerable amount and that each of these has a wide tax base, interaction of individual taxes between them are large. In order to minimise the cascading effect what was needed was an integrated approach which would cover all these major duties and other indirect taxes.\(^3\)

MODVAT is the outcome of the findings submitted by various committees. The following three committees have contributed abundantly to the introduction of MODVAT.


The three important duty relief schemes in operation were the Proforma Credit procedure, the Set off procedure, and In Bond Movement Procedure commonly known chapter X Procedure. Of these, the most extensively applied input relief scheme was Proforma credit procedure. These three schemes were in operation even before the introduction of MODVAT. These schemes suffered certain disadvantages which made compulsory to introduce a refined scheme, MODVAT.

In November 1962, the Government introduced Proforma credit procedure to be applied in relation to excisable commodities. The rules of Proforma Credit were contained under Rule 56A. Manufacturer were permitted to obtain duty paid materials and components; the duty paid on such inputs would be utilised by the manufacturers for payment of duty on the final product. At the time of introduction of this procedure it was clarified that it was the intention that debit in the proforma account should be made only of the excise duty amount on the quantity of material used in the manufacture of finished goods. But, the manufacturers were permitted credit of entire amount of duty available in proforma account, even though some materials or parts received by him are lying in the factory. Afterwards it was made certain that
proforma credit could be drawn upon only to the extent of the duty paid on materials and components used in the manufacture of notified goods. The coverage of this procedure was selective. More often, it has been extended to dutiable final products whose inputs fall under the same tariff item as final product. The procedure was not applicable to packing materials and consumable stores. The procedures, provided for physical checks at various stages which tended to impede the smooth flow of manufacturing process.

Another point made was that proforma credit remained unutilised and could not be drawn upon whenever the relevant goods (i.e) those manufactured out of material and component in respect of which proforma credit was given) were exported under bond. But this difficulty was removed through an instruction issued in August 1973, which provided that credit of duty in respect any material, component used in manufacture of goods exported under bond towards payment of duty on other finished excisable goods.

The scheme had restricted scope of application. It was not applicable to consumables. There were delay in obtaining permission from the Assistant Collector, submission of D3 on receipt of inputs within 24 hours, separate storage of inputs and verification by Inspectors within 48 hours. There was insistence of 1:1 correlation of inputs and final products. The inputs on which the duty credit is intended to be availed, must form part of that final product which is going to be cleared.

This scheme and Rule 56A are now deleted from the Excise Rules with effect from 20.5.1994.
Set off procedure under rule 8(i): At present it is found incorporated in section 5A of Central Excise Act.

It was a procedure under which the relief in respect of input taxation was provided by a notification exempting the final product to the extent of excise paid on the specified inputs used in its manufacture.

This scheme operated on the principle of physical ingredient. The scheme was stricter than the proforma credit procedure in terms of compliance requirement.

The credit is restricted to the quantum of input contained in the finished products. This procedure is extended to excise duty paid on inputs and not on countervailing duty paid on imported inputs.

The other procedure meant to relieve input duty burden is the one laid down in chapter X of Central Excise Rules. This permits removal under bond and for use in specified industrial processes of dutiable raw materials or intermediate products with full or partial exemption from duty. The basic distinction between the provisions discussed earlier and this procedure is that in case of former, full duty is collected on inputs at the first instance and allowed to be set off or used as proforma credit, eventually.

In case of the latter, the intended duty concession on the input (whether full or partial) is allowed ab initio at the time of their clearance and further movement is under bond to safeguard against diversion and abuse. These provisions were contained in Rule 192 to 196 BB.
Comparing set off and proforma credit, the requirement under the proforma credit procedure is less rigorous. It provides the manufacturer with greater flexibility of using the duty credit. Unlike Set-off procedure, in the scheme of proforma credit, the benefit of duty credit is not denied in respect of inputs which may be lost in the process and do not actually get ingrained in the product. In comparison with chapter X procedure, the proforma credit procedure is more appropriate as measure of giving duty credit on a wider basis, since it ensures payment of duty on input at the first stage there by reducing the risk to revenue to a considerable extent.

In order to alleviate the demerits of the above schemes and to bring about a step towards Value Added Tax, Modified Value Added Tax was introduced with effect from 01.03.1986.

The following Figure-II shows the Input Duty Relief Scheme:

**FIGURE - II**

**INPUT DUTY RELIEF SCHEME**

<table>
<thead>
<tr>
<th>Schemes operated initially</th>
<th>Schemes currently in operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Proforma Credit Procedure</td>
<td>a. MODVAT credit scheme for inputs.</td>
</tr>
<tr>
<td>b. Set off Procedure</td>
<td>b. MODVAT credit scheme for Capital Goods.</td>
</tr>
<tr>
<td>c. Chapter X Procedure</td>
<td>c. Exemption for captive use.</td>
</tr>
<tr>
<td></td>
<td>d. Remission of duty for special industrial purposes.</td>
</tr>
<tr>
<td></td>
<td>e. Money credit scheme.</td>
</tr>
</tbody>
</table>
History of MODVAT Scheme

November 1985 - Announcement of likely introduction of MODVAT.

1.3.1986 - Actual introduction of MODVAT by inserting Rules 57A to 57J in the Central Excise Rules, covering goods mentioned in 37 chapters of the Tariff.

01.03.1987 - Extension of MODVAT to a Total of 76 Chapters.

2.11.1993 - Major Procedural relaxations permitted

1.3.1994 - MODVAT permitted on all petroleum products under chapter 27 (except Petrol and Diesel oil)

- Introduction of MODVAT credit on capital goods in serting Rules 57Q to 57U.

4.7.1994 - MODVAT Scheme widened to include registered dealers and importers.

16.3.1995 - MODVAT scheme liberalised so that credit earned on any input can be utilised for payment of duty on any final product manufactured in the factory.

- extension of MODVAT scheme to cover a total of 87 chapters.

22.7.1996 - Providing for mandatory penalty and penal interest for misuse of MODVAT Credit Scheme.

- Simplification of Excise Payment Procedure.
Origin of MODVAT

The introduction of MODVAT in 1986, represented a major step in the reforms of the Central indirect tax system.

It is agreed among fiscal experts all over the world that any system of indirect taxation (i.e) tax on commodity will have to be in the form of either Retail Sales Tax or Value Added Tax. The retail sales tax does not interfere with the processes of production and does not affect the cost. Thus, it has the advantage of capturing the entire value added. But the retail sales tax is difficult to administer and not feasible for various reasons. In India there are numerous retail networks outside the purview of Excise Department. Most of them are not registered. It is very difficult to bring them under Excise net. The only rational alternative is Value Added Tax.

The Jha Committee report says that for switching over to VAT, three conditions would have to be met.

a. the existing sales tax would have to be converted into a single point tax at the last stage, so as to eliminate cascading effect.

b. all indirect taxes would have to become the responsibility of a single authority.

c. proper accounting records have to be maintained.

In India, the powers of raising revenue are in the Concurrent List. The Sales Tax is the major revenue to States, the State has the autonomy in fixing and adjusting the tax rate according to their revenue needs.
In India, all types and sizes of business organisations exist. They range from sole proprietorship to multi-national companies. Unless, their accounts are fully computerised it is difficult to bring them under a single tax net.

In a federal state, the States cannot surrender their autonomy to the Central government. Due to these pitfalls VAT could not be introduced in India.

In order to minimise cascading effect and to promote industries, a modified version of Value Added Tax was introduced with effect from March 1, 1986. Unlike VAT in European and other countries of the world, MODVAT does not replace excise but introduces the principle of VAT under the system of union excise duty levied by Union Government.

The recent study on the ‘Value Added Tax’ examined different options.\(^4\)

The first option is a Central Vat, which falls on the value added at each stage from the stage of production to retail stage. The tax would be collected by the Centre and distributed among the States. The demerits of this system were discussed above.

---

\(^4\) Ishwar. C. Dhingra, op.cit., p.675.
The second option as suggested by Dr. Raja Chelliah was MODVAT at the Centre and rationalised Sales tax system at the State level. The Centre would collect MODVAT at the level of manufacturers and the States would collect it at the wholesalers' level. In addition, sales tax would be collected from the manufacturer or wholesaler depending upon the structure of the Sales Tax in the State. This option is also not useful as it will lead to more taxation on tax payers.

The third option is to have two different VATs, one at the Central level and the another at the State level. The Central VAT would substitute Union Excise duties and the State VAT would replace Sales Tax.

The fourth option could be that the whole of the excise structure and sales tax structure be converted into State VAT. The tax would be levied on all sales beginning with production or manufacture. The tax levied at the stage of manufacture would be given set off at the time of levy of VAT. Hence, the tax at the second stage would be levied only on value added. This would be continued on the subsequent stages of transactions.

The fifth option was to have a complete State VAT where in the total revenue from the Union Excise duties is pooled for disbursing the amount to the States on the basis of collection.

Inclusion of MODVAT commodities under the State VAT would avoid complete cascading.
In a federal country like India it is ideal to have State and Central VATs, the Central VAT upto manufacturing stage and the State VAT on wholesaling and retailing stage. The MODVAT is tax on "value addition" levied upto the stage of clearance of goods by the manufacturer.

MODVAT is not a new taxation system. It is an extension and modified forms of various input duty credit relief systems existed before.

It is an important development in the sphere of indirect taxation. Initially MODVAT was introduced for a select number of commodities. But the coverage was extended with effect from March, 1, 1987, to all commodities except petroleum products, textiles, tobacco, cinematographic films and matches. Under the MODVAT Scheme, credit is given in respect of duty paid on inputs and this goes to reduce the duty payable on the final product.

This scheme avoids repeated payment of duties from raw material stage to the final product and thus reduces the total burden of duties on the final product. It helps in simplifying export procedure. The scheme helps considerably the manufacture- exporter who would avail themselves of credit of duties on inputs and will use the same in any excisable product manufactured by them.

Advantages

The scheme was introduced for self reliance and indigenisation. The manufacturers who have allowed higher degree of indigenisation would stand to benefit while those importing components are not covered. This scheme intends to wipe out industries depending upon imports and
make the manufacturers develop their own products. Under MODVAT scheme, industries using imported raw materials or duty free intermediate goods do not gain since the manufacturer can claim credit only when they are using inputs on which excise duty is paid.

2. The shifting of the burden of excise taxation away from inputs to final product is the very objective of MODVAT scheme.

3. The scheme will prevent the cascading effect of excise duty. Where an item suffers duty on manufacture he can avail himself of the credit of duty on input, thus reducing the final duty liability.

4. MODVAT is expected to curb tax evasion. Under this scheme no tax can be avoided; it could work as a measure against generation of black money.

5. Under this system, the manufacturer can seek tax concession in an easier manner following a simplified procedure. Under Proforma credit system, every time goods are received the manufacturers are required to make declarations regarding the goods received by them. Under MODVAT scheme, this requirement has been done away with. The manufacturers will be required to give only an initial declaration about the inputs used in the final product. Hereafter, they need not give such information to the excise officials nor there be any statutory inspection or verification of stock. But they have to submit monthly reports to excise officials.
6. MODVAT is expected to bring down the cost of final product through utilisation instant credit of duties paid on inputs and subsequent reduction of interest cost. Lower capital outlay is expected to help in reducing the cost of production. It is believed to reduce the cost of production, encourage ancillaryisation and help increasing exports.

7. The unethical jacking up of price by the manufacturers on the pretext of any additional increase in taxes is expected to be effectively curbed. The scheme provides for an in built system of price monitoring since the element of excise duty would be known for every final product.

8. MODVAT scheme is expected to help in encouraging exports by facilitating duty drawbacks. Exporter manufacturer could seek refund of the final duty paid without having to bother about the duty charged on the inputs which have gone into the manufacturing of final products.

**Drawbacks of MODVAT**

1. The expectation of the Government as to Revenue neutrality was not fulfilled. The Finance Minister, while presenting the Budget in 1986 stated that the introduction of MODVAT scheme would result in considerable decrease in the cost of final product and in order to retain the collection of excise duties at the earlier level, the rates of duties on final products had been suitably adjusted. It therefore, follows that the MODVAT was supposed to be revenue neutral.
2. Various misuses of the scheme were reported in the Report of the Comptroller and Auditor General of India (1989). There were unintended benefits to manufacturers on inputs procured by them from small scale units. As much as 851 cases were filed in 1989.

3. There were irregular use of MODVAT credit without filing a declaration or without obtaining acknowledgement. Nearly 311 cases were filed on 1989.

4. The MODVAT scheme enables a manufacturer to obtain instant credit of excise duty paid on certain specified inputs used in the manufacture of specified final products and to utilise the credit for payment of excise duty on final product. The scheme debars taking credit unless, inputs are accompanied by a prescribed document evidencing payment of duty on such inputs. The Rule 57 G(2) of Central Excise Rules, empowers the Government to direct that all stocks of specified input (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 documents evidencing payment of duty, leading to duty paid on undeclared stock being taken for credit. There were 128 cases referred.

5. Excisable goods manufactured in a factory as job work or used in relation to the manufacture of final products are exempted from the whole of duty under certain conditions. Some assessees 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 assesses to take MODVAT credit at normal rates. Additional MODVAT credit of Rs.2.05 crores was taken on this account in 24 cases in 1989.

6. MODVAT credit on Capital goods was introduced in 1994 only. But the credit was taken on duty paid on machinery, equipment, tools, appliances etc leading to irregular credit of Rs.2.81 crores in 118 cases, as reported in 1989.

7. The manufacturers took credit of input duty used in final products exempt from duty or chargeable to nil rate of duty.

Features of MODVAT Scheme

Section 37 of Central Excise Act was amended with effect from 1st March, 1986 giving powers to Central Government to make rules to provide for the credit of duty paid on goods used in or in relation to manufacture of excisable goods, to provide for giving credit of sums of money with respect to raw materials used in manufacture of excisable goods.

In exercise of these powers, MODVAT credit scheme has been introduced vide Rules 57A to 57U.
Credit of duty paid on input

It is principally based on system of granting credit of duty paid on inputs. Under MODVAT, a manufacturer has to pay duty as per normal procedure on the basis of Assessable Value. (based on Selling Price).

<table>
<thead>
<tr>
<th>Position before MODVAT</th>
<th>Position after MODVAT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage 1. Cost of Production to Manufacturer A Rs. 100</td>
<td>Cost of Production to Manufacturer A Rs. 100</td>
</tr>
<tr>
<td>Tax at 10% 10</td>
<td>Tax at 10% 10</td>
</tr>
<tr>
<td>Selling Price to B 110</td>
<td>Selling Price to B 110</td>
</tr>
<tr>
<td>Conversion cost of B 40</td>
<td>Conversion cost of B 40</td>
</tr>
<tr>
<td>150 Assessable value</td>
<td>150</td>
</tr>
<tr>
<td>no input duty -</td>
<td>Tax at 10% 15</td>
</tr>
<tr>
<td>relief -</td>
<td>Input credit 10</td>
</tr>
<tr>
<td>150 Duty payable 5</td>
<td></td>
</tr>
<tr>
<td>Tax at 10% 15</td>
<td>The price should be Rs. 155</td>
</tr>
<tr>
<td>Selling Price 165</td>
<td></td>
</tr>
<tr>
<td>Tax Paid by B Rs. 15</td>
<td></td>
</tr>
<tr>
<td>Price 165</td>
<td></td>
</tr>
</tbody>
</table>

Thus B has to pay duty only on value added by him.
(Note: Duty on input forms part of assessable value. Commissioner of Central Excise, Bombay II, Trade Notice No. 55/95 dated 5.9.95 as referred by R.K.Jain Central Excise Law Manual 1999-2000, Centax Publication p. 12.38.)

MODVAT credit does not directly affect or reduce the assessable value under section 4 of the Act. Valuation is relatable to the normal price. The larger Bench in Dai Ichi Karkaria Ltd., Vs Collector of Central Excise has held that the duty paid on the input in regard to which MODVAT credit was availed by a manufacturer is not includible in the assessable value of final product under section 4(i) (b) or rule 6(b) (ii). The Supreme Court has admitted a Special Leave Petition against this decision. (CBEC Circular No.264/98/96- CX, November 11, 1996).

**Inputs eligible for MODVAT**

Credit will be available of duty paid on raw materials, materials used in relation to manufacture for example consumables. (c) packaging materials and paints.

1. MODVAT credit is available only on inputs used in or in relation to manufacture of final product.

2. Inputs may be used directly or indirectly or in relation to manufacture. The inputs need not be present in the final product.

3. No credit is available if final product is exempt from duty (Rule 57C). If a manufacturer produces more than one product, it may happen that some of the products are exempt from duty. In such cases, duty paid on inputs used for manufacture of
exempted products cannot be used for payment of duty on other products which are not exempt from duty. The exceptions are a) if the goods are supplied to units in Free Trade Zone, 100% Export Oriented Units, Software Technology Park, Electronic Hardware Technology Park b) if the goods are exported c) if part of inputs are contained in scrap or waste which is exempt from duty.

4. The credit is available only on the basis of specified documents as proof of payment of duty on inputs.

5. Credit of duty on inputs can be taken up instantly as soon as the inputs reach the factory. In case of goods the credit is available, once they are installed and used.

6. Where the duty paid on inputs is more than duty payable on final products, the excess of duty paid on inputs over the duty on final product is not refundable.

7. MODVAT rules do not require input output correlation to be established.

8. Sometimes, credit is given for specified products or specified inputs. This is not on the basis of duty paying documents, but to encourage use of some inputs, for instance vegetable only for vegetable products, margarine etc.

9. Credit of duty paid on machinery, plant, spare parts of machinery, tools, dies are available.

10. MODVAT on inputs is available only if the process amount to manufacture otherwise MODVAT is not available.
MODVAT CREDIT ON INPUTS - RULES

As discussed earlier, MODVAT scheme is incorporated in Rules 57A, to 57U. Adherence to these rules are necessary to judge the eligibility of a product to take this credit or eligibility of input and avoid disputes.

At present MODVAT has been extended to all items included in Central Excise Tariff Act except a) matches (36.05) b) Cinematography films (37.06,C) Certain Tobacco products (24) d) Ingots and billets of non alloy steel under rule 7206.90 and 7207.9 on which duty is paid on the basis of production capacity. f) Hot rolled products of non alloy steel under rule 7211.11 to 7216.10 as specified on which duty is paid under 3A (i.e) on the basis of production capacity.

The goods covered under the scheme are food product, chemicals, plastics, suffer products, leather and wood articles, textile articles, paper, metals, engineering goods, textile products, electric and electronic goods and automobile sector, cement and mechanical goods.

Applicability of MODVAT

Rule 57A, lays the applicability, scope and nature of MODVAT credit scheme on inputs. In order to take credit, both final products and inputs must be notified. The credit is available only on specified duty as laid down in Notification No:5/94 CE dated 1/3/94.

-------------

I) Basic excise duty under Section 3 of CEA.

II) Additional Duty of Excise under Section 3 of
    b) Additional Duties of Excise (Goods of Special Importance Act, 1957)

III) Additional Duty under Section 3 of Customs Tariff Act, 1975 equivalent to 1 and 2(a) and b above.

Input means anything put into the stream of manufacture. It includes raw materials, components, consumables, parts etc. used in or in relation to manufacture of final product. It also includes inputs notified as capital goods which are used as component parts in the manufacture of final products. They are eligible for MODVAT credit as inputs.

Anything that enters into and forms part of the process is deemed to be raw material or component part of the end product, and are eligible for MODVAT. (i.e) the inputs used in the process. The process must contribute to the marketability of final product or connected to ultimate production of goods. But for that process, the manufacture or processing of goods must be commercially inexpedient. Then the inputs used in such process are eligible for credit. Consumable which are burnt up in the process of manufacture are eligible for credit for example oxygen, hydrogen. MODVAT credit is available for packaging material in a ready to use conditions like boxes, bottles etc. The credit is also available in respect of raw material used for making packing material.
In case of industrial products like glass or metal articles, sometimes, final products are returned by the customer to the manufacturer, if such products are defective or unusable. In such case the manufacturer can treat the rejected final product as input (Rule 57A) and re-melt or re-manufacture afresh.

MODVAT credit cannot be included in the assessable value of final product under (Section.4) Dai Ichi Karkaria Vs CCE, Rule 57A.⁶

The deemed credit facility is also available on inputs used in Iron and Steel Rolled products. The deemed duty shall be equivalent to amount at the rate of 12% of the invoice price. Credit of deemed duty can be availed only towards payment of duty of excise payable on specified final product. The excess of MODVATABLE credit can not be used for clearance of other final product.

There were eleven circulars and trade notices issued by the CBEC under Rule 57A, in the years 1996 and 1997 alone. Eight notifications were issued from 1.3.94 to 30.8.97. There are nearly 237 cases, referred judgement passed and reported. These cases were referred only under Rule 57A.⁷

----------


Following are the various steps to verify the Eligibility of Inputs under Rule 57

**Incoming materials**

<table>
<thead>
<tr>
<th>Is it capital goods?</th>
<th>Yes</th>
<th>MODVAT available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Packing material not included in assessable value of finished goods</td>
<td>Yes</td>
<td>No Credit</td>
</tr>
<tr>
<td>Returnable crates, Glass bottle</td>
<td>Yes</td>
<td>No Credit</td>
</tr>
</tbody>
</table>

Is it classifiable under the following heads?

a. inputs used in manufacture of final product
b. paint, packing material
c. fuel
d. input for generation of electricity used written the factory
e. Accessories the cost of which is included in Assessable value

Yes

Valid input

<table>
<thead>
<tr>
<th>Is it used for manufacture of exempted Goods</th>
<th>Yes</th>
<th>No credit is available. Keep a separate account for the use of such inputs or Rule 57CC is followed, if credit is to be claimed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>File declaration and avail credit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The procedure take MODVAT credit on inputs can be discussed under 6 steps.

**Step 1 - Receipt of Goods**

The MODVAT credit is admissible only on receipt of the input material. The ownership of material is irrelevant for the purpose of claiming MODVAT credit. The invoice should be addressed to the manufacturer. The various documentary proof of receipt are to be retained. Entries must be passed in Security Register, Delivery Challan of supplier, 57F (4) challan, Invoice of the Supplier. Bill of Entry, Lorry Receipt, Railway Receipt, Bill of Transporter, Goods Inward Note of Manufacturers, Entry in the "Goods Inward Register, entry in the Stock Records etc., Generally, third party documents have more evidential value.

**Step 2 - Eligibility Under Rule 57A**

The eligibility under rule 57A is to be determined by the exclusion method. The inputs which are eligible would fall under the categories mentioned in Rule 57A. In the event of doubt eligibility may be determined after reference to various judicial decisions. Once the eligibility is ascertained, the manufacturer should verify whether the inputs are used in the manufacture of exempted final products. This gives rise to 4 options namely. 
<table>
<thead>
<tr>
<th>Option</th>
<th>Availability of Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Used only for manufacture of exempted products</td>
<td>No credit is available.</td>
</tr>
<tr>
<td>2. Used in or in relation to dutiable final product.</td>
<td>Credit is available.</td>
</tr>
<tr>
<td>3. Used for dutiable and exempted products but the quantity of use at</td>
<td>Credit is available and 8% of selling price of exempted</td>
</tr>
<tr>
<td>the stage of inputs not ascertainable.</td>
<td>goods debited or Rule 57CC followed.</td>
</tr>
<tr>
<td>4. Used for dutiable and exempted products where at the time of</td>
<td>Credit to be availed in proportion of quantity used in</td>
</tr>
<tr>
<td>receipt, the use is ascertainable and separately recorded</td>
<td>dutiable final product only.</td>
</tr>
</tbody>
</table>

**Step 3 - Declaration**

The Rule 57 requires prior declaration of inputs used in or in relation to manufacture of final products. Once the inputs are received and eligible under rule 57A, the manufacturer is to ensure that the inputs are duly declared. Or a declaration is to be immediately filed.

**Step 4 - Valid Invoice**

This step involves the procedure for verification of invoice. The duty paying document must tally with the declaration filed. It is necessary that what is mentioned in the declaration is reasonably correct and tally with that of duty paying documents. Sometimes there are chances that both the documents and the declaration may differ in
respect of description of inputs or classification of inputs. In such case, the manufacturer is required to follow the following procedure.

1. Where there is difference between the two in the description of input, the manufacturer shall intimate the same to the Assistant Commissioner of Central Excise providing the reason for the difference.

2. Where the description of inputs declared is not tallying due to different trade name / brand name, the manufacturer shall ensure that classification has been declared correctly, the input is an eligible one and the duty is paid under correct classification.

3. Where the heading and the sub heading does not tally, but the chapter is correct and the nomenclature also tallies, the manufacturer shall ensure that classification has been declared correctly and duty is paid.

4. It is advisable to make a consolidated declaration once in a year providing there in, all probable descriptions and probable classifications of inputs without prejudice to earlier declarations.

Step 5 - Accounting

The inputs are required to be entered in RG 23A Part I for the quantitative aspects of receipts and issues. The entries in RG 23 Part II is for the monetary aspect of MODVAT credit.
Step 6

The manufacturer is to file a monthly return specifying there in the particulars of inputs received, the amount of credit used, original duty paying documents and extracts of RG 23 A Part I & II.

For a manufacturer claiming exemption based on value or quantity of goods manufactured (for instance SSI), this return has to be filed in every 3 months.

**PROFORMA FOR DECLARATION**

| 1. Name of the Manufacturer |
| 2. Range |
| 3. Division |
| 4. Commissionerate |
| 5. Particulars of Inputs and Final Products |
| Description of Final Products and its Tariff classification |
| Description of Inputs and its classification |
| Nature of input Raw Material Component packaging material etc. |
| Description & Tariff classification of Intermediary products. |
| Name of final product |
| Classification un sub heading No |
| Name of input |
| Classification sub heading |

6. Any other Particular
Declaration

We hereby declare that particulars furnished above are true and correct to the best of our knowledge.

Place: ____________________________  Signature of Applicant
Date: ____________________________

Rule 57B. Eligibility of Credit of Duty or Certain Inputs

Rule 57B enlarges the scope of 57A. This rule is the reproduction of the erstwhile explanation to Rule 57A. The following categories of inputs are eligible for MODVAT credit.

a) Inputs manufactured and used with in the factory of production (i.e) captive consumption.

b) Paints- Paints ensures that the final product becomes marketable. Thinners which are used to dilute paints are also eligible for MODVAT credit.

c) Inputs used as fuel.

d) Inputs used for generation of electricity or steam, furnace oil, light diesel oil, low sulphur heavy stock used in producing steel which in turn used in the manufacture of final products is eligible for credit.

e) Packing material- Rule 57B overrides Rule 57A. The present Rule 57B specifically says that packing materials and materials from which such packing materials are made are eligible inputs provided the cost of such packs is included in the value of finished product.
f) Accessories: The term accessories is defined in Oxford English Dictionary as "something contributing in a subordinate degree to general result or effect". Websters Dictionary defines "it as an object that is not essential in itself but adds to the beauty convenience of or effectiveness of something else". The amendment to include accessories as an eligible input came with effect from 29.6.95. The accessories which are cleared along with the final product and which is included in the assessable value of the final product are eligible for MODVAT credit.

g) Lubricating oil, greases, cutting oils and coolants: With effect from 1.3.97 lubricating oils, greases, cutting oils, coolants were excluded from the scope of inputs and they were specifically held eligible from 1.9.97. under Rule 57B and 57Q.

h) Parts of Machinery are eligible for credit as Capital goods.

Rule 57C

Credit of Duty not to be allowed if final products are exempt.

a) No credit of the specified duty shall be allowed on such quantity of inputs which is used in the manufacture of final product which is exempt from the whole of duty of excise leviable there on or are chargeable to nil rate of duty. But this rule 57C is not applicable to finished products a) cleared to a unit in a Free Trade Zone b) cleared to 100% export oriented undertakings c) cleared to a unit in a Electronic Hardware Technology Park or Software Technology Park d) supplied to
United Nations Organisation or International organisation for their official use or supplied to projects funded by them.

The manufacturers can take credit and use it for payment of duty on home consumption if the finished goods are exported under bond as per the provisions of Rule 57F (13).

The MODVAT scheme allows for taking of credit instantly after receipt of inputs. If the assessee wants to take the benefits of Exemption Notification, which stipulates non-availment of MODVAT as a condition for taking the benefits of exemption notification, then that assessee has to reverse the MODVAT availed prior to clearance.

Input duty credit is available, if they are used on manufacture of dutiable intermediate product though the final product is exempt from duty.

Once the final products are exempted, MODVAT on inputs already availed has to be reversed.

Rule 57CC

Where a manufacturer is engaged in the manufacture of any final product which is chargeable duty as well as in any other final product which is exempt from the whole of excise duty leviable there on or chargeable to nil rate of duty and the manufacturer takes credit of the specified duty on any inputs (other than fuel) which is used or ordinarily used in or in relation to the manufacture of both the above categories, the manufacturer shall pay an amount equal to 8% of the price (excluding sales tax and other tax payable on such goods) of the
that exempted goods or goods charged to nil rate of duty, at the time clearance from the factory.

2. Such 8% price shall be paid by the manufacturer by adjustment in the credit account maintained under Rule 57G (7) or in the accounts maintained under Rule 9 or Rule 173 G(1) ie, (PLA).

3. If such adjustment is not possible for any reason, the amount shall be paid in cash.

4. The provisions of Sec. 57CC(1) shall apply even if the inputs on which credit has been taken are not actually contained or used in any particular clearance of product.

5. Rule 57CC is applicable only to final products cleared from the factory which are not chargeable to duty. Where the final products are exempt but the parts which are used in the manufacture of the product are dutiable, MODVAT credit can be availed on the duty paid on raw materials used in the manufacture of parts, provided the raw materials and the parts are covered under the scheme.

**Rule 57CC(1)** Reversal of credit at rate of 8% of the price of exempted final product is not applicable to

a) final products falling under chapters 50-63 of the schedule to CETA (i.e) silk, wool, cotton, other vegetable textile fibre, paper yarn, man-made filaments, staple fibres, twine, ropes, cables, and carpets, textile floor coverings, special woven fabrics, tufted textile fabrics, lace, embroidery knitted, crocheted fibre etc.
b) articles of plastic (chapter 39)

c) tyres of a kind used on animal drawn vehicles or handicrafts and their tubes (chapter 40).

d) black and white television (chapter 85)

d) news print in rolls and sheets falling under chapter 48.01 which are exempt from the whole of excise duty or chargeable to nil rate of duty.

In case of these products, the manufacturer has to pay amount equal to the credit of duty attributable to inputs contained in such final product at the time of clearance.

Rule 9 to 57CC (i.e) 57CC(9) says that the manufacturer shall maintain separate inventory and accounts for the receipts and use of the inputs used for production of exempted goods or goods chargeable with 'nil' rate of duty. He shall not take credit on such inputs.

I Procedure for separate maintenance of account for common inputs used in the manufacture of exempted product

The process of maintenance of separate records is possible where the manufacturer finds that the inputs can be bifurcated at the point of receipt and then use in the manufacture of dutiable and non dutiable final products.

1. The inputs for the manufacture of non-dutiable final products are received and recorded separately in stock Register and in RG 23A, Part I meant for recording of MODVAT credit.
2. The issues are made from this register for the production of non-dutiable final product.

3. The finished product is recorded in RG.1. (Stores Ledger). A proforma of Stores Ledger is furnished in the Appendix 1 under List of Forms.

4. The invoice for the removal of such non-dutiable final product is prepared in the normal excisable invoice and the fact that it is exempted goods must be stated clearly.

5. The duty paying documents for these inputs must be filed in order of their receipt separately from those on which credit is being availed.

6. At periodic intervals reconciliation must be made as to reconcile the quantity of final products and quantity of inputs used.

7. The transfer of input "from duty paid stock RG1" for the manufacture of dutiable final product would be without the duty being passed on.

   It is better to maintain separate accounts if the duty on input is less than 8% of the price.

II Procedure for Adjustment of credit availed on common inputs used in dutiable and non-dutiable goods

   If such inputs cannot be bifurcated at the point of receipt,

   a. all inputs are recorded in RG 23A Part I and credit is availed on all inputs going into the manufacture of dutiable and non dutiable final products.
b. correlation between the usage is not mandatory between dutiable and non-dutiable issues.

c. at the time of removal of exempted final product or product leviable to nil rate of duty, an amount of 8% on the value of the product would be debited in the RG 23A Part II or PLA. Value means value as set out in Section 4 of CEA.

d. The customer or job worker receiving the final product (on which 8% is debited) would not be eligible to avail himself of MODVAT credit on the amount debited.

Rule 57D

Credit of duty not to be denied or varied in certain cases:

a) Credit of specified duty shall not be denied or varied on the ground that part of the inputs is contained in any waste, refuse or by product arising during the manufacture of the final product or that the inputs have become waste during the course of manufacture of final product whether or not such waste or refuse or by product is exempted from duty or chargeable to nil rate of duty or is not specified as final product under Rule 57A.

b) Credit of specified duty shall not be denied or varied in case any intermediate products have come into existence during the course of manufacture of final products or the inputs are used in the manufacture of capital goods as defined in Rule 57Q and such intermediate products or capital goods are not chargeable to duty of excise.
The Union Budget 1997-98, has given revised Rule 57D. The credit of duty is not denied or varied

a) Where part of the input is contained in waste, refuses or by-products arising during the manufacturing of final products.

b) Where the inputs have become waste during the course of manufacture of final product.

During any manufacturing process, it so happens that part of inputs may become waste or by-product. There may be process rejection of inputs rendering such inputs waste. In such circumstances, irrespective of whether such waste, by-product is exempt from the whole of duty or is chargeable to 'nil' rate of duty or is not specified as final product under Rule 57A, the credit of duty allowed in respect of such inputs shall not be denied or varied.

Rule 57D is a beneficient provision enabling the manufacturers to retain the full MODVAT credit, even though the inputs have not been fully utilised in production. So, is the case of intermediate product. Intermediate product may be exempt or chargeable to nil rate of duty and still the benefits of Rule 57D, are available.

Rule 57D(2), takes care of inputs used in the manufacture of intermediate goods or in the manufacture of capital goods though such capital goods are exempt or chargeable to nil rate of duty.
Procedure for taking credit on inputs used in manufacture of
Exempted intermediate products

As per rule 57C, a manufacturer cannot avail himself of credit
on inputs used in manufacture of exempted final products. But Rule
57D(2) provides exception by allowing credit on exempted intermediate
products which in turn are used in the manufacture of dutiable products.

The manufacturer should ensure that such intermediate are
declared in Rule 173B.

The manufacturer should treat the intermediate product as a
final product and make entries in RG-1 register for production.

The intermediate product must be issued to production on an
invoice for captive consumption.

Where the inputs are destroyed by fire before they are used in
manufacture, MODVAT credit is not available. Where the inputs are
destroyed in the process of manufacture (i.e) after issue to production
then MODVAT credit is admissible. Where the inputs are lost by spillage
or evaporation on the same is not covered as waste and no MODVAT
credit is admissible.

Procedure where exempted by-product emerges in the
manufacture of Final Product

The manufacturer has to file under Rule 173B a declaration
giving description of the final product, its tariff classification, by-product
which may arise in the course of manufacture of final product. He has
to give a detailed flow chart of process of manufacture and the stage
where the by-product emerges. If the by-product is exempt from duty, the credit of duty availed need not be denied. If the by-product is dutiable the manufacturer shall treat the by-product as a final product and make entries in RG-1 register he shall remove the by-product under the cover of invoice under Rule 52A, after debiting the duty, in PLAs in RG23II.

**Procedure for treatment of Losses which are invisible**

The credit shall not be denied on the ground that part of inputs is contained in the waste and other invisible losses. The manufacturer shall estimate the percentage of such invisible loss arising in the course of manufacture. The manufacturer shall intimate such invisible loss in the "manufacturing process flow chart" to be filed at the time of filing 173B declaration, along with evidences. At periodical intervals, the manufacturer shall compute the actual percentage of invisible loss and compare the same with what has been estimated. The manufacturer is not required to reverse the duty on such losses. Such input duty can be used for paying duty on final product.

**Rule 57E Adjustment in Duty Credit**

(1) 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 refund to the manufacturer of such input then the manufacturer of the final product shall reverse the amount of credit and if such adjustment is not possible the manufacturer of final product has to pay the amount equal to the amount of refund allowed to manufacturer of inputs or importer inputs.
(2) If the manufacturer of final product has not taken any credit or has taken credit on any inputs and subsequently it so happens that any additional amount of duty is recovered by the manufacturer of such input, then the manufacturer of final products shall be allowed an additional credit equal to the amount of duty recovered provided the manufacturer or importer of input has passed on the incidence of additional duty amount.

Rule 57E is an important rule providing adequate flexibility towards availing of MODVAT credit. Say, a manufacturer of input, pays duty under protest or pays duty under provisional assessment to the extent of Rs.1,00,000, after resolving the dispute, the manufacturer of inputs is directed to pay an additional duty of Rs.25,000. In such cases, the duty originally paid (Rs.1,00,000) would have been availed as MODVAT credit by the consignee/manufacture will be increased by additional credit of Rs.25,000 In order to get the additional credit the manufacturer of final products has to produce a certificate issued by superintendent of Central Excise having jurisdiction over the factory of manufacturer of inputs. This certificate shall indicate the full description of inputs, original duty paid and particulars of documents under which the inputs were cleared from the factory.

Sub Rule 57E(1) This provides that if the supplier of input is allowed refund, then the manufacturer of final products who took MODVAT credit would be required to reverse the credit or pay cash equal to the amount of refund.
In the context of Section 11B (Unjust enrichment) normally the supplier of inputs cannot get a refund since he would have passed on the duty to manufacturer. This rule leaves no choice but to reverse the credit.

a) The manufacturer who has paid the differential duty shall apply to Range Superintendent for getting certificate

b) The certificate can be obtained consignee-wise declaring all the relevant particulars of inputs. This certificate is to be submitted in Triplicate. The Range Superintendent will endorse the certificate regarding payment of differential duty on all copies of declaration. The Original copy is for the manufacturer for sending the same to the consignee factory. Duplicate copy of certificate is for Range in charge of the factory which had received inputs and availed MODVAT credit. Triplicate copy of certificate is retained by Range in charge of factory manufacturing the inputs, for its own record. On receipt of original copy from the consignee factory on comparing the original with the duplicate copy of certificate the Range officer in charge of consignee factory will allow the manufacturer to take credit of differential duty paid and suitably make endorsement.

Sub rule 57E(2) provides, that if the manufacturer of inputs pay additional duty, such additional duty can be taken as credit by the manufacturer of final product. But where this additional duty is paid due to fraud, collusion or wilful mis-statement or suppression of tax or with an intention of evading duty, then Rule 57(3) bars the manufacturer
of final products. He can not take of MODVAT credit on such additional duty.

**Rule 57F Manner of utilisation of inputs and the credit allowed in respect of Duty Paid there on.**

This rule has 21 sub rules and prescribes the manner of utilisation of both inputs and corresponding credit of duty. The rule is the basic foundation on which the entire MODVAT rests.

As a measure of rationalisation and simplification of MODVAT Rule 57(F) has been thoroughly revised by Union Budget 1997-98 vide notification No.6/97-Central Excise, March 01, 1997. The gist of the amended Rule 57 is given below:

<table>
<thead>
<tr>
<th>Rule Coverage</th>
<th>Rule Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. <strong>57F(1&amp;2)</strong> Manner of utilisation or removal of inputs for home consumption or for export under bond in respect of which MODVAT credit has been availed.</td>
<td>2. <strong>57F (3)</strong> Removal of inputs in respect of which MODVAT credit has been availed of for home consumption.</td>
</tr>
<tr>
<td>3. <strong>57F (4&amp;5)</strong> Removal of inputs or semi finished goods for purposes of tests, repairs, refining or for manufacture of intermediate products under certain conditions.</td>
<td></td>
</tr>
</tbody>
</table>
4. **57F(6) to 8 (6,7,8)** Payment of duty whenever inputs or processed inputs are removed for Job work and for taking credit when they are received back in factory.

5. **57F(9,10,11)** Condition to be satisfied for availing of such credit mentioned above.

6. **57F(12to16)** Manner of utilisation of MODVAT credit

7. **57F (17)** Lapse of unutilised credit with the manufacturers of tractors / motor vehicles as on 16/3/95.

8. **57F(18&19)** Disposal of waste arising from processing of inputs.

9. **57F (20&21)** Transfer of unutilised credit on account of shifting the factory.

57F(1)

i) The inputs on which credit has been taken may be used in or in relation to the manufacture of final products.

ii) The inputs may be removed for home consumption or for export under bond.

iii) All removals of inputs for home consumption shall be made on payment of duty equal to the amount of credit availed in respect of such inputs and under the cover of invoice.

Under Rule 57(A), the Central Government is empowered to specify the goods in respect of which credit is restricted. The manufacturers while removing such inputs for home consumption has to pay duty equivalent to the credit availed on such inputs.
Where inputs are removed for home consumption, then a sum equal to credit availed must be paid and goods must be sent under the cover of invoice. 57F(3).

**Sub-Rule 4&5 to 57F**

The sub rule 4 permits a manufacturer using of MODVAT credit facility to remove the inputs as such or after the inputs have been partially processed during the course of final products to a place outside the factory for one or more of the following purposes;

a. test, repair, refining, reconditioning, any other operation necessary for the manufacture of final products.

These inputs are received again in the factory

a) for further use in the manufacture of final product

b) for removing the same under bond for export

c) for removing the same for home consumption after payment of duty.

Sometimes inputs or partially processed inputs may be removed from factory, for manufacture of intermediate products necessary for the manufacture of final products. These intermediate products are received back in the factory a) for further use in the manufacture of final product

b) for removing the same under bond for export

c) for removing the same for home consumption after payment of duty. **The following Figure III explains the procedure for removing inputs/partially processed inputs for Test, Repair, Refining (i.e Job work).**
REMOVAL OF INPUTS FOR JOB WORK UNDER RULE 57F(4)

Inputs / Semifinished goods on which credit has been availed under rule 57A.

Pre-authenticated levial no pre-printed challan in Triplicate to be authenticated

- Original
  - Debit 10% duty on value of input/ or value of input contained in semifinished goods in RG 23A Part II, PLA
  - Enter in Register

- Duplicate

- Triplicate
  - File chronologically

File Application with relevant challan.

Job Worker Processes Goods returns them afterdate. making entries in Register

Ensure full quantity received back along with scrap

Take credit of amount of duty debited on duplicate copy of challan (57F4) after making entry in Part III of challan. Yes

Make entries in Register.
Steps under rule 57F(4)

1. Intimation letter is filed in prescribed form to the Assistant Commissioner, intimating all details about the inputs and nature of process and address of job worker to whom such inputs are sent.

2. Removal of such goods is to be done using the prescribed challan

3. A simple "account of goods removed from factory for further processing" is to be maintained in the form prescribed by the factory sending these goods.

4. A similar account in the form prescribed is to be maintained by the job worker receiving the inputs.

5. After processing etc. the inputs are returned along with the waste to the parent factory using the duplicate challan.

Rule 57F(5)

The waste arising in the course of further processing, test, repair etc. shall be returned to the factory of the final product. Where the excise duty on the waste is paid, the waste need not be returned to the manufacturer of final product.

Rule 57F(6)

While removing inputs or partially processed inputs to a job worker, he shall debit 10% of value of such inputs. This debit of 10% shall be made in the account maintained under rule 57(G) or Account-current maintained under rule 173 G.
Rule 57F(7)

Notwithstanding anything contained in Rule 57A, the manufacturer is eligible to take credit of an amount equal to the amount debited by him, when the inputs are received back in full in his factory.

57F(8)

The manufacturer can take credit on the waste arising in the course of processing, only if he receives such waste, in his factory.

57F(9)

All such processed goods or waste must be received under the cover of duplicate copy of challan under which such inputs were sent for processing.

57F(10)

If the duplicate copy of challan is lost, then the Assistant Commissioner may allow the manufacturer of final products to take credit on the basis of triplicate copy of the challan.

57F(11)

If the inputs are not received back in the factory within 180 days, the Assistant Commissioner may allow the manufacturer to calculate the amount of actual credit attributable to the input after taking into account the amount already debited.
57F(12) Utilisation of credit

Credit of duty allowed in respect of inputs may be utilised in three distinct ways.

1) towards payment of duty on any of the final products declared under Rule 57G(1).

2) towards payment of duty on waste arising in the course of manufacture of final product.

3) towards the payment of duty on inputs cleared under 57 F(4).

57F(13)

Where any inputs are used in the final products which are cleared for export under bond or used in the intermediate products cleared for export in accordance with Sub.rule (4), the credit of duty shall be used towards payment of excise duty on any final product cleared for home consumption or for export on payment of duty. Where such adjustment is not possible, the manufacturer shall be allowed refund of such amount.

57F(14)

But no such refund shall be allowed if the manufacturer takes in respect of (a) duty drawback under the Customs and Central Excise (Drawback) Rules, 1971 (2) Rebate of duty under Rule 12A. For refund of MODVAT credit in cash there is no specific provision in the Excise Law. But, for export promotion purposes, a manufacturer who is having MODVAT credit in respect of inputs used in exported final products and
is not in a position to utilise the credit for payment of duty for reasons like domestic clearance is insignificant or within full exemption limit under Small Scale Exemption scheme, he may be refunded the credit in cash.

Rule 57F(15)

The credit of duty on inputs, used in the final products cleared to Free Trade Zone (FTZ) or to a unit of 100% export oriented or Electronic Hardware Technology Park, to unit in Software Technology Park or where the final products are supplied in United Nations Organisation or International Organisation for their official use or to projects funded by them, such input duty may be used for clearing any other final product.

Rule 57F(16)

The credit of duty on input shall be used for removal of other inputs to a job worker for testing, repairing, further processing.

Rule 57F(17)

Lapse of unutilised credit as on 16/3/95 with a manufacturer of Tractors, Motor Vehicles.

In respect of manufacturers of tractors (chapter number 87.01) Motor vehicles (87.02, 87.04) and chasis (87.06), the unutilised credit in so far as it does not relate to inputs lying in stock or contained in final product as on 16/3/95, shall lapse and shall not be allowed to be utilised for payment of duty on clearance of goods for home consumption or export.
(ii) in respect of manufacturer of bulk drugs (chapters 28/29) and the manufacturer of black and white picture tubes (8504.12), any unutilised credit in so far as it does not relate to inputs lying in stock or contained in finished product as on 1/3/97 shall lapse and shall not be allowed to be utilised for payment of duty on clearance of goods for consumption or export.

Rule 57F 18,19 - Methods of disposal of waste, arising from the processing of input.

The waste arising from the processing of inputs, in respect of which credit has been taken, can be disposed of in three different ways.

a. Waste may be removed on payment of duty as if such waste is manufactured in the factory.

b. Waste may be removed without payment of duty in accordance with the order of Government in this regard.

c. Waste may be destroyed in the presence of proper officer. Thereafter the duty on such waste is remitted if such waste is found unfit for further use or not worth the duty payable there on.

Rule 57F 20

New Rule 57F(20) permits transfer of unutilised credit where there is a change of ownership or where there is a change in the site of factory. The changes may result in shifting of factory to another site or due to sale, merger, amalgamation or transfer to joint venture with specific provision for transfer of liabilities of old factory. In such cases
stock of inputs as such or inputs in process are also transferred along with the factory to the new site or to the new owner. All inputs in respect of which credit has been availed for must be duly accounted for to the satisfaction of the Commissioner.

Procedure for disposal of waste arising from Processing of Input - Rule 57F(19)

The destruction of waste shall be done by following the procedure:

1. The waste arising from the processing of inputs in respect of which credit has been taken may be
   a) removed on payment of duty as if such waste is manufactured in the factory.
   b) removed without payment of duty as provided in section 18 to 57F
   c) destroyed in the presence of proper officer

2. The manufacturer may destroy such waste by following this procedure.
   a) The manufacturer seeking for destruction and remission of duty on such waste may make an intimation to superintendent of Central Excise.
   b) The application shall be made well in advance and prepared in triplicate.
   c) The application shall be sent in duplicate to the Range superintendent.
d) The dutiable waste can be destroyed only after duty there on, is paid.

e) After 7 days from the date of intimation the manufacturer (covered under Self Removal Procedure) may destroy the waste without the physical presence of officer.

f) Where the manufacturer is not covered under SRP the destruction shall be done under the supervision of proper officer.

g) The destruction of waste shall be carried out in manner specified from time to time.

The procedure for transferring the credit is as follows. 57F (20)

1. The transferor company has to apply to the Jurisdictional Assistant Commissioner for permission to transfer credit to the new concern alongwith the copy of document effecting the shifting of factory to another site or change of ownership.

2. The credit is restricted to the extent of unutilised amount (i.e) the balance of credit lying in RG 23 A. Part II.

3. The permission would be grantable when all the following conditions are satisfied.
   a. the liabilities of the transfer company are also transferred.
   b. the stock of inputs, work in process and finished goods are transferred.
   c. the credit availed by transferor company are duly accounted to the satisfaction of Assistant Commissioner.
Sometimes the inputs sent to the Job Worker may be received in piecemeal. In such case, the following procedure is adopted for receiving goods from job worker in peace meal under Rule 57F (4).

1. The job worker should maintain a subsidiary challan book.

2. This subsidiary challan should be prepared in duplicate which need not be in different colours.

3. Each set of challan should have pre-printed serial number.

4. The subsidiary challan book is pre authenticated by the job worker.

5. As and when the processed goods are sent in piecemeal the subsidiary challan is prepared and the original and duplicate copies are sent along with the consignments.

6. When the last piecemeal consignment is sent, duplicate copy of the challan is also sent.

The following is the Proforma of Subsidiary Challan (in Triplicate)

**Proforma of Subsidiary Challan**

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>For Sending Goods in piecemeal</th>
<th>Date:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Main challan Number and Date:</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Quantity dispatched (in terms of length or weight)</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>Nature of processing done:</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Quantity left in balance (in terms of length or weight)</td>
<td>Signature of the Processor</td>
</tr>
</tbody>
</table>
Procedure of cash Refund of Accumulated Credit - 57F(13)

The MODVAT credit availed under Rule 57A can be utilised as provided under the provisions of Rule 57F(12). Where the inputs are used in the manufacture of final products cleared for export under bond or used in the manufacture of intermediate products cleared for export, the credit availed in respect of such input can be

1) utilised towards payment of duty of excise on any final product cleared for home consumption or for export on payment of duty
2) if the above adjustment is not possible, then by way of cash refund.

Procedure to Claim Refund

1. The manufacturer-exporter should have exported the final products by following Rule 13.

2. The claim for cash refund shall be made once in 3 months (i.e) once in quarter. But where the average export clearance is 75% or more of the total clearances of dutiable goods in the preceeding 3 month, then claim for refund may be made for each calendar month.

3. The manufacturer-exporter shall make application for refund of duty under Rule 57F to the Assistant Commissioner of Central Excise.

4. The exporter shall give the following particulars in his application
1) full description of the goods exported

2) full description of inputs used in the manufacture of such goods and credit availed in respect of such inputs under Rule 57A.

3) relevant extracts of RG 23A.

4) number and date of bill of lading/ shipping bill/ export application.

5) amount of refund claimed.

5. The manufacturer-exporter has to enclose bill of lading or shipping bill or export application duly certified along with application.

6. The exporter has to give an undertaking to the Assistant Commissioner of Central Excise stating that he will pay back the refund erroneously paid to him, within 6 months of the date of payment.

7. The exporter is eligible for cash refund only if he is not in a position to utilise the credit available of under Rule 57A.

8. The exporter shall make this refund claim before the expiry of the period.

9. The refund claim is not admissible if the exporter avails himself of duty draw back under Customs Act or rebate of duty under Rule 12.
RULE 57G Procedures to be observed by the manufacturer

This rule requires every manufacturer to file a declaration with the Deputy Commissioner or Joint Commissioner and getting a dated acknowledgement before taking MODVAT credit. This declaration shows the final products manufactured by him and the inputs used in respect of which he is taking MODVAT credit. The declaration must show the specific tariff headings under which the finished goods and inputs are classified.

Rule 57(G) (2) provides that the manufacturer who has filed declaration may after obtaining the acknowledgement, take credit of duty on the inputs received by him.

Rule 57G(3) the credit shall be taken only when the inputs are received in the factory under the cover of any of the following documents:

a) invoice issued by a manufacturer of input under Rule 52A or 100E

b) an invoice issued by the manufacturer of input from his depot.

c) triplicate copy of Bill of Entry

d) a certificate issued by an Appraiser of customs posted in a foreign post office.

e) an invoice issued by a first stage dealer of excisable goods registered under Rule 174.

f) an invoice issued by second stage dealer of excisable goods registered under Rule 174 and duly authenticated by proper officer.
g) an invoice issued by an importer registered under Rule 174 and duly authenticated by proper officer.

h) an invoice issued by an importer from his depot or from the premises of the consignment agent of importer provided the depot of the premises is registered under Rule 174 and the invoice is duly authenticated by proper officer.

i) duplicate copy of a bill of entry generated on Electronic Data Interchange system installed in any Customs or Central Excise Commissionerates.

j) an invoice issued by a first stage or second stage dealer of imported goods registered under rule 174 and duly authenticated by proper officer.

k) a certificate (of differential duty) issued by the Superintendent of Central Excise or by proper officer in the customs area under Rule 57E.

l) an invoice issued by a manufacturer of final product under Rule 57F(3) or 57S(1).

**Time limit for taking credit 57G(5)**

Credit shall not be taken by the manufacturer after 6 months of the date of issue of any document specified under Rule 57G3 and where the intermediate products, are received after 9 months.
Rule 57G(6)

If the duplicate copy of invoice relating to the inputs, is lost in transit, then credit can be taken on the basis of original invoice, subject to the satisfaction of the Deputy Commissioner or Assistant Commissioner. Under Rule 52A, the invoice is issued in triplicate as follows:

1. original for buyer
2. duplicate for transporter (used for taking credit Under Rule 57G
3. triplicate for assessee.

The duplicate copy is required to accompany the duty paid goods. It is received by the consignee along with the goods. MODVAT credit is taken only on the strength of duplicate copy of Invoice, as it vouchsafes the receipt of the inputs.

Rule 57G(7)

This sub rule stipulates that the manufacturer using MODVAT credit should maintain the following register.

1. RG 23A Part I and II. These registers are furnished in Appendix I of this research report.

RG 23A Part I relates to stock of inputs and their movement and RG23A Part II pertains to MODVAT credit availed and utilised corresponding to such inputs.
Rule 57G(8)

If a manufacturer fails to make declaration of inputs as given in 57G(1), but files the same subsequently, the Deputy Commissioner or Assistant Commissioner of Central Excise is empowered to condone the delay in filing up to 6 months provided the inputs were used and duty have been actually paid. The manufacturer must give reasonable reasons for not filing the declaration prior to availment of credit. On the reasons, the Assistant Commissioner may condone the delay. The Assistant Commissioner shall condone the delay, if he is satisfied that

a) the inputs were received in the factory not before 6 months of filing such declaration.

b) the duty on inputs has been actually paid

c) the inputs have been actually used in the manufacture of final product. (Rule 57G(a) and 10)
The following Figure clearly depicts the procedure contained under Rule 57G

**FIGURE IV**

**RULE 57G**

<table>
<thead>
<tr>
<th>Incoming inputs</th>
<th>Checking eligibility Under Rule 57(A)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Has Declaration filed &amp; acknowledgement obtained already</td>
</tr>
<tr>
<td></td>
<td>File declaration immediately or condonation application with reason for delay</td>
</tr>
<tr>
<td></td>
<td>If yes</td>
</tr>
<tr>
<td></td>
<td>Check the validity of Invoice dated before 6 months of clearance</td>
</tr>
<tr>
<td></td>
<td>File declaration immediately or condonation application with reason for delay</td>
</tr>
<tr>
<td></td>
<td>If yes</td>
</tr>
<tr>
<td></td>
<td>Make entries in RG23A Part I</td>
</tr>
<tr>
<td></td>
<td>Avail credit in RG 23A Part II</td>
</tr>
<tr>
<td></td>
<td>At the end of the month/quarter file abstract of figures inform RT 12</td>
</tr>
</tbody>
</table>

**Following are the various steps to verify the validity of Duty Paying documents under Rule 57G (3).**

<table>
<thead>
<tr>
<th>Step I</th>
<th>Inputs received from --- No --- not eligible supplier who pay Central Excise duty.</th>
</tr>
</thead>
<tbody>
<tr>
<td>II</td>
<td>Is it excisable goods --- No --- File separately on which MODVAT credit is sought?</td>
</tr>
<tr>
<td>III</td>
<td>Is invoice specified — No —</td>
</tr>
<tr>
<td>IV</td>
<td>Is duplicate for transporters copy available — No —</td>
</tr>
<tr>
<td>V</td>
<td>1. Does the invoice bear — No — authentication of owners, partner, MD, Secretary or authorised person.</td>
</tr>
<tr>
<td></td>
<td>2. Refer the chapter heading/ sub-heading</td>
</tr>
<tr>
<td>VI</td>
<td>Whether the Invoice Contains the ECC number of Supplier</td>
</tr>
<tr>
<td>VII</td>
<td>Are the duty paying particulars clear? (Amount in words/Rs. rate etc.)</td>
</tr>
<tr>
<td>VIII</td>
<td>Is quantity received or accepted are equal — Yes —</td>
</tr>
<tr>
<td>IX</td>
<td>Valid invoice</td>
</tr>
</tbody>
</table>

Following are the various steps for availing of MODVAT Credit on Original Copy of Invoice

1. Receipt of inputs without duplicate copy (transporters copy)
2. Intimate SCE & ACCE about non receipt.
3. Enter in RG 23A Part-1, the quantity received and reference
to the document on which the entry is made.

4. Trace out the invoice by writing to the transporter and supplier

5. Duplicate invoice Traced -Yes - Intimate Superindendent of Central Excise and avail credit of duty in Part I

6. a) Apply to Assistant Commissioner with affidavit of person or agency who lost the invoice

b) an undertaking to handover the duplicate, if traced

c) declaration that inputs eligible for credit

Permission granted - Yes - Avail credit by entry in Part II

No

ACCE gives personal hearing and pass order

Permission granted - Yes - Avail credit by entry in Part II

No

Follow Appeal to Commissioner (Appeals)

Where the manufacturer has imported the inputs which are used in or in relation to the manufacture of final products he is eligible to avail himself of MODVAT credit in respect of such inputs to the extent of additional duty on customs duty otherwise known as
countervailing duty paid by him. The procedure to be followed at that time is given below

1. The MODVAT credit is admissible under rule 57A(1) on the countervailing duty (CVD) or additional duty of customs under section 3 of Customs Tariff Act.

2. The declaration under Rule 57(G) should be made to Assistant Commissioner.

3. The manufacturer-importer should make a declaration on all copies of entry that MODVAT credit would be availed on countervailing duty.

4. The declaration has to be attested by the Customs officer.

5. The manufacturer importer should make a declaration to the jurisdictional superintendent of central excise stating that no refund of countervailing duty has been claimed.

The manufacturer can take the MODVAT credit on goods imported by post parcel by following undermentioned procedure.

1. The MODVAT credit is admissible under Rule 57A(1) on the countervailing duty (CVD) or additional duty of customs under section 3 of customs Tariff Act.

2. The declaration under rule 57(G) should be made to Assistant Commissioner of Central Excise.

3. The foreign post office (FPO) will intimate the receipt of imported goods to the importer.
4. The importer shall apply to the jurisdictional Assistant Commissioner, Central Excise, (Foreign Post Office) in proforma 'A' declaring therein that MODVAT would be claimed on countervailing duty.

5. The Appraiser has to prepare the certificate of import in proforma 'B' in duplicate after duty has been discharged and issue the original to manufacturer-importer and duplicate to Range Superindent of manufacturer importer.

6. The manufacturer-importer may take credit on original certificate.

7. The manufacturer importer has to make a declaration to the jurisdictional superintendent stating that no refund of countervailing duty has been claimed.

**Maintenance of RG23A Register**

The manufacturers of final products who are working under MODVAT scheme are required to maintain statutory records which are provided under rule 57G(7). The manner in which such records are to be maintained is as under:

1. RG 23A Part I and II register are prescribed for MODVAT input-quantity account and MODVAT credit account respectively.

2. As and when inputs are received and issued for production, they shall be entered RG 23A Part I.
3. The assessee can make a consolidated entry of the issue after getting the permission of Assistant Commissioner.

4. The assessee can maintain a consolidated RG 23A Part I register for different inputs provided he maintains separate private records for receipt and issue of such inputs.

5. He has to furnish a list of all accounts maintained and reports to the Proper Officer.

6. The assessee shall maintain RG 23A Part II final product wise, chapterwise. A consolidated register can also be maintained.

7. The assessee are required to submit a statement along with RT-12 return indicating separately for each final product the details of credit taken and utilised.

8. The inputs not covered under MODVAT scheme need not be entered in the register.

Rule 57GG-Procedure to be followed by persons issuing Invoices under rule 57G or Rule 57T

Registered Dealers and MODVAT Scheme

The genesis of registered dealers as a class of traders in excisable goods, has its seeds in the history of MODVAT itself. In 1994, when abolishing the then gate pass system, introducing invoice based assessment system, the Central Government decided to dispense with adhoc system and introduce a new class of persons who could issue valid duty paying documents. The traders who purchased their goods from manufacturers or their depots or who import their merchandise were
allowed to issue commercial invoices containing specified particulars which are accepted as duty paying document for allowing MODVAT credit on the inputs purchased by a manufacture assessee. The traders are required to maintain a simple register to record the receipt of invoices/Bill of Entry and also invoices issued by them.

The procedure to be followed by such traders are as follows:

1. Every person who issues invoice under Rule 57(G) or 57(T) shall get himself registered under Rule 174.

2. The registered person shall maintain a stock account in Form RG 23D.

3. He shall make entry regarding receipt and issue of excisable goods and shall
   a. at the time making any entry, insert the date when the entry is made.
   b. correctly maintain such book, account or register in the manner required.
   c. keep the book, account or register ready for the inspection by the officers and shall permit any officer for inspection of records.

4) The registered person shall issue an invoice containing all details specified by the CBEC or Commissioner.

5) The invoice must be in duplicate and marked as follows:
   - Original for Buyer (white in colour)
- Duplicate for Transporter (Pink in colour)
- Registered person (dealer) (Green in colour)

The copies of invoices issued by a first stage dealer and a second stage dealer shall also be marked at the top in bold capital letters as FIRST STAGE DEALER and SECOND STAGE DEALER.

**Rule 57GG(6):**

Each invoice must bear a printed serial number running for the whole financial year beginning on the 1st April of each year.

**Rule 57GG(7):**

Before using the invoice book, each foil of the invoice book must be authenticated by the owner or working partner, Managing Director or Secretary. Such pre-authentication is done by affixing the signature of authorised person at the right hand corner of the invoice and indicating below the signature, the designation of the person who has signed the invoice. The registered person has to intimate the serial number of the invoice, before being used, to the ACCE and a dated acknowledgement of receipt of such intimation shall be retained by the registered person. The first and last copy of the invoice book shall be pre-authenticated by the jurisdiction range superintendent before the book is brought into use. But such pre-authentication is not necessary in the case of invoice generated on computers. The Inspectors of Central Excise, will authenticate all invoices issued by second stage dealer. Then only invoices issued by second stage dealer can be used for taking MODVAT credit.
Rule 577 GG(8)

When the invoice is generated through a computer, the registered person is required to intimate the serial number likely to be used in the forthcoming quarter. A revised intimation is sent after this invoice is exhausted. He must also send detail of software used including the format used for information of ACCE.

57GG(9)

The registered dealer has to issue only one invoice in respect of one consignment, if the all the packages in the consignment are despatched in one lot at one time. If the consignment is sent though different lorries, carriers, either on the same day or on different days a separate invoice shall be made out in respect of each lot.

57GG10

The registered person within seven days after the close of each month, submit to the Range Superintendent, a monthly return and other documents as per the specification of Central Board of Excise and Customs or Commissioner for verification.

57GG(11)

The registered person (dealer) has to preserve the documents specified under Rule 57GG for a period of 5 years and produce them to the central excise officer, on demand.
This section talks about defacing of Invoice. The registered person, within 7 days of each month, submit duplicate copies of invoices to the Superintendent Central Excise containing the matter that entire quantity shown in the invoice has been sold. Then the Superentendent defaces the same with the remark "MODVAT ALLOWED - NOT TO BE SOLD AGAIN". The invoice shall also contain

- that where the entire quantity has not been sold, the Range superintendent has to endorse on the back of the invoice, details relating to quantity received, quantity issued, total amount of duty available as input stage credit, the amount of duty for which invoices have been issued the balance quantity and the balance amount of duty (23D) available for issuing invoices.

Rule 57GG came into effect from 4.7.94, for the purpose of allowing manufacturers of final products to take MODVAT credit on dealers invoices. Every person who issues invoice under Rule 57G (relating to inputs) or Rule 57T (relating to capital goods) are to be registered under Rule 174. The first stage and second stage dealers invoice are only eligible for MODVAT credit. The other dealers cannot issue MODVATABLE invoice as this measure was taken to restrict the practice of falsification of invoices / accounts. It is mandatory for registered dealers to maintain RG23D register to record at the end of the day, receipt and issue of excisable goods. This register is a stock account. At the time of making the entry, date has to be entered. This register is to be kept ready for inspection by the officers of the department. The invoices issued by them have to be in the prescribed
format. A perusal of the format will make it clear that the original duty paying particular of the manufacturers have to be disclosed. From this figure, it is easy to determine the dealers' margin through a simple process of multiplication. For this reason, many dealers do not register themselves.

1. The applicant should file application for registration in the prescribed form.

2. The registration application shall be accompanied by the following documents.

   i) proof of ownership of premises or legal possession if the premises is hired one.

   ii) sales tax registration certificate/ income tax registration certificate.

   iii) let out premises, godown etc.

3. A copy of partnership deed if dealer is in partnership and a copy of resolution of the Board authorising the registration if the dealer is a company.

4. The signatories to the application

   | Proprietary business      | Proprietor |
   | Unregistered partnership  | All partners |
   | Registered partnership    | One partner |
   | Company                   | Person authorised by the Board |

5. The applicant should submit the description and tariff heading of excisable goods.
6. Name and Address, Permanent Assessee Number, Sales Tax Number, Banker's name, name, address and bank account number of the Applicant.

   Name, official and residential address, permanent assessee number, bankers' name, address and account number of the directors/partners/proprietor.

7. The applicant should apply for and obtain separate registration certificate for each premises from where he intends to issue the invoice.

8. On filing the application a dated acknowledgement must be obtained as proof of submission.

9. The registration certificate will be granted within 30 days of receipt of the application. If no certificate is received within this time, it is deemed to have been granted.

10. This registration certificate must be exhibited in the registered premises.

11. Sometimes, different portions the same godown, premises may be located in the adjoining premises separated by road, railway or canal, then separate registration is not necessary. But this fact must be indicated in the registration application.

12. Any change in godown or office premises used for storage of goods must be intimated to jurisdictional Superintendent and the new premises must be registered before it is used.
In-transit sale

In-transit sale implies sale of goods while they are in transit from the premises of one person to that of another person.

The Board vide its circular No. /96/7/95-C dated 13/2/95 clarified that under "Transit Sale", the movement of goods could take place directly with invoice issued under rule 52A from the manufacturer's premises to the users premises on an order placed by a dealer of excisable goods without being brought to the latter premises. The duplicate copy of the manufacturers invoice will serve as a cover for transport and for use of MODVAT credit.

The registered dealer may place an order to the manufacturer for supply and delivery directly to a specific customers. The goods will be directly taken to the customer's premises, without bringing them to the dealer's premises. The invoice issued by manufacturer will show the user's name, address (consignee) and the registered dealers' name and address. This invoice is used as relevant document for utilisation of MODVAT credit. The dealer need not issue any invoice.

Importer and MODVATABLE Invoice

Importers are now permitted to sell their goods directly from the harbour in one or more consignment to one or more customers. Importers who wish to issue "MODVATABLE" invoice shall get themselves registered under Rule 174 with range superintendent in the jurisdiction of importer. After registration, they can issue invoices under rule 57G or 57T, on the basis of the duplicate of relevant bill of entry.
They are also required to maintain stock account in Form RG 23D and follow all conditions laid down in rule 57GG.

Where the entire consignment is sold from dock to a single consignee, no invoice is required to be issued because the duplicate copy of the bill of entry duly signed and stamped by the proper officer of customs (indicating the name and address of the consignee), will serve as the transporters document for MODVAT credit purposes.

But where the consignment is split up for different consignees, the duplicate copy of bill of entry will be suitably endorsed by the proper officer of customs indicating the name and addresses of consignees, quantities sold, value and duty involved invoice-wise. The duplicate copy of invoice issued by the importer under Rule 57G duly endorsed by the proper officer of customs shall serve both as a transport document as well as duty paying document for MODVAT credit purposes.

The central excise officers can visit and inspect the premises and documents of registered dealers and importers only under the written orders of the jurisdictional Assistant Commissioner of Central Excise.

**Rule 57H-Transitional Provision in MODVAT Scheme**

The most important, purpose of transitional provision is to provide for switching over from one scheme to another scheme. This provision also aims at taking care of contingencies which may arise when the Government decides to introduce a new scheme which is open to existing tax payers. A transitional provision also provides for mitigating
the difficulties which may arise during the implementation of change on account of amendments to existing schemes.

Keeping in view that MODVAT Scheme now extended to almost all commodities, the rule 57H makes a general provision for allowing credit on a manufacturer who opts for MODVAT scheme afresh. The manufacturer is required to file a declaration of inputs lying in stock or received after filing a declaration. The manufacturer may also file a declaration of inputs contained in the final products cleared from the factory after filing of declaration under Rule 57G.

Rule 57H(3) provides for the transfer of unutilised credit availed on materials and component parts, where the manufacturer was availing of proforma credit or enjoying exemption with respect to the duty paid on such materials or components. Before transfer of unutilised credit the manufacturer must file a declaration with the ACCE.

Rule 57H(4) provides that transfer of credit shall be allowed if the materials, component parts and finished excisable goods have been specified in the notification issued under Rule 57A.

Rule 57H(5) A manufacturer who has filed declaration under Rule 57H, may after obtaining the dated acknowledgement take credit of the duty paid on inputs received by him.

57H(6) says that such credit shall be taken only if the inputs were received in the factory under the cover of a document as specified under Rule 57G, evidencing the payment of duty on such inputs.
Rule 57H(7) permits the manufacturer to opt out of MODVAT scheme. Where a manufacturer opts out from MODVAT benefit to exemption facility he shall be required to pay an amount to equal to the credit allowed to him in respect of inputs lying in stock or used in finished excisable goods. The balance lying in RG23A, would lapse and shall not be allowed to be utilised for payment of duty on any excisable goods.

Procedure to claim

MODVAT credit ON STOCKS UNDER RULE 57H

Stock of inputs in process:

1. Are inputs eligible under Rule 57A — No — Ignore
   | Yes

2. Has declaration been filed — No — File declaration
   undr Rule 57G
   | Yes

3. Are inputs covered by valid invoices — No — No credit
   | Yes

4. Make an application to ACCE

Rule 57-I Recovery of credit wrongly availed of

57-I (i) It deals with recovery of credit utilised on account of error, omission, misconstruction by issue of a show cause notice within 6 months from the date of filing of the monthly or quarterly return prescribed under Rule 57G(4) or within 5 years, in the case of wilful mis-statement, collusion or suppression of facts on the part of assessee.
57-I (2) deals with cases where the inputs on which MODVAT credit has been taken, are not fully accounted for as having been disposed of in the manner provided for in the Rules. The manufacturer has to pay the duty leviable on such inputs within three months of receipt of such demand.

Sub rule 57I (3) This rule provides for payment of interest in addition to the amount so determined as payable under sub-rule 1 and 2 if the assessee or manufacturer fails to pay the amount, within 3 months from the date of written demand till the date of payment. The rate of interest is 20%.

Where the credit of duty paid on inputs has been taken wrongly by reason of fraud, wilful mis-statement, collusion or suppression of facts or contravention of any provisions of the Act, the quantum of penalty has been determined as equal to the credit disallowed.

Rule 57J Credit of Duty in respect of Inputs used in Intermediate Product.

Rule 57J, provides for taking of MODVAT credit on the inputs used in production of intermediate products for discharging duty on final product. This Rule 57J contains a table of specified inputs and corresponding intermediate and final products. The credit is allowed to a manufacturer of final products on fulfillment of the following conditions.

1. the intermediate products are manufactured by a job worker in respect of which the exemption under notification No. 214/86 has been availed of
2. the intermediate products are received by the manufacturer of final products accompanied by documents under Rule 57G evidencing the payment of duty on such inputs.

A figure showing the procedure for availing of MODVAT credit on inputs used in manufacture of Intermediate products under Rule 57J is furnished below.

**FIGURE V**

**RULE 57J**

1. Manufacturer provides declaration under Notification No. 214 to jurisdictional Assistant Commissioner of Job worker

2. Filing 57G declaration clearly indicating input intermediate product and final product

3. Inputs sent to job worker directly supplier

4. Job worker to enter simple account in prescribed Form

5. On intimation of receipt, manufacturer to prepare a challan send to Job worker

6. Enter details of inputs sent directly in prescribed Register

7. After process job worker send challan invoice / B/E in original and duplicate to manufacturer along with the intermediate goods

8. Manufacturer to take credit after receipt of all the materials

9. Manufacturer to provide Jurisdictional AC of Job worker with details of use in duty paying final product.
The manufacturer get the intermediate products produced outside the factory and such intermediate product is exempted from duty liability, then the manufacturer cannot avail himself of the credit paid on such intermediate products. In order to enable the manufacturers to claim MODVAT credit in such circumstance, the Central Government has issued notification. The procedure is as under:

a. The manufacturer is to file a declaration under Rule 57G indicating description of the inputs, final products and particulars of intermediate products.

b. The manufacturer shall prepare the challan in Triplicate indicating the name of the supplier.

c. He shall give an undertaking to the Assistant Commissioner having jurisdiction over the factory of the job worker that the intermediate products will be used in or in relation to the manufacture of final products. An undertaking to discharge the duty payable on the finished goods must also be given.

d. After the intermediate products are manufactured, the job worker can despatch the goods to the manufacturer factory under the cover of challan.

e. The job worker should also send invoices, bill of entry evidencing duty having been paid on the raw materials received by him, in original and duplicate along with the consignment.

g. The manufacturer has to maintain a simple account in the form prescribed.
h. The job worker should also maintain a simple account in the form presented.

i. The manufacturer shall furnish evidence to the Assistant Commissioner having jurisdiction over the job worker that the products have been used in the manufacture of final products.

j. The manufacturer shall take credit on inputs after the same is received from the job worker in full.

The following Table XI shows the number of cases filed and decided in respect of MODVAT from the year 1986-1987 to 1996.\textsuperscript{8}

\textsuperscript{8} K.L. Rekhi and M.C. Agarwal Digest of Excise cases for the year 1996-'97, Centax publication, New Delhi, (Compiled).
<table>
<thead>
<tr>
<th>Relevant Rule</th>
<th>Number of cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>57A</td>
<td>500</td>
</tr>
<tr>
<td>57B</td>
<td>26</td>
</tr>
<tr>
<td>57C</td>
<td>56</td>
</tr>
<tr>
<td>57CC</td>
<td>80</td>
</tr>
<tr>
<td>57E</td>
<td>36</td>
</tr>
<tr>
<td>57F</td>
<td>20</td>
</tr>
<tr>
<td>57F(3)</td>
<td>37</td>
</tr>
<tr>
<td>57F(4)</td>
<td>31</td>
</tr>
<tr>
<td>57F(5)</td>
<td>18</td>
</tr>
<tr>
<td>57(F)</td>
<td>20</td>
</tr>
<tr>
<td>57(G)</td>
<td>393</td>
</tr>
<tr>
<td>57 GG</td>
<td>7</td>
</tr>
<tr>
<td>57 H</td>
<td>89</td>
</tr>
<tr>
<td>57 I</td>
<td>167</td>
</tr>
<tr>
<td>57J</td>
<td>1</td>
</tr>
<tr>
<td>57 K</td>
<td>25</td>
</tr>
<tr>
<td>57 O</td>
<td>5</td>
</tr>
<tr>
<td>57 P</td>
<td>2</td>
</tr>
<tr>
<td>57 Q</td>
<td>53</td>
</tr>
<tr>
<td>57 S</td>
<td>1</td>
</tr>
<tr>
<td>57 T</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1568</strong></td>
</tr>
</tbody>
</table>
Due to possibility of many interpretations and the nature of the text, endless litigations are pending in High Courts, Supreme Court and before the appellate authorities. There are wrong utilisation of MODVAT credit. In the year 1998-99, in Madurai Commissionerate 228 cases were filed for wrong utilisation of MODVAT credit with revenue loss of Rs.564 lakhs under Rule 57A. Similarly under Rule 57Q, as much as 155 cases are detected with revenue loss of Rs. 254 lakhs.\(^9\)

MODVAT CREDIT ON CAPITAL GOODS

Capital goods means machines, machinery, plant and equipment, apparatus, tools or appliances used for producing or processing any goods or for bringing about any change in any substance for the manufacture of final products. The term capital goods also covers components, parts and accessories of the item mentioned above. Moulds, dyes, generating sets and weigh bridges used in the factory of manufacturer also fall within the ambit of capital goods.\(^\text{10}\)

MODVAT on capital goods was a long standing demand of the manufacturing industries. The industry considered it essential that credit of duty paid on capital goods used in the manufacture of excisable goods also be allowed. Otherwise the purpose of introduction of MODVAT Scheme would not be fully achieved. The scheme for allowing credit of duty paid on capital goods was introduced in the Union Budget of 1994 as a part of restructuring and modernisation of taxation system. MODVAT on capital goods, MODVAT Scheme to petroleum products, introduction of ad valorem duties, removal of price list system were expected to give impetus to the growth of industries employment. It was a right step towards Value Added Tax. It came into vogue with effect from 01-03-1994.

\(^{10}\) Guidance Note on Accounting Treatment for MODVAT, The Chartered Accountant, August 1995, p.69.
The scheme allows credit of duty paid on capital goods used in the manufacture of excisable goods, for being utilised for payment of duty on final product.

GOODS ELIGIBLE FOR MODVAT CREDIT

1) Air Compressor

2) Air Filters, Alternator for Generator Set

3) Auto-Manual Station Installed on Boilers to control water level in the Boilers

4) Bags for Collecting Dust and Filter bags used in Cement Industry

5) Chilled Water Coil

6) Circuit Breakers

7) Cold Water Cleaning Machine

8) Batteries

9) Black Steel Tubes

10) Boiler

11) Brass Tubes and Pipes

12) Bucket Elevator Pipes

13) Ducts

14) Metal Bellow Screws

15) Bus Ducts
16) Transformer Chokes, Cable Fault Locator
17) Capacitors
18) Carding Machine
19) Spares
20) Cement and Steel used in construction of plant
21) Chain
22) Pulley Block Circuit Breaker
23) Computers used for designing Final Belt
24) Conveyor Belt, Part
25) Conveyor System
26) Control Equipment Switches
27) Starter
28) Control Panels
29) Cranes
30) D.C. Conductor
31) Diesel Engine for Generator
32) Effluent Treatment Apparatus
33) Electric Motors
34) Electrical Spares such as Control Cable
35) Press Switch
36) Micro Switch

37) Power Transformer

38) Electrodes

39) Fan Coils

40) Flexible Pipe Fittings

41) Fork Lift Trucks

42) Gas Analyser

43) Gas Generator

44) Gear Box

45) Shaft

46) Grease and Gear Oil

47) Material handling Machinery

48) Mechanical Spares for various types of Machinery

49) Nickel Plate used in Caustic Soda

50) Oil Compressor Ring Parts of Turbine

51) Pay Loader

52) Pipes and Tubes

53) Pneumatic Cylinders

54) Pollution Control Equipment

55) Portable Platform Scale
56) Digital Weighing Scale
57) Pressure Gauge
58) Printing Machine
59) Process Control Instruments
60) Parts of Programmable Logic Controller
61) Pulley
62) Pulley-Drive
63) Refractory Material
64) Rubber Hose
65) Roto Pumps
66) Safety Torch Fitted with Reactor
67) Safety Valves used in Boilers
68) Bottle Conveyor
69) Spares for Magnetic Clutch used for UPS
70) Spares for Trolley
71) Speed Controller
72) S.S.Fitter
73) Static Inverters
74) Steam Joining Steels
75) Steel Wire Rods
76) Steel Wire Rope Slings
77) Storage Tank
78) Temperature Controller-Aplat
79) Testing Machine for Yard
80) Transformers and Parts
81) Tools Fine Jack
81) Cutting Nozzle
82) Timmer Card
83) Trumpets of Cast Iron used for Pouring Mellon Metal
84) Ultrasonic Cleaner
85) Uster Tester
86) Valves
87) Voltage Stabilizer
88) Wagon Loader
89) Water Treatment Plant
90) Wires and Cables
91) Weighing Machine used for Weighing Raw Materials and Products
92) Yarn for Packing
The above listed items were covered under the definition of capital goods based on judgement of innumerable cases filed by the Industry.

The following list shows the items ineligible for MODVAT Credit.

1. Air Conditioners
2. Aluminium Tubes having no nexus with manufacturing process.
3. Arc Furnace
4. Asbestos Packing
5. Bed Drive Assembly
6. Cable, Cable Trays for Transmission of Electricity
7. Cement used for Construction
8. Cooling Lower Material having no nexus with manufacturing process.
9. Manufacturing used for Combing and Carding of Cotton
10. Modic Resins
11. Mercury used in Steel Dial Thermometer
12. Fire Extinguishers.
13. Humidifiers used in Cotton Spinning Mill to prevent breakage of Yarn
14. Malic Resins
15. Mercury used in Steel Thermometer
16. Oxygen Gas Level Gauges
17. Personal Computer
18. Pipes, Valves, Pumps, Rubber Tubes for Air Compressor
19. Safety Torch if carried by Individual in a Drug Manufacturing Unit
20. Steel Structural Tops
21. Steel Structural used for construction
22. Steel Plates, Ceramic Tiles
23. Storage Tanks and Bin Tanks
24. Thermic Bearing Metal
25. Thermodynamic Tap
26. Vacuum Pressure Calibrator
27. Walk Away Platform, Ladder railings

These were certain items ineligible for MODVAT credit as per the judgement pronounced in various legal cases.\textsuperscript{11}

When a manufacturer cannot take MODVAT Credit on Capital Goods

A manufacturer cannot take MODVAT credit on capital goods in the following cases.

1. If the capital goods are used in the manufacture of final products which fall under Chapter 24, Chapter Heading 36.05 - 37.06 (i.e. Tobacco, Tobacco Substitutes, Matches, Cinematograph Films)

2. If the capital goods were received before insertion of Rule 57Q-57U.

3. Where the capital goods are not installed or used in manufacture of final products and without providing Certificate to the Central Excise Office.

4. Where the capital goods are exclusively used in the manufacture of exempted final product.

5. Where the capital goods are used in the manufacture of intermediate product not covered under Rule 57Q.

6. Where the capital goods are acquired on lease, hire purchase or loan agreement and the manufacturer has failed to comply with the conditions and restriction as laid down in Notification number 27/96, Central Excise.

7. If the manufacturer claims depreciation under section 32 of Income Tax Act or claims as revenue expenditure in respect of the value of capital goods which represents the amount of excise duty on such capital goods.
8. If he has not filed the Declaration.

9. The capital goods are received into the factory without a valid Duty Paying Document.

PROCEDURE FOR AVAILING OF MODVAT CREDIT ON CAPITAL GOODS

Step-1

The manufacturer shall ensure that capital goods received are eligible capital goods within the definition of Rule 57Q.

Step-2

The manufacturer has to file a Declaration (5T(1)) with the jurisdictional Assistant Commissioner of Central Excise before the receipt of capital goods to the factory site.

Step-3

On receipt of capital goods into the factory, an intimation is to be given to the Range Superintendent.

Step-4

He shall maintain the required RG 23C Register and enter the receipt of capital goods in Part-I, RG 23C.

Step-5

He can take credit of duty paid only after he used the capital goods.
Step-6

Before availing himself of the credit, the manufacturer shall file with the Range Office, a Certificate that all the capital goods on which the credit was proposed to be availed have been put into use.

A manufacturer can take credit only on specified duties. The specified duty includes central excise duty payable under the Act as well as additional duty of customs under section 3 of Customs Tariff Act 1975.

Rule 57 R

Rule 57R lays down certain conditions which have to be satisfied for correct availing of credit on capital goods. This lays down conditions which are peculiar to availing of credit on capital goods.

Rule 57R(1)

Capital goods cannot be used exclusively in the manufacture of final products which are exempt from payment of duty or chargeable to nil duty, (except in relation to goods made for 100% EOUS, Free Trade Zones, Software Technology Park and Electronic Hardware Technology Parks).

Rule 57R(2)

MODVAT Credit on capital goods can be availed even if such goods are used in relation to intermediate products which come into existence during the manufacture of final product. Such intermediate
products must also be mentioned in Annexure to Rule 57Q (List of Eligible Capital Goods).

**Rule 57R(3)**

At the time of introduction, the rules did not permit the use of credit if the capital goods were procured on hire-purchase, lease, loan Agreement or any other transaction not involving direct purchase, whereby the property in the capital goods is not transferred to the manufacturer. In order to take credit on capital goods procured on hire purchase, lease etc. The following procedure is followed:

a) The manufacturer has to file a Declaration under Rule 57 T.

b) If the financing arrangement excludes the specified duty as defined in Rule 57 A, the manufacturer has to submit a copy of invoice evidencing payment of duty and also a copy of the agreement entered into with the Financing Company.

c) If the financing arrangement includes the specified duty then the manufacturer taking credit has to pay the amount of duty on capital goods to the finance company before payment of first lease rental or instalment. Thereafter, the manufacturer has to obtain a certificate from the finance company that such amount has already been paid. This certificate has to be produced to the Central Excise Department.

d) The finance company or the manufacturer can claim depreciation on the amount of specified duty.
e) The invoice must carry the name of the financing company as well as that of the manufacturer taking credit on such capital goods.

**Rule 57R(4,5,6)**

These three rules are composite in nature, providing for variation of credit already taken, recovery of credit already taken and denial of credit under certain circumstances.

**Rule 57R(4)**

This rule provides for recovery of credit if the duty paid on capital goods is refunded to the manufacturer or importer of capital goods. In such cases, the manufacturer is required to adjust the credit taken by him to the extent refund is granted. If sufficient credit is not available for adjustment the manufacturer has to pay the same in cash.

**Rule 57R(5)**

If a user/manufacturer has taken credit on any capital goods and subsequently it so happens that any additional amount of duty is recovered from the manufacturer of such capital goods, he shall be allowed an additional credit equal to the amount of such additional amount recovered.

**Rule 57R(6)**

It provides that the manufacturer can not take additional credit, where he pays additional duty on account of fraud, collusion or wilful mis-statement or suppression of facts or contravention of rule.
The additional credit will be allowed by proper officer on the basis of a certificate issued by the Superintendent of Central Excise, indicating the full description of capital goods, original duty paid, particulars of documents under which the capital goods were cleared from the factory and the differential duty recovered from the Manufacturer.

Rule 57(S) - Utilisation of MODVAT Credit on Capital Goods

a) The capital goods must be used in the factory in manufacture of final products.

b) The final goods may be removed from factory for home consumption or for export, on payment of duty.

Some times, the capital goods may be removed from factory without being used for making a final product, for home consumption or for export, then excise duty has to be paid which would be equal to the amount of credit already allowed.

Rule 57S(2)

This rule envisages two alternative methods for payment of duty on capital goods removed by the manufacturer.

1. When the capital goods are removed from factory without being used.

2. When the capital goods have been used in the factory.

The duty payable shall not be less than the amount of credit that has been allowed. When the capital goods are removed without
being used, credit can be taken immediately upon receipt. The provision requiring installation of capital goods does not apply.

Where capital goods are removed after being used in the factory for home consumption on payment of duty of excise or for export under rebate on payment of excise duty, such duty shall be calculated by allowing deduction of 2.5 per cent of credit taken for each quarter of a year. The quarterly periods are calculated from the date of taking credit.

If the capital goods are removed as scrap or waste, duty is payable at the rate applicable to such waste or scrap.

Rule 57 (S(3))

This rule lays down the basic provision governing the utilisation of credit taken on capital goods. There are three applications for the credit.

a) Payment of duty on any final products manufactured in the factory.

b) Payment of duty on waste arising in the course of manufacture of the final products.

c) Payment of duty on the capital goods when removed as such either for home consumption, export.

The credit available under RG23C register can not be used for:

a) Payment of a sum equal 8% of the value of exempted production under Rule 57 CC (Where common inputs are used for both dutiable and non-dutiable final products).
b) Debiting of 10% of the value of inputs or partially processed inputs when removed under Rule 57F(4) for job work.

The un-utilised portion of MODVAT credit on capital goods is not refundable.

**Rule 57S(5&6)**

They govern the transfer of credit on capital goods from one factory to another in case of;

a) shifting of factory to another site.

b) change in ownership due to merger, amalgamation, etc.

There should be a specific provision in the agreement for transfer of liabilities of old factory to the transferee factory. It is mandatory that the capital goods must also be transferred.

**Rule 57 S(7)**

It provides for the removal of capital goods to any place for test, for repairs, for reconditioning of such capital goods.

A manufacturer intending to send the capital goods for testing, repair, etc. has to follow, the following steps:-

1. Filing intimation with Assistant Commissioner of Central Excise.

2. Challan in Annexure-II of the Act must be authenticated by Central Excise Officer.
3. A simple account of 'Capital Removed In' register is to be maintained.

4. Goods must be returned in one lot along with the duplicate copy of Annexure-II with necessary endorsement.

5. In order to move the capital goods from repairer to another, Annexure-II Challan of the Act is to be used.

**Rule 57 S(8)**

This rule lays down the statutory provision for removal of moulds and dies without payment of duty, to a job worker for the production of goods on behalf of the manufacturers according to his specification. For this, the manufacturer is required to obtain the permission of the Commissioner. The goods thus produced and moulds and dyes are to be returned within one year\(^{12}\) or within such extended period. If they are not so received back within the stipulated period, the duty shall be paid which is equal to the credit taken on moulds and dies.

**Rule 57(T) - Declarations and Intimation**

This rule is similar to Rule 57(G). But it differs in certain aspects. It lays down the procedure subject to which credit is allowed. A declaration is to be filed for receipt of every capital goods.

\(^{12}\) B.N. Gururaj, Ibid., pp. 693-694.
Rule 57 T(1)

The manufacturer who intends to take credit on capital goods has to file a declaration in the prescribed form with the jurisdictional Assistant Commissioner of Central Excise and obtain a dated acknowledgement.

Rule 57 (T(2))

The form prescribed for this purpose is exhaustive and requires particulars such as description of capital goods, description of final products manufactured in the factory, declaration as to non availment of depreciation on the specified duty, that the capital goods are not exclusively used for production of exempted final product, declaration that the specified duty will not be charged as revenue expenditure.

The credit will not be denied even if there are some defects in the declaration. It is the discretion of Assistant Commissioner of Central Excise to allow credit. The new factory can start utilising MODVAT credit only after the production begins.

Rule 57-T, empowers the Assistant Commissioner of Central Excise to condone any delay in filing the declaration. Declaration must be filed before the receipt of capital goods into the factory. Rule 57 T(3) provides for filing the declaration within one month of receipt of capital goods. In case of delay, the Assistant Commissioner of Central Excise can condone delay upto 3 months. In case of delay, the manufacturer has to apply for condonation. A belated declaration is allowed to be filed only after the condonation of delay. Where the manufacturer intends to take credit of duty paid by the job worker who undertake modernisation,
renovation and setting-up of factories, additional declarations have to be filed.

**Rule 57-T (6-8): Documents evidencing Payment of Duty**

The capital goods on which credit is intended to be taken have to be received under a document specified under Rule 57G. The credit can be taken based on invoice / bill of entry/ dealer's certificate.

The credit on inputs has to be taken within 6 months. But for capital goods there is no time limit. The age of document is not a bar for taking credit on capital goods. Large capital equipment project require long lead time for completing installation. The time limit of 6 months from the date of issue of duty paying documents becomes unrealistic and highly restrictive. The Rule 57T permits a manufacturer to take credit on capital goods after it is installed or used.

The Rule 57T(7) provides that credit is not to be denied for reasons such as duty paying documents do not contain all the particulars required to be contained therein. The document shall contain details of payment of duty, description of capital goods, assessable, value, name and address of supplier's factory. While condoning such defects and allowing credit. The Assistant Commissioner is required to satisfy himself that duty on capital goods has been paid and such capital goods have been actively used in the manufacture of final products.

If the documents evidencing payment of duty (i.e) invoice, bill of entry are lost in transit, credit may be allowed if the Assistant
Commissioner of Central Excise is satisfied that the capital goods have been received into the factory and the duty thereon is paid.

**Rule 57 U - Demand, Recovery and Penalty**

Rule 57 U provides for disallowance and recovery of wrongful credit taken on the capital goods.

Sub Rule (1) deals with recovery of wrongly availed credit taken on account of error, omission or mis-construction on the part of an officer or manufacturer, by issue of show cause notice within 6 months from the date of filing the monthly, quarterly return prescribed under rule 57T(10) or within 5 years in case of wilful mis-statement, collusion or suppression of facts on the part of assessee or manufacturers.

The proper officer after considering the representation from the assessee shall determine the amount of credit to be disallowed and thereupon the amount shall be refunded.

Rule 57U(4) deals with cases where the capital goods on which MODVAT credit has been taken, are not fully accounted for as having been disposed of. In such cases the manufacturer upon a written demand by the Assistant Commissioner of Central Excise, pay the duty leviable on such capital goods, within 3 months.

Rule 57U(5) provides for payment of interest in addition to the amount determined, if the assessee fails to pay the amount within 3 months from the date of written demand till the date of payment. The rate of interest is 20%.
Sub Rules 6 & 8 of 57 U, provide that where credit of duty paid on inputs has been taken wrongly by reason of fraud, wilful mis-statement, collusion or suppression of facts or contravention of any of the provisions of the Act, with the intention to evade duty, the person is liable to pay the amount equivalent to the credit disallowed. He is requested to pay interest at such rate as decided by the Board.

**RECORDS AND RETURNS**

The provisions governing maintenance of records and filing of returns are substantially the same under both MODVAT on inputs and MODVAT on capital goods. The rules for maintaining records and returns are contained in Rule 51.

RG 23C Part I and II are the registers prescribed for the purpose of entering the receipt of capital goods and of credit of duty paid on such capital goods. Part-I register is also a Stock Register. RG23C Part-I Register has 9 columns which requires date of verification by the Superintendent, his remarks and initials. Issue of capital goods must be recorded. The issue register has columns regarding place of installation, date of commencement of use of capital goods.

Particulars of removal of capital goods from the factory either on payment of duty or without payment of duty must also be recorded.

**Returns**

A return is to be filed monthly basis. This return is called RT-12 Return which takes care of disclosure of amount of credit taken on inputs and capital goods. The time limit for filing the return is 5 days from
the end of the month in which capital goods are received or credit is taken. The proforma of RT. 12 return is furnished in Appendix I of the research report.

The original documents which are submitted along with the monthly return to the Superintendent will be returned to the manufacturer after verification of genuineness documents and defacing the same. The small scale industries can file returns once in a quarter.

ACCOUNTING TREATMENT OF MODVAT

There are two alternative methods of treatment of MODVAT in accounts.

a. Specified duty paid on inputs may be debited to a separate account for example MODVAT credit Receivables (Input) Account. As and when MODVAT credit is actually utilised against the payment of excise duty on final products, appropriate accounting entries are required to adjust the excise duty paid out of MODVAT Credit Receivable (Inputs of credit to the account maintained for payment/provision for excise duty on final product. In this case, the purchase cost of the inputs would be net of specified duty on inputs. The inventory is valued at purchase cost net of specified duty on inputs. The debit balance in MODVAT credit Receivable account is shown on the asset side under the head "Advances".

b. In the second alternative, the cost of inputs may be recorded at the total amount paid to the supplier inclusive of the specified duty on inputs. To the extent of the MODVAT credit
is utilised for payment of excise duty on final products, the amount could be credited to a separate account for example, MODVAT Credit Availed Account. Out of the MODVAT Credit Availed Account, the amount of MODVAT credit availed in respect of consumption of inputs would be reduced from the total cost of inputs consumed. The balance amount standing to the credit of MODVAT Credit Availed Account represent MODVAT credit in respect of Inputs lying in stock and is shown as deduction from the value of inventory.

In case of MODVAT credit on capital goods, the credit can be considered to be of the nature of a refundable tax. Therefore MODVAT credit should be reduced from the purchase cost of capital goods concerned. The specified duty on capital goods should be debited to separate account (i.e) MODVAT Credit Receivable (Capital Goods) Account. On actual utilisation, the account will be adjusted against excise duty on final products. Accordingly the purchase cost of capital goods is net of specified duty on capital goods. The unadjusted balance is shown on the asset side under the head "Advances".\(^\text{13}\)

**EVALUATION OF MODVAT SCHEME**

In other countries of VAT, the introduction of VAT was preceded by a year long administrative preparation, computerisation and tax payer

\(^{13}\) Guidance Note on Accounting Treatment for MODVAT, The Chartered Accountant, August, 1995 pp.71-72.
education. In India, the process has been one of iteration towards VAT (MODVAT) both in terms of structure and tax administration. Most countries have introduced the VAT with only a few rates and have a few excise taxes levied on the value of production (rather than on value added) such as petroleum products, tobacco, alcoholic drinks. In India, the transformation process of excise structure into MODVAT has almost eliminated the traditional excises. The scheme has been evaluated by examining duty erosion, irregular utilisation of credit and MODVAT offences.

The MODVAT scheme was not a complete boon to industries. The Report of the Comptroller and Auditor General of India had brought out the pitfalls.\textsuperscript{14} The expectation of the Government as to revenue neutrality was not fulfilled. It was thought that the MODVAT Scheme would result in considerable reduction in the cost of final product and therefore to retain the collection of excise duties at the earlier level, the rates were suitably adjusted. The Government believed that more industries would come forward to pay excise duty, so that they could take advantage of MODVAT credit scheme and pass on this benefit to the next buyer. However, comparison of the Excise Revenue, reveals a bitter truth that the revenue increased very marginally (i.e) from

\textsuperscript{14} Report of the Comptroller and Auditor General of India for the year ended 31-03-1988, p. 39
Rs. 14,470 crores in the year 1986-87 to Rs. 16,426 crores in 1987-88, and to Rs. 18,841 crores in 1988-89. The growth was not phenomenal but only marginal.

The special treatment accorded to the small and tiny sector under the excise tax system represented another distortion. There is suppression of output and turnover to evade excise duty. Out of 1,26,000 SSI sector units in Delhi, only around 10,000 units have been reported to be registered with Excise Department. The duty evasion by SSI is suspected to be around Rs. 800 crores according to an estimate by excise department. The duty evasion has been alarming. Crores of rupees are locked up in duty evasion cases. The following table shows the number of duty evasion cases and the amount locked up in cases.

TABLE XII

DUTY EVASION (ALL INDIA)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Cases</th>
<th>Duty Evasion (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985-1986</td>
<td>7625</td>
<td>277.00</td>
</tr>
<tr>
<td>1986-1987</td>
<td>751</td>
<td>426.00</td>
</tr>
<tr>
<td>1987-1988</td>
<td>6179</td>
<td>306.97</td>
</tr>
<tr>
<td>1988-1989</td>
<td>5120</td>
<td>284.51</td>
</tr>
<tr>
<td>1989-1990</td>
<td>5333</td>
<td>451.69</td>
</tr>
<tr>
<td>1990-1991</td>
<td>4891</td>
<td>435.93</td>
</tr>
<tr>
<td>1991-1992</td>
<td>5585</td>
<td>451.60</td>
</tr>
<tr>
<td>1992-1993</td>
<td>5295</td>
<td>662.29</td>
</tr>
<tr>
<td>1993-1994</td>
<td>5135</td>
<td>638.01</td>
</tr>
<tr>
<td>1994-1995</td>
<td>7437</td>
<td>827.78</td>
</tr>
<tr>
<td>1995-1996</td>
<td>7193</td>
<td>1003.08</td>
</tr>
<tr>
<td>1996-1997</td>
<td>6814</td>
<td>1033.46</td>
</tr>
</tbody>
</table>


The above table depicts the picture of duty evasion over a period of twelve years. The aforesaid table clearly shows that the cases pending in various courts and judicial offices are increasing. The amount of revenue locked up in cases had exceeded Rs.1000 crore which is disproportionate to the overall revenue of Rs.46916 crores in 1996-97, forming nearly 2% of total revenue.
In Madurai Commissionerate alone, 293 cases of duty evasion had been identified in 1997. The following table explains the duty evasion by industries in the territorial jurisdiction of Madurai Commissionerate.

**TABLE XIII**

**DUTY EVASION IN MADURAI COMMISSIONERATE**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Cases</th>
<th>Duty Evaded (Rs. in Crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-1993</td>
<td>407</td>
<td>3.69</td>
</tr>
<tr>
<td>1993-1994</td>
<td>564</td>
<td>3.63</td>
</tr>
<tr>
<td>1994-1995</td>
<td>425</td>
<td>4.69</td>
</tr>
<tr>
<td>1995-1996</td>
<td>338</td>
<td>15.75</td>
</tr>
<tr>
<td>1996-1997</td>
<td>293</td>
<td>6.10</td>
</tr>
<tr>
<td>1997-1998</td>
<td>46</td>
<td>4.25</td>
</tr>
</tbody>
</table>

Source: Records maintained by Central Excise Department-Madurai. As at the end of every Financial Year compiled for the book "Excise at a Glance".

It is clear from the above table that on an average Rs.4 crore was lost by the Commissionerate due to evasion of duty. In 1995-1996 alone, there is an evasion of Rs.15.75 crores. The revenue collection of Madurai Commissionerate in 1997-1998 was Rs.492.33, and the duty evasion was Rs.4.25 crore.

There are cases of irregular utilisation of MODVAT Credit. The Anti-evasion Cell of Madurai Commissionerate has brought out the fact
that there were 259 cases pending on 01-04-98. The MODVAT Credit irregularly utilised of under rule 57A (input credit) were 114 cases with a revenue loss of 417.19 lakhs and 79 cases of irregular utilisation of MODVAT credit on capital goods with a revenue loss of Rs.172.88 crores.

The number of irregular utilisation of MODVAT credit cases reported in 1998-1999, were 228 (under Rule 57A) with a revenue loss of Rs.564 lakhs. On the capital goods side, the number of cases were 155, with a revenue loss of Rs.254 lakhs.\textsuperscript{16}

Even though credit is given for tax paid on capital goods, the post tax price of capital goods is used for the calculation of production value for tax purposes in the next stage. Thus, a cascading element remains in MODVAT.

There are too many proformas and records to be maintained. There is lack of clear guidance to MODVAT Assesees. In order to understand and follow the rules 57A-57U, the industries must hire the services of consultants and lawyers, involving additional cost. Necessarily, the cost is passed on to buyers.

Even after the passing of nearly fifteen years of introduction of MODVAT, the Government could not adopt transparency and simplified documentation which are necessary for VAT.

\textsuperscript{16} Records of Central Excise Commissionerate - Statistics Department, Madurai.
MODVAT scheme provides for lot of exemptions, concessions and different layers of taxation. This makes the implementation more complex. There are many loop-holes through which the unscrupulous assessees escape. The approach of selective concessions coupled with exemptions granted through more than 500 notifications led to several complications.  

Almost every rule made under MODVAT scheme became a subject matter of dispute, eroding the revenue of the Government as well as that of the manufacturer who had to go up to Supreme Court for decision. For example, the expression "in or in relation to the manufacture of the said final product" occurring in Rule 57A causes maximum headache to revenue as well as to the manufacturer since the eligibility for credit is to be decided under the provision of the said rule.

The Central Excise law is deficient towards the needs of the industry. In the budget (1999-2000)\textsuperscript{18}, an amendment is made in Rule 57A(4) by adding a provision, that provides a facility to send the processed finished product from a job worker premises to the customer clearly indicates that so far the existing law was deficient to the practical needs of the industry. Prior to the addition of this provision, a

\begin{flushleft}
\textsuperscript{17} S. Gurumoorthy, Towards an Appropriate VAT System for Federal Economy- Economic and Political Weekly, October 2-8, 1999, pp.2875-2887.

\end{flushleft}
manufacturer had to receive the processed goods back to his factory and then send the same to the customers. In this way, the manufacturer had to bear the expenses of double transportation which ultimately enhanced the price of products and the public had to bear the burden.

The implementation of MODVAT provides administrative difficulties. It requires honest and efficient machinery to cross check and link-up the various production activities and determine tax liability. The efficiency of MODVAT scheme depends on the co-operation of tax payers. Besides calculating its own tax liability, a firm has to determine the taxes paid by earlier firms. If the government machinery is ill-equipped and fails to do the necessary cross checking, the tax payers may resort to creation of false purchase invoice showing taxes paid by others. To that extent, tax evasion becomes easier.

The system is abused by manipulation of documents and lack of control over dealers who are also in the chain of movement of goods.

Procedural complication and hardships have adverse impact on industry. In a move to simplify the procedures in recent time, many measures are taken by the revenue department. Procedures for expeditious assessment, clearance of import goods, rationalisation of duty structure, relaxation of maintaining statutory records of excise by companies paying over Rs.5 crores duty in one year, self clearance procedure for 100% Export Oriented Units are some of the recently introduced measures intended to simplify procedure. But no practical relief to the industry is available, as they have to maintain PLA, duty paying documents, RG23A,C records. The industries have to submit monthly returns in form RT-12. (A proforma of RT 12 is annexed in
Appendix 1 of this research report) as usual, other returns, application, declaration, intimation have to be followed as in the present practice. The criteria for eligibility is based on payments from PLA and does not include MODVAT payment, this restricts the facility to very large units only.

The removal of the matching requirement of inputs with output for crediting purposes starting from 1995-1996 have a negative impact on MODVAT Revenue. The main reason for increase in MODVAT credit is elimination of condition of matching input with particular output, leading to building up of raw materials with respect to which MODVAT credit for the duties paid would have been availed against the clearances of some products. This suggests that MODVAT credit ratios could decline in the subsequent years. 19

Bulk of offences tend to be procedural or technical nature. They are of (a) improper documentation (b) wrong utilisation of credit of capital goods (c) inadmissible input (d) undeclared inputs (e) wrong interpretation of notification (f) unregistered dealers invoice (g) credit on

original invoice (h) invoice not on factory address (i) invoice not in the name of unit. 20

Interpretation of what is creditable goods is based on a positive list than a negative list leading to representations from industry. They have to be inferred from decided cases, which vary widely.

The study carried out by the National Institute of Public Finance and Policy (1994) made this observation that the domestic tax (Union Excise Duty) operating at present is archaic, irrational and complex. It is the most complex in the world. It interferes with the free play of market forces and competition, causes economic distortion and entails high cost of compliance.

The findings of the 'Study of Incidence of Indirect Taxes in India' 21

a) The total effective rate of taxes varied between 3% - 40% for most of the commodities.
b) For essential commodities the rate varied between 3-12%.
c) On an average, sales tax accounted for the highest burden


exceeding 5% points of the effective tax rate; union excise duties and customs duty accounted for less than 5% point; Countervailing duty generally did not account for more than 1% point, reflecting the availability of tax credit against the MODVAT.

d) The contribution of sales tax in the input taxation was the highest, the contribution of Union Excise Duty was substantial followed by contribution of Customs Duty.

e) It is recommended that, given the high incidence of input taxation, the States should also move to a credit mechanism in their respective sales tax structure.

The Tax Reforms Committee formed by the Government to evaluate MODVAT Scheme under the chairmanship of Dr.Raja J.Chelliah, made a vital recommendation that, if VAT is to be adopted, it is necessary to switch over to the mode of assessment based on invoice price. At present, taxes are levied on the basis of advalorem, specific rate, maximum retail price and plant capacity. All these are to be converted into Advalorem to move to VAT.

MODVAT TO VAT

The Modified Value Added Tax has been introduced to bring about transparency of the Tax to reduce cascading effect on input taxation and to provide for self checking of its evasion. The studies relating to impact of introduction of MODVAT indicate that individual units have been able to save on interest (0.5% to 1% of total duty paid),
the effect have been revenue neutral and has not caused any price effect.^^

Unlike VAT in European and other countries of the world, MODVAT does not replace excise but introduces the principle of VAT under the system of union excise duties levied by Union Government. There is substantial difference between MODVAT and VAT prevailing in United Kingdom. In VAT system, thee is levy of tax only on the value added. If the value of input is Rs.100 and by work done on the same, the value of output becomes Rs.250, the tax is only on Rs.150, which is value added. In other words VAT enables the deduction of entire value of input. On the other hand in MODVAT, there is credit given in respect of duty already paid on inputs and this goes to reduce the duty payable on the final product or output.

The concept of VAT has been gaining recognition lately and it has been regarded as Worlds' fastest growing tax. Since the tax is levied on the value added, it is VAT. It is claimed that the tax possesses the merits of final state sales concept and measurement.

For the purpose of imposition of the VAT, it is essential to measure the value added and the base on which the tax is to be levied. In a unit engaged in productive operation, the value added is regarded as the difference between the gross value of output and that of the intermediate goods purchased for the purpose of production. VAT could

..........................

be levied in three ways. These are derived from different concepts of measurement of income.

The success of tax reforms depends on its careful calibration. A series of sequential steps are involved in the introduction of VAT. Measures such as minimising exemptions, adopting four floor rates (0, 4, 8, 12), reduction in the rate of central sales tax, phasing out tax incentives, restructuring administration, computerisation of returns, creating a Management Information System and educating tax collectors and tax payers should be achieved in the first phase. In the next phase, the number of tax rates should be reduced to two and the base should be extended. There may be separate tax on luxury items like motorcars.

To begin with, the centre has to set his own house in order. Reforming taxes should begin with rationalisation of the excise duties. Specific rates are to be completely abolished. It is also necessary to complete the computerisation process to prevent illegitimate refunds. The Union Government has to coordinate and monitor the States to make them function within the fiscal framework agreed to by them collectively. Forging an agreement to reduce and eliminate sales tax will be difficult at each state. It is here that the negotiating skill of the centre is crucial. To enable a proper goods and service tax, the Central Government should amend the Constitution to allow tax powers to the

States in respect of services.

States on their part should realise that introduction of VAT helps to impart competitiveness. In the long run, the levy designed and implemented with sufficient preparation and care will enhance revenue and productivity.

Secondly, the tax may be gross product type in which case no capital outlays, depreciation allowance will be deductible from the base.

In the third case, which is net income type VAT, depreciation is deductible for the purpose of estimation of base. For computation of the base of VAT, the methods adopted are a) Income Method b) Product Method.

Income method is essentially an addition procedure. In this method, payments on various factors of production namely rent, wages, interest, profits are accounted for.

In the Product method, subtraction procedure is followed. The subtraction procedure is adopted either in the form of Tax Credit Method or Cost Subtraction Method.

In the Tax Credit method, a firm is permitted to deduct the VAT paid by it (on its purchases from units) from the VAT which the firm has to pay. In this case computation of bases becomes quite easy. It is effected with the help of sales invoices of the firm. In the European Economic Community Countries, the Tax Credit Method has been operative quite successfully. In case of Cost Subtraction Method, the base
is computed by subtraction of firms expenses on intermediate products etc. from its sales income.

The following figure clearly brings out the essential bases of computation of VAT.

**FIGURE VI**

**BASES OF COMPUTATION OF VAT**

<table>
<thead>
<tr>
<th>Gross Product VAT</th>
<th>Income Variant</th>
<th>Consumption variant</th>
</tr>
</thead>
<tbody>
<tr>
<td>(tax levied on all sales with no deduction for business inputs.)</td>
<td>(tax levied on all sales with set-off for depreciation on capital goods.)</td>
<td>(Tax levied on all sales with deduction for business input.)</td>
</tr>
</tbody>
</table>

**Addition Method**

- Identification of value added by summation of wages, profit, rent and interest.

**Subtraction Method**

- Estimating value added by taking difference between output and input.

<table>
<thead>
<tr>
<th>Direct subtraction</th>
<th>Intermediate subtraction method</th>
<th>Deducting tax on inputs from tax on sales for each tax paid (also known as tax credit method/invoice method. (Used in India.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(deduction aggregates tax exclusive of value of purchase from the tax-exclusive value of sales.)</td>
<td>(deducting tax inclusive value of purchases from sales and taxing the difference between them.)</td>
<td></td>
</tr>
</tbody>
</table>

---

NEED FOR VAT

The original interest in the VAT stemmed from the desire for a general sales tax which would avoid the cascade feature of general turnover tax. It is believed that turnover tax treats distortions in the pattern of relative goods prices and facilitates vertical integration of firms. In the case of VAT, each firm is taxed only on the portion of final product which is over and above what it has purchased from other VAT paying unit. Hence, the final goods are taxed proportionately to their selling price.

The concept of sales tax not only discriminates against consumers having high preference of goods which pass through numerous transactions, but also discriminates against non-integrated units.

The VAT is neutral in effects. It is easier to get a large revenue from a relatively low tax rate spread over a large number of firms involved in VAT instead of planting all responsibility for a high tax collection on a single stage in production.

VAT, on the whole, would be less regressive in nature. One does not know how much tax is included in the final price paid. It also forces business community to keep proper records of their business at different stages. This in turn will help the tax authorities in checking evasion. It is helpful in economic planning, curbing evasion, efficient management of national resources and mobilisation of resources to the government.

The tax on value added prevents the cascading effect of indirect tax. VAT replaces other taxes which are in fact multiple taxes. In case of exports with input taxes removed, the export promotion gets a boost.
This tax is a good instrument to regulate demand for products. VAT has a much broader base. In case of VAT, small changes can bring about substantial changes in demand because many goods are affected.

Demerits

1. There is an increase in costs involved in working of VAT. There is a need for larger administrative personnel for additional work of assessment, collection and verification.

2. The tax payers incur heavy cost in keeping records on an extensive scale because VAT require maintenance of accounts of almost all the sales and purchase transactions.

3. VAT is against the principle of equity in taxation. With almost uniform tax rate on many goods and services subject to tax, the rich and the poor may have to bear almost equal money burden. As much, the impact will be more on the poor than on the rich. This is the regressive nature of VAT. But rich man's goods can be taxed heavily compared to poor man's goods.

4. The major drawback is that in order to change to VAT, the successive producer or manufacturer must know the cost. Data of his predecessors are very difficult to obtain.

5. The replacement of VAT means loss of power to levy sales tax and octroi which would seriously erode the fiscal autonomy of State Government.
6. Due to large number of tax payers, the enforcement of VAT at wholesale stage and retail stage will pose administrative difficulties.

7. It has been difficult to measure the incidence of excise duty and sales tax, their effect of production, consumption or export of commodities to examine the possibility of determining the proportion that combined money burden of excise duty and sales tax bore to the selling price of each commodity. In India, the States were not in a position to furnish data regarding the total value of rates and total sales tax collection under each item. As per the Report of Fourth Finance Commission - 1965 it was of the opinion that unless they are in a position to undertake for each excisable item detailed cost analysis studies, they would not be able to determine whether the production, consumption or export was being hampered on account of excessive burden of excise duty and sales tax.

8. It should be recognised that the prevailing sales tax system in India is based on the "origin" principle which allows the retention of revenue in the producing States. If VAT is to be levied, it should be on the selling price. So, a switch over to the destination principle which would allow revenue to accrue to the consuming State and would be difficult since several industrial States might stand to lose revenue.

9. International experience shows that successful implementation of VAT requires determination of the VAT rates by the centre and that a centrally determined VAT should replace sales tax.
It is very difficult to convince the States about the superiority of VAT over the first point sales tax.

10. The economic proposition that VAT eliminates the eascading effect and thereby makes allocation of resources less distorted is not true. Regarding the escading effect it must be remembered that in an under developed country like India, where prices are many, subsidies rampant, resources scarce mere VAT has very little impact on resource allocation. If prices are continued to be controlled by the Government, the advantages of VAT cannot be attained.