V. REFORM OF CENTRAL EXCISES

The structure of excise duty, which emerged in the early 1980s could not be considered rational and conducive to the growth of the economy. The problems included: a large number of tax rates with wide spread, many exemptions, tax cascading, the discretion of the Finance Minister to make *ad hoc* changes in the duty rates, and complex administrative procedures. Reform of the excise system began in earnest in the mid 1980s. The excise duty reforms focused on relieving tax cascading, rationalisation of duty rates, and simplification of rules and procedures. As a first step towards mitigating tax cascading, a scheme of MODVAT credit, though with limited scope, was introduced in 1986. This permitted the manufacturers to avail of tax credit for the excise duty paid on their purchase of specified raw materials (and not capital goods) used in the manufacturing of specified goods. Over time, scope of the MODVAT scheme was enlarged to reduce tax cascading by expanding the list of inputs as well as end products eligible to MODVAT credit (Table V.1). The rate structure has been rationalised along with reduction in the number of rates and their spread. Rules and procedures have been simplified, though some times, at the cost of revenue.

1. Prevailing Structure

a. Rates, Base, Valuation and Credit

Goods subjected to excise duty are only those goods which are specified in the schedules to Central Excise Tariff Act, 1985 (CETA). The authority for levy of excise duties is through Entry 84, List I, Seventh Schedule and Entry 97 of the same List. Entry 84 empowers Central Government to levy duty of excise on all articles produced or manufactured in India excluding alcohol for human consumption. Entry 97 gives residuary powers under the Union List. A taxable event comprises manufacture, though duty can be collected at a later stage such as clearance from depot. Classifications are matched upto four digits with customs Tariffs.

Table V.1	
Major Changes in the Coverage of Raw Material and Capital Goods under MODVAT	
Year	**Coverage**
1986-87	MODVAT introduced for selected raw materials when used in production of specified goods.
1987-88	Most of the raw materials covered under MODVAT
1988-89	Minor expansion in the coverage of MODVAT
1989-90	Minor expansion in the coverage of MODVAT
1990-91	Minor expansion in the coverage of MODVAT
1991-92	Minor expansion in the coverage of MODVAT
1992-93	Minor expansion in the coverage of MODVAT
1993-94	Minor expansion in the coverage of MODVAT
1994-95	1. Capital goods, petroleum products and specified spun yarns covered under MODVAT.
	2. Small scale industrial (SSI) enterprises given the option to pay normal excise duty in place of concessional duty.[1]
1995-96	1. The scheme extended to cut tobacco, plastic woven sacks, specified textiles and equipments.
	2. Scope of SSI concessions enlarged. Turnover limit for availing SSI concessions raised from Rs.2 crore to Rs.3 crore.[2]
	3. Conditions of matching raw materials/capital goods with output for allowing MODVAT credit, withdrawn.
1996-97	1. MODVAT credit in respect of some capital goods has been denied.
	2. In the case of processed textile fabrics, a deemed MODVAT credit has been allowed, without production of duty paying documents.
	3. The scope of availing MODVAT credit in the case of production of exempt goods supplied to specified buyers such as 100% EOUs has been extended.
	4. The rule for reversal of MODVAT credit in respect of exempted final product has been simplified to 20% of value of such goods.
	5. When the manufacturer clears inputs or partially processed inputs for job work, MODVAT credit availed of on this account should be reversed.
	6. MODVAT credit on the basis of invoices issued by third and subsequent dealers denied to check evasion.
	7. In the case of invoices issued by the second stage dealer, credit will be admissible only if the same has been signed by the proper officer.
	8. Mandatory penalty of 100% and interest to be charged in case of wrong availment of MODVAT credit on inputs.
1997-98	1. Duty rates have been restructured with basic rates of 8, 13 and 18%.
	2. Some exemptions have been withdrawan.
	3. Exemption scheme for SSIs has been modified with exclusion of certain goods from it's purview. If MODVAT credit is not availed then duty rates are 0, 3 and 5% respectively on clearances upto Rs.30lakh, next Rs.20lakh and next Rs.50lakh.
	4. Accummulated MODVAT credit, as on 1.3.1997, with the manufacturers of bulk drugs to lapse.
	5. MODVAT credit allowed to the extent of 75% of the CVD paid on goods imported under project imports.
	6. Invoices issued by the depot or consignment agent of an importer made eligible for availing credit.

Table V.1 (Contd.)

Major Changes in the Coverage of Raw Material and Capital Goods under MODVAT

Year	Coverage
1998-99	1. MODVAT credit in respect of inputs restricted to 95% of the excise paid on inputs, with effect from June 2, 1998.
	2. Exemption scheme for SSIs has been liberalised. Duty rates have been modified to 0 and 5% respectively on clearances upto Rs.50lakh and next Rs.50lakh. SSI benefit has been extended to computers while withdrawan on copper alloys.
	3. Maximum retail sale price (MRP) based assessment has been extended to many products such as chocolates, malt extract, pan masala and glazed tiles.
1999-00	1. MODVAT credit in respect of inputs restored to 100%.
	2. The restriction on taking MODVAT credit to the extent of 10% or the amount of CVD in respect of certain petrolium products has been removed.
	3. The scope of capital goods credit has been extended to duty paid on certain machines.
	4. The exemption in respect of independent processors of yarn has been withdrawan. The duty is fixed at Rs.5 per Kg. with no benefit of MODVAT credit.
	5. The excise duty on packaged tea has been withdrawan. However, on bulk tea, a duty of Rs.2 per Kg. has been imposed.
	6. Eleven existing excise rates have been compressed into three: 8,16 and 24% with two non-rebatable special duty rates: 6 and 16% to make up for the existing rates of 30 and 40%.
	7. MRP based assessment has been extended to 27 more products.
	8. SSIs have been allowed to pay duty on monthly basis instead of daily.
	9. The discretion to grant ad hoc exemptions has been given up, excepting in the case of goods for security, strategic or charitable purposes.
2000-01	1. MODVAT has been renamed as CENVAT with a single CENVAT rate of 16%. In addition there will be non-rebatable special duty at the rates of 8, 16 or 24%.
	2. MODVAT credit extended to all inputs except high speed diesel (HSD) oil and motor spirit (pertol).
	3. MODVAT credit would be available in respect of all finished goods except matches.
	4. MODVAT credit has been extended to all capital goods. Restriction of 75% in respect of capital goods credit (for CVD) on project imports has been removed. The condition of installation has been removed. However, availment of capital goods credit has to be spread over two years.
Source:	Budgets of Union Government of India, for different years.

There is a multiplicity of levies. These are:

- Central Value Added Tax (called CENVAT) and special duty of excise.
- (AED) ST): Additional duty of Excise (Goods of Special Importance) Act, 1957. This is in lieu of Sales Tax on sugar, fabrics, tobacco products.
- Additional duty on motor spirit (Petrol) and diesel.

- AED (T&T): Additional duty of Excise (Textiles and Textiles Articles), 1978 –on fibres, yarns and fabrics—to subsidise controlled cloth scheme.
- Cesses leviable under miscellaneous enactments.

For the levy of central excise duty, there has to be manufacture. "Manufacture" is defined in Sec 2(f) of Central Excise Act, and includes any process,

(i) incidental or ancillary to the completion of a manufactured product, and

(ii) which is specified in relation to any goods in the Section or Chapter Notes, as amounting to manufacture. This is an extended definition. For example, labelling or repacking is "manufacture" with respect to medicines.

The Supreme Court has held that (Ujagar Prints Case) even if a process covered by the extended definition does not appear to amount to manufacture in conventional sense of the term, the definition would still be constitutionally valid under Entry 97 of List I (if not under Entry 84).

But in general, the twin test is—

(a)New articles should come into existence; and

(b) It should be marketable.

Courts have tended to give the opinion that a facilitating artificial definition is acceptable as long as there is value addition by the manufacturer, even if manufacturing event is not present by any general definition.

Types of Excise Control

• Physical Control	-	For cigarettes
• Compounded Levy	-	Stainless steel patti, embroidery
• Collection at point of consumption	-	Only for molasses where the

		user pays the duty
• Production based levy	-	Independent processors processing fabric. Duty is determined by the capacity of the stentering machine
• Self Removal Procedure (Since 1968)	-	All other goods.

There is a multiplicity of exemptions. Though the Tariff rates are prescribed in the schedule of CETA, the effective rates can be lower because of exemption. The types of exemptions are :-

- Exemption/concessional rates for small scale industry (SSI).
- Specified products of village industry, and marketed with the assistance of KVIC.
- Specified goods made in rural areas—areas comprised in a village as defined in the land revenue records.
- Specified goods supplied to public funded research institution, non commercial institutes, university.
- Goods produced by ordinance factories, defence related exemptions
- Goods donated to national defence fund.
- Specified goods produced without the aid of power.
- All goods made in factories of NorthEast and commencing production after 24/12/97 or old units having substantial expansion (25 percent and more) after 24/12/97.
- Tea cleared by factories belonging to cooperative society or bought pan leaf factory.
- A number of food products—khandsari sugar, bread, spices, coffee, certain unbranded food items.
- Fertilizers. Cereals, edible oils.
- Aircraft, ship, boat etc.
- Ready made garments.
- Clocks. Watches of MRP upto Rs. 500/- per piece.
- Electric bulbs of MRP upto Rs. 20/-

This is not an exhaustive list.

Exemptions relating to small scale industry (SSI) apply to units :-

(a) Total clearance of excisable goods for home consumption (excluding exempted goods) not exceeding Rs. 3 crores in preceding financial year.

(b) Does not apply to goods produced with the brand name of others (except KVIC brands, or state/National Small Industries Cooperative brands)

There are two schemes regarding clearances in a financial year.

For units opting for CENVAT Credit:-

- 0-100 lakhs[1] -> 60 percent of normal rate
- exceeding 100 lakhs -> normal rate

Units not opting for CENVAT Credit :-

- 0-100 lakhs -> nil
- exceeding 100 lakhs -> normal rate

The rate structure is as follows. The central or median rate of 16 percent (known as Cenvat). In addition, SED (Special Excise Duty) rates of 8 percent, 16 percent and 24 percent exist.

8 percent	-	Kerosene, cotton/woollen yarn
16 percent	-	Most goods (about 80 percent)
24 percent (16+8)	-	Cement, Two wheeled motor vehicles
32 percent (16+16)	-	Cosmetics, Tyres, Polyesster filament yarn, air conditioners
40 percent (16+24)	-	Pan Masala, Aerated water, Chewing tobacco, Motor cars.
Matches	-	Specific rates
Cigarettes, bidi	-	Specific rates

1 Just increased from 50 to 100 lakhs in 2000

Processed fabrics	-	Production based levy. Specific rates for independent processors.

The value for assessment is based on transaction price which is the price actually paid or payable i.e. the invoice price, and includes all payments by reasons of or in connection with sale but does not include duty of excise, sales tax actually paid, or actually payable on such goods.

Various situations arise from this practice.

A. Sales to non related persons where price is the sole consideration. Transaction price is the 'value'
   - Applies to both clearances from factory and depot. In respect of sales from depots, the duty is payable at the factory but the relevant value is the value prevailing at or about that time at the depot.

B. Price is not the sole consideration—for example, raw materials are supplied by buyer.
   - Value will include the cost of money value of such consideration.

C. Goods used captively.
   - Value will be 115 percent of cost of production.

D. Goods sold through related persons.
   - Value will be the transaction value of the sale through related persons.

E. Sales from depot etc. –value will be the normal transaction values of such goods sold from such place.

F. Any other case.
   - To be determined using reasonable means consistent with the above principles.

Valuation may be based on tariff values which Government may fix independent of sales price, but this method is rarely used now. For more than 70 items, it is based on Maximum Retail Price (MRP)—being used more and more on items which are subject to declaration of retail sales price under the standards of Weights and Measures Act, 1976, though there is an abatement varying bbetween 30—55 percent of MRP in price fixation. For most items, assessment is based on transaction price. This is the general pattern for assessment.

There is a production based levy for Independent processors. It applies to textile fabrics processed by independent processors and the duty liability depends on chamber capacity of the machine, and on the average values of the fabrics, which is decided by the previous year's clearance of processed fabrics. No input/capital goods tax credit is given.

For exports, all the taxes paid are refunded. For example, for export under rebate duties already paid are refunded (1) Duty paid on finished goods; (2) Duty paid on imputs used in finished goods.

For export under bond, for (1) Removing finished goods without payment of duty and (2) Processing raw materials without payment of duty, the procedure is as follows:

(1) Examination is generally carried out at port. But there is an option for examination in the factory under excise supervision.

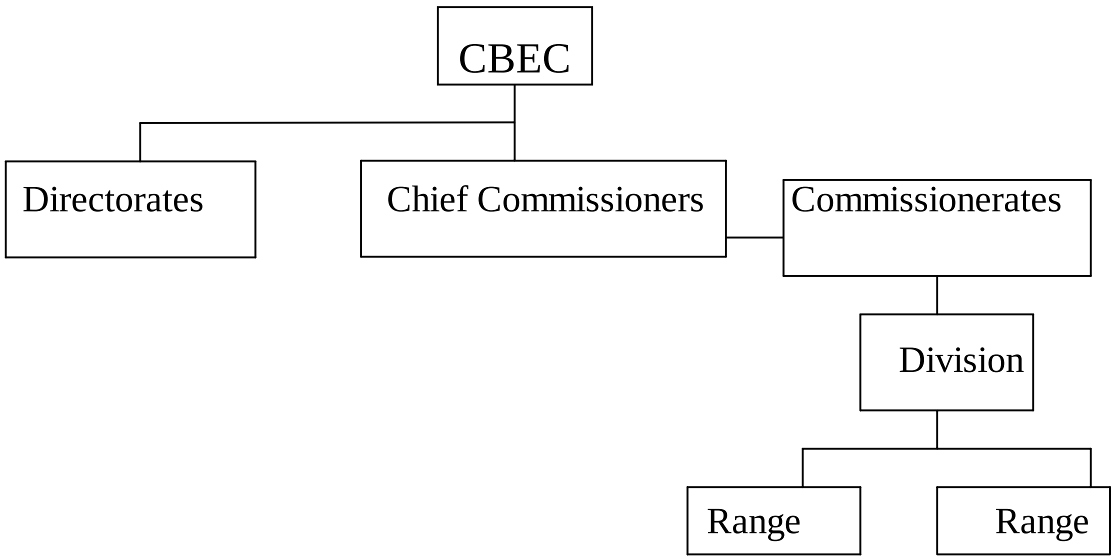
(2) Documents needed are: (a) AR-4; (b) excise invoice; (c) shipping bill at the point of export.

Rebate is given, or bond discharged, on proof of export. The proof of export generally is Customs endorsed copy of Form AR-4 and the shipping bill. Rebate can be given by the Maritime Commissioner where available or the jurisdictional excise officer.

Cenvat credit is given for Cenvat duty, not of SED in general. Credit is also given for AED (ST), AED (T&T) and additional duty under Customs Tariff Act, 1975 loosales known as Countervailing Duty (CVD). Almost all goods (except matches) are covered under Cenvat Scheme. Inputs include all goods (except HSD and petrol) and fuel used in or in relation to manufacture (whether directly or indirectly). Credit is given for capital goods used in the factory of manufacture but excludes office equipment. Credit for capital goods is given in two stages – 50 percent in the first and 50 percent in the next year. No input tax credit is given if inputs are used for making exempt products (some exceptions are exports and clearances to EOU's). No declaration for availing is necessary. Credit can be taken on the strength of excise invoices of purchase. Credit is given instantly on receipt of goods. Credit can be used for payment of duty on any final product, or on inputs cleared as such. Normally no cash refund of credit is given. A facility exists for sending inputs, partially processed, to job worker without reversal of credit, and for sending inputs directly to job worker. There is an exemption on intermediates produced capitively. Credit on inputs manufactured in North East region fall under a special exemption scheme and is allowed to users even though no duty is effectively paid on such inputs.

b. Structure of Excise Administration

The organisation of administration is shown in the following diagram.



Every manufacturer:

1. Needs to be registered before commencing production, of whom there are more than 100,000 approximately. He is given a ECCN based on (Permanent Account

Number given by Income Tax Department) PAN. But SSI units, so long they are exempted (which is upto Rs 1 crore) do not need any registration. But they have to file a declaration when their clearances reach a level which is Rs 10 lakhs less than the exemption limit.

2. Has to file a classification declaration giving details of products and rate of duty.

3. Has to give a price declaration if the sale is through related persons, or where price is not the sole consideration.

4. Has to pay the duty every fortnight—For clearances between 1-15th by 20th, and for clearances between 16-30th by 5th of next month. For March, there is a separate provision for the second fortnight of March. In case of cash payment, it can be only through nominated banks. There remains a need to have the facility to make payments through any bank. SSI units can make monthly payments but by 15th of the next month.

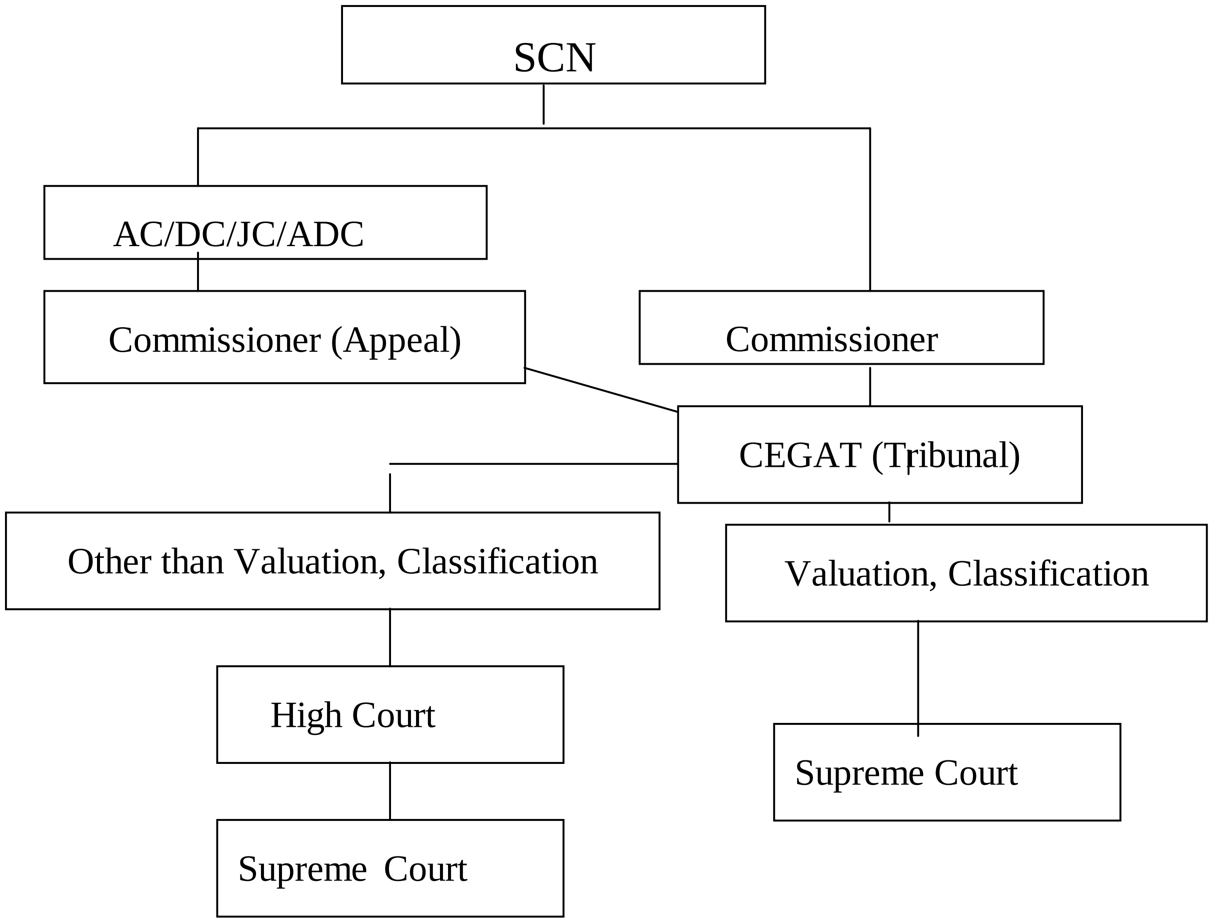
5. Has to file a monthly RT-12 return of assessment (Quarterly for SSI units) and monthly Cenvat return of Cenvat availment. No statutory records are prescribed. But records kept must document all production, use of inputs, sales, purchases etc. A self removal procedure is allowed.

Checks by officers are conducted through:

- Scrutiny of assessment returns
- Inspection/visits by Officers
- Audit
- Anti-evasion measures.

With liberalisation, and abolition of statutory needs, audit has an increasing role to play. For this, there is a need to have trained staff, and develop techniques of audit selection so as to focus on suspect units. Also, anti-evasion needs to be strengthened with stress on intelligence gathering.

Finally, the sequence involved in dispute settlement is depicted in the following diagram:



2. Revenue Productivity of Excises

There seems to be the perception that the excise duty reforms have had an adverse effect on its yield. Although the revenue from excise has been growing (column 2, Table V.2), its growth has been lower than that of gross domestic product (GDP). During the reform period, revenue from excise[2] to GDP ratio has declined by 1.05 percentage points. The ratio declined from 3.81 percent in 1986-87 to 2.76 percent in 1999-2000 (column 2, Table V. 3). This was accompanied by sharp declines in the growth of revenue in some of the years such as 1993-94, 1995-96 and 1997-98 (column 2, Table V.4). This has been the cause of concern for the government since excise duty has been the mainstay of the central government.

Table V. 2

Revenue from Excise and MODVAT Credit

Year	Net revenue (Rs.crore)	MODVAT credit on			Gross revenue (Rs.crore)	GDP at market prices: New series (Rs.crore)	(4) as percentage of (5)
		Inputs (Rs.crore)	Capital goods (Rs.crore)	Total (Rs.crore)			
1	2	3	4	5	6	7	8
1986-87	11960	1914	0	1914	13874	313580	0.00
1987-88	13047	2820	0	2820	15867	355417	0.00
1988-89	15012	3809	0	3809	18821	423497	0.00
1989-90	17339	5279	0	5279	22618	487740	0.00
1990-91	19606	6496	0	6496	26102	568772	0.00
1991-92	23092	7965	0	7965	27572	653298	0.00
1992-93	25702	10840	0	10840	36542	747387	0.00
1993-94	26368	11896	0	11896	38265	859220	0.00
1994-95	31328	20639	1048	21687	53014	1009906	4.83
1995-96	33895	28115	1841	29956	63851	1181961	6.15
1996-97	38151	32042	2180	34222	72373	1361952	6.37
1997-98	41450	32562	2624	35186	76636	1515646	7.46
1998-99(RE)	45726	32272	3217	35489	81215	1762609	9.06
1999-00(RE)	53245	38778	4866	43644	96889	1931819	11.15

Notes: 1. Revenue from union excise duty is taken exclusive of additional duties on textiles and high speed diesel oil, additional duties in lieu of sales tax, and cesses.

Sources: 1. Economic Survey (1999-2000), Government of India, Ministry of Finance, Economic Division.

2. National Accounts Statistics (2000), Central Statistical Organisation, Government of India.

[2] Excluding additional duties and cesses. The ratio of revenue from these duties and cesses to GDP has also declined by more than 0.5 percentage points. It declined from about 1.0 percent in mid. 1980s to about 0.45 percent by late 1990s.

The objective here is to examine revenue implications of the excise duty reforms and suggest measures to stimulate growth of revenue without any or with minimum

Table V. 3

Revenue from Excise and MODVAT Credit as Percentage of GDP

Year	Net revenue (Rs.crore)	MODVAT credit on			Gross revenue (Rs.crore)
		Inputs (Rs.crore)	Capital goods (Rs.crore)	Total (Rs.crore)	
1	2	3	4	5	6
1986-87	3.81	0.61	0.00	0.61	4.42
1987-88	3.67	0.79	0.00	0.79	4.46
1988-89	3.54	0.90	0.00	0.90	4.44
1989-90	3.56	1.08	0.00	1.08	4.64
1990-91	3.45	1.14	0.00	1.14	4.59
1991-92	3.53	1.22	0.00	1.22	4.22
1992-93	3.44	1.45	0.00	1.45	4.89
1993-94	3.07	1.38	0.00	1.38	4.45
1994-95	3.10	2.04	0.10	2.15	5.25
1995-96	2.87	2.38	0.16	2.53	5.40
1996-97	2.80	2.35	0.16	2.51	5.31
1997-98	2.73	2.15	0.17	2.32	5.06
1998-99(RE)	2.59	1.83	0.18	2.01	4.61
1999-00(RE)	2.76	2.01	0.25	2.26	5.02

adverse consequences for the economy.

Section 'a' describes the reforms carried out in the excise system. It contains an overview of the expansion in the coverage and structure of MODVAT credit scheme and the reforms carried out in the structure of excise duty rates. Section 'b' attempts to analyse the revenue impact of modifications in the scheme of MODVAT credit and the structure of excise duty. Section 'c' focuses on administrative factors that might have an impact on excise revenue. Recommendations are contained in Section 'd'.

Table V.4

Growth rates of Revenue from Excise and MODVAT Credit (Percent)

Year	Net revenue (Rs.crore)	MODVAT credit on			Gross revenue (Rs.crore)	GDP at market prices: new series (Rs.crore)
		Inputs (Rs.crore)	Capital goods (Rs.crore)	Total (Rs.crore)		
1	2	3	4	5	6	7
1986-87	NA	NA	NA	NA	NA	NA
1987-88	9.09	47.36	NAP	47.36	14.37	13.34
1988-89	15.06	35.08	NAP	35.08	18.62	19.15
1989-90	15.50	38.58	NAP	38.58	20.17	15.17
1990-91	13.07	23.06	NAP	23.06	15.40	16.61
1991-92	17.78	22.63	NAP	22.63	5.63	14.86
1992-93	11.30	36.09	NAP	36.09	32.53	14.40
1993-94	2.59	9.74	NAP	9.74	4.71	14.96
1994-95	18.81	73.49	NAP	82.30	38.55	17.54
1995-96	8.19	36.22	75.67	38.13	20.44	17.04
1996-97	12.56	13.97	18.41	14.24	13.35	15.23
1997-98	8.65	1.62	20.37	2.82	5.89	11.28
1998-99(RE)	10.32	-0.89	22.60	0.86	5.98	16.29
1999-00(RE)	16.44	20.16	51.26	22.98	19.30	9.60
Notes:	NAP = Not applicable; NA = Not available.					

a. Development of MODVAT Scheme and Restructuring of Duty Rates

(i) MODVAT scheme (Now known as CENVAT)

Under the system of excise duty, inputs are relieved of the burden of taxation through the scheme referred to as modified value added tax (MODVAT) credit scheme that operates on the principle of value added tax (VAT). As discussed earlier, the scheme was introduced in 1986 and made applicable to some specified inputs when used in the production of specified end products. Over time, its scope has been enlarged. High-speed diesel (HSD) oil, motor spirit (petrol), and matches are still not covered by this scheme, denying the benefit of tax relief to their users. Currently, the excise duty collected from the commodities covered by the MODVAT scheme accounts for about 90 percent of the total excise duty. As against this, the excise from MODVAT commodities accounted for only about 30 percent in 1986-87.

The major reforms carried out in the MODVAT credit scheme are indicated in Table V.1. On capital goods, MODVAT credit has been allowed with effect from 1994-95. The restriction of 75 percent in respect of capital goods credit (for countervailing duty (CVD) payable on imports) on project imports has been removed with effect from 2000-01. Because of revenue considerations, with effect from January 1, 1996, availing of the credit in respect of capital goods was postponed until the goods were put to use in the production process. Further, with effect from 2000-01, availing of the credit in respect of capital goods has to be spread over two years. The condition of 'put to use' was withdrawn in the process of simplification by the budget 2000-01. Regarding inputs, scope of MODVAT credit has been enlarged over time to mitigate tax cascading though the process was not free from certain set backs. A restriction was imposed in 1998-99 on the MODVAT credit that could be availed of in respect of inputs: it was restricted to 95 percent but was restored to 100 percent with effect from the year 1999-2000.

The maximum retail sale price (MRP) based assessment has been extended to many products in the years 1998-99 and 1999-2000 implying a reduced scope for undervaluation.

Small scale industry (SSI) exemptions have been enlarged over time (Table V.1). Turnover limit for availing of SSI concessions was raised from Rs.2 crore to Rs.3 crore in 1995-96. The value of sales (clearances) subject to concessional duty was raised from Rs.50 lakh to Rs.100 lakh with duty rates as 0, 3 and 5 percent respectively on sales upto Rs.30 lakh, next Rs.20 lakh and next Rs.50 lakh, with effect from 1997-98. The concessional duty rates were further revised in 1998-99 to 0 and 5 percent respectively on sales upto Rs.50 lakh and next Rs.50 lakh. Recently, during October 2000, the rate of 5 percent has also been reduced to nil implying full exemption of sales upto Rs.100 lakh. Also, with effect from 1994-95, SSI enterprises are given the option to pay duty if they intend to be covered by the MODVAT scheme. This provision benefits those SSI enterprises that intend to attract taxable manufacturers to buy their products and claim MODVAT credit in turn. Currently, such units have to pay 60 percent of the duty otherwise applicable upto clearance limit of Rs 1 crore.

(ii) Restructure of duty rates

The excise duty rates have been substantially modified or restructured in the last one and a half decades in the process of tax reforms in the country. Prior to 1990s, the duty rates were many: *ad valorem*, specific, and *ad valorem* plus specific. The *ad valorem* rates varied from 0 percent to above 200 percent. In the 1990s, following the submission of reports by the Tax Reforms Committee (1991, 1992 and 1993), attempts have been made to rationalise the structure of excise duty. The peak rate of *ad valorem* duty has been lowered and most of the specific duties have been converted into *ad valorem* duties. By 1995-96, the number of duty rates was reduced to nine, with a spread from 10 percent to 50 percent. In addition, there were a few specific and *ad valorem* plus specific duty rates. During 1998-99, there were 11 ad valorem rates varying from 5 to 40 percent though there were some exceptions. Some products continue to be subject to specific duties[3]. During

[3] Refers to higher or lower of *ad valorem* and specific duties.

1999-2000, the existing 11 duty rates were compressed into 3 (8 percent, 16 percent and 24 percent). In addition, non-MODVAT (non-rebatable) special duty rates (6 percent and 16 percent) were introduced. These rates were used to make up for the previously existing rates of 30 and 40 percent by combining rebatable and non-rebatable rates (24+6 = 30; 24+16 = 40). Thus, a three-rate VAT system was put in place with some exceptions. In 2000-01 MODVAT was renamed as CENVAT with further restructuring of the duty rates. The three MODVAT rates have been replaced by a single CENVAT rate of 16 percent though there are several exceptions as has been already described. In addition, there are three non-rebatable special duty rates (8 percent, 16 percent and 24 percent). The special duty rates are used to replace previously existing rates of 24 percent, 30 percent and 40 percent by combinations of CENVAT and non-rebatable special duty: 16+8, 16+16 and 16+24 respectively.

b. Revenue Implications of Excise Duty Reforms

(i) Factors affecting revenue

The growth rate of net excise revenue (that is actual collection) would depend on the growth rates of both gross revenue and MODVAT credit.[4] A faster growth rate of MODVAT credit as compared to that of gross revenue would have dampening effects on the growth rate of net revenue. In other words, a rise in the ratio of MODVAT credit to gross revenue suggests that net revenue grows at a rate lower than that of gross revenue. Therefore, for identifying the factors responsible for the rise or decline in the growth rate of net revenue, it should be useful to analyse the ratio of MODVAT credit to gross revenue, and the growth of gross revenue. As the factors affecting growth of gross revenue may differ from those affecting MODVAT credit, an analysis of growth of these factors may be expected to give rise to varied policy perspectives.

[4] Actual revenue collections from excises are referred to as net revenue, and net revenue plus MODVAT credit is referred to as gross revenue from excises.

Factors affecting gross revenue include changes in (i) the rate structure, (ii) tax base, (iii) exports, and (iv) under reporting of clearances. The reduction in the tax rates of many commodities as well as raising the ceiling for the provision of allowing concessions to the SSI (from a turnover of Rs.2 crore to Rs.3 crore) along with liberalisation of the exemption would have tended to lower the growth rate of gross revenue. A faster rise in exports as compared to output can also be expected to lower the growth rate of gross revenue, as exports are exempt from excise duty.

As net revenue is gross revenue net of MODVAT credit, all the factors affecting gross revenue and MODVAT credit would impact upon net revenue. As discussed earlier, the factors affecting MODVAT credit include: (i) extension of MODVAT credit to raw materials as well as capital goods; (ii) elimination of the requirement to match inputs with particular outputs for availing MODVAT credit; and (iii) provision of allowing MODVAT credit on capital goods on the basis of purchase irrespective of when it is put to use (this provision was withdrawn with effect from January 1, 1996 but restored by the budget 2000-01).

(ii) Revenue growth

The growth of gross revenue can not be said to be unsatisfactory as the ratio of gross revenue to GDP has not declined during the reference period, that is 1986-87 to 1999-2000 (column 6, Table V.3). In fact, the ratio has increased over time from 4.42 percent in 1986-87 to 5.02 percent in 1999-2000. This is not surprising, as the revenue neutral duty rates are supposed to be higher to yield higher gross revenue when the set off provisions in respect of duty paid on inputs are liberalised. This however did not seem to have compensated for loss in revenue arising from liberalisation of set off provisions in respect of duty paid on inputs and SSI exemptions, as the ratio of net revenue to GDP has registered a sharp decline during the reform period. The ratio has declined from 3.81

percent in 1986-87 to 2.76 percent in 1999-2000 (column 2, Table V.3). The decline in the net revenue to GDP ratio can be fully explained in terms of the rise in the MODVAT credit to GDP ratio that has increased by 1.65 percentage points as against 1.05 percentage points decline in the former. The MODVAT credit to GDP ratio has increased from 0.61 percent in 1986-87 to 2.26 percent in 1999-2000 (column 5, Table V.3). The rise in this ratio can be attributed largely to the liberalisation of MODVAT credit provisions relating to inputs. The ratio of MODVAT credit on inputs to GDP has increased from 0.61 percent in 1986-87 to 2.01 percent in 1999-2000 (column 3, Table V.3). Although the provision of allowing MODVAT credit in respect of capital goods has caused concern, the loss in revenue on this account does not appear to be significant. It was only 0.1 percent of GDP in 1994-95 that has increased to 0.25 percent of GDP in 1999-2000 (column 4, Table V.3). This suggests that the MODVAT credit on capital goods was no more than 10 percent of the total MODVAT credit. It would mean that the small saving in tax revenue on account of spread of the MODVAT credit on capital goods over two years may not be worth the complications caused in administration and compliance.

The above findings are corroborated by the growth rate analysis and buoyancy coefficients of gross revenue, MODVAT credit and net revenue. Growth of MODVAT credit is found to be greater than that of gross revenue in most of the years, affecting the growth of net revenue (columns 2, 5, and 6, Table V.4). From Table V.6, it would be noted that buoyancy of gross revenue with reference to GDP is slightly greater than one implying that the growth in gross revenue has been almost the same as the growth in GDP. On the other hand, buoyancy coefficients of total MODVAT credit and MODVAT credit on inputs are 1.73 and 1.67 respectively. Consequently, the buoyancy of net revenue is 0.79, which is much below unity. Clearly, low buoyancy of net revenue is attributable largely to faster expansion of MODVAT credit, particularly in respect of inputs.

c. Focus on Administrative Factors

A substantially faster growth in the MODVAT credit vis-à-vis growth of gross revenue has caused concern regarding the potential misuse of MODVAT credit invoices. According to a survey study, in many areas of MODVAT administration where physical control has been replaced by financial control, lapses have taken place (Shome, Mukhopadhyay and Saleem, 1997). Besides the procedural/technical offences, the major violations included: (i) undervaluation of goods, (ii) availing of credit on exempted final

Table V.5

Net Revenue from Excise and MODVAT Credit as Percentage of Gross Revenue

Year	Net revenue (Rs.crore)	MODVAT credit on		
		Inputs (Rs.crore)	Capital goods (Rs.crore)	Total (Rs.crore)
1	2	3	4	5
1986-87	86.21	13.79	0.00	13.79
1987-88	82.23	17.77	0.00	17.77
1988-89	79.76	20.24	0.00	20.24
1989-90	76.66	23.34	0.00	23.34
1990-91	75.11	24.89	0.00	24.89
1991-92	83.75	28.89	0.00	28.89
1992-93	70.33	29.67	0.00	29.67
1993-94	68.91	31.09	0.00	31.09
1994-95	59.09	38.93	1.98	40.91
1995-96	53.08	44.03	2.88	46.92
1996-97	52.71	44.27	3.01	47.29
1997-98	54.09	42.49	3.42	45.91
1998-99(RE)	56.30	39.74	3.96	43.70
1999-00(RE)	54.95	40.02	5.02	45.05

products, (iii) non-reversal of credit in respect of returned rejected inputs, (iv) availing of

Table V.6						
Buoyancy Coefficients and Allied Statistics of Excise Duty : 1986-87 to 1999-00						
Serial No.	**Variable name**	**Constant**	**Buoyancy coefficient**	**t-stat (constant)**	**t-stat (buoyancy coefficient)**	**R^2**
1	**2**	**3**	**4**	**5**	**6**	**7**
1	Net Revenue	-0.63	0.79	-2.82	48.59	0.99
2	Modvat Credit on Inputs	-13.37	1.67	-12.84	21.81	0.98
3	Total Modvat Credit	-14.21	1.73	-14.17	23.53	0.98
4	Gross Revenue	-4.21	1.09	-10.65	37.39	0.99
5	Net Revenue inclusive of additional duties etc.	0.24	0.74	0.96	40.26	0.99
6	Gross Revenue inclusive of additional duties etc.	-3.04	1.01	-9.41	42.52	0.99
7	Additional Duties and cesses	1.80	0.50	2.57	9.68	0.89

credit in respect of basic customs duty, (v) misuse of the facility of job work, (vi) availment of credit twice on the same invoice, (vii) availing of credit without payment of duty, and (viii) availing of credit by using fraud/fake documents. On the basis of discussions with well-informed persons, it has been learnt that the revenue loss on account of these factors would be around 10 percent of revenue from excise duty. It is also the perception that some loss occurs because of the exempted sector (including SSI) that facilitates misuse of MODVAT credit invoices. In this respect it is important to note that the goods flow in one direction and the invoices flow in another direction. As the exempted sector has no interest in MODVAT credit invoices, the invoices relating to their purchases are being misused by the non-exempted sector. Thus, rationalisation of the exemption for SSI would go a long way in checking evasion of excise duty.

3. Measures to be Undertaken in Excises

a. Manufacture—Need to Change the Definition

As indicated earlier, manufacture as defined in Section 2(f) of the Central Excise Act, includes any process:

(i) incidental or ancillary to the completion of manufactured product; and

(ii) which is specified in relation to any goods in the Section or Chapter Notes of the Schedule to the Central Excise Tariff Act, 1985 as amounting to manufacture.

This is an inclusive definition and the test commonly used whether manufacture for the purpose of levy of excise duty has taken place or not, is to find out: -

(a) Whether a new commercial product has come into existence and

(b) Whether the product is marketable.

It is thus not the nature of the process or activity, which determines the issue, but the end result of that process or activity, that is, whether or not a different product comes into existence.

Certain processes have been defined as amounting to "manufacture" in respect of Specific Commodities. Thus, for example:

(a) In case of tea waste, blending, sorting, packing or re-packing into smaller containers amounts to 'manufacture'.

(b) Labelling or re-labelling of containers and re-packing from bulk packs to retail packs of preparations of vegetables, fruits, nuts etc. amounts to manufacture.

(c) Cutting, slitting, perforation of photographic plates, films or rolls amounts to manufacture.

(d) Bleaching, mercerising, dyeing, printing, twisting, texturising, doubling fabrics amounts to manufacture.

The Constitutional validity of the deemed manufacturing provision has been tested and upheld in Courts of Law. It appears that deemed “manufacture” provision might be permitted to be accepted by the Supreme Court as long as there is ‘nexus’ between the process and actual manufacture. Taking an extreme case, if legislature defines ‘trading in goods’ as ‘amounting to manufacture’, such provision is not likely to be upheld by the Courts.

These deeming provisions are, however, only for selective items. Consequently, when there is no such definition, such activity like labelling or printing a brand name may not amount to manufacture. This may give incentive to produce the goods in one factory and give it a brand name outside. In that case, the value addition will escape payment of excise duty. In a recent case, it was held by the Apex Court that, where manufacture is complete at some stage and excise duty leviable at that stage, duty has to be paid on the value of the goods being cleared for marketing, if the assessee subjects the goods to further processes before marketing, even though such subsequent processes may not amount to manufacture.

As a logical extension, there is no reason why such value addition done outside the factory should not be charged to excise duty so long it is done on behalf of the manufacturer. In fact, it will be appropriate if any process, which results in value addition, is charged to CENVAT (the 16 percent basic rate). It may be necessary to test its constitutionality, but it may not be difficult to levy duty on value addition in the process of completing the manufacture.

The definition of manufacture must be made wide enough for the entire value addition to be charged to duty. This can be done by providing that all processes which are undertaken before marketing the products, by or on behalf of the manufacturer should amount to manufacture. This would deter the industry to segregate the manufacturing activities so as to avoid tax.

b. Manufacture—Abolish the Concept of Manufacture from MODVAT

While the excise duty is on manufacture the credit given under the MODVAT scheme need not be based on manufacture since it is in the nature of an exemption and not the levy itself. At present the scheme is based on manufacture so that all the uncertainties in the definition of manufacture have made the scheme complicated and litigation prone. If MODVAT is made to be based on plain value addition but not necessarily due to manufacture, then it can be much less prone to litigation and also can become VAT. Excise and VAT are altogether different in essence in that, in excise the value addition due to manufacture only can be taxed (if input credit is allowed) while in VAT the tax has to be on value addition due to any reason and not necessarily manufacture.

To achieve the removal of all the controversies (so far as MODVAT is concerned) and to introduce full VAT at the same time, we need to allow the input credit on the basis of "use in the factory" rather than on the basis of "use in manufacture of final products ". The concept of use in manufacture, directly or indirectly, still occurs in the definition of inputs and of capital goods. The latest CENVAT rules define Capital goods as some listed goods "used in the factory of the manufacturer". This is the correct approach. But the inputs are defined as some listed goods "used in or in relation to the manufacture of final products whether directly or indirectly". Here the concept of manufacture comes in with all the virulent implications of uncertainty and possibility of litigation some of which we have discussed above. Interestingly the definition of capital goods incorporated the use-concept for the last two years after the National Institute of Public Finance and Policy

(NIPFP) suggested in its report[5] in 1996 to the Ministry of Finance to that effect. So it is now a tested concept since no misuse has been reported. It is the right time to introduce the use- concept in respect of other inputs as well, which should eliminate all the controversies associated with the concept of manufacture at least for the purpose of allowing MODVAT credit.

c. Procedural Reforms for MODVAT:

The MODVAT procedures, before this year's budget were so complicated that "it has become a monster", says a retired Member of the Tribunal[6]. The largest number of violations is basically procedural. They get solved only at the level of the Tribunal. NIPFP conducted a study[7] on the basis of data from Jan 94 to July 95 gathered from field formations. It was found that 87 percent of offences were procedural, 7 percent were substantial where duty was evaded and 6 percent were of fraudulent nature. On the basis of wide ranging discussions with trade and officers it was suggested that it was necessary to free the officers from too many (87 percent) procedural cases so that they can concentrate on detection of substantial and fraudulent cases which will save revenue. For this the following reforms are necessary: --

(i) Make MODVAT available to all goods. Then have only a negative list which should include where giving of the credit is not intended, such as, petrol, diesel, paint and building material used in the factory building, items used in the office, air conditioner used in the office, car, computer used in the office etc. The list can be increased or decreased as the Government wishes.

(ii) The artificial distinction between capital goods and inputs should be abolished. Capital goods are also inputs and there is no need to keep separate definition and Rules for them. This change in the concept of input will solve many problems, which are affecting the system adversely. Thus there should be no distinction between input duty and capital goods duty. The capital goods duty can now be

5 Later published as P. Shome (1997) edited, *Value Added Tax in India : a Progress Report* (p.54).

6 See R.Jayraman, *Excise Law Tribune*, Vol 99, p. A179.

7 Parthasarathi Shome, S. Mukhopadhyay and N.Hasheem (1997), op.cit., (p.32).

taken only in two instalments. The earlier provision of full credit in one instalment should be restored.

(iii) Routine checks of returns and accounts are not yielding results. We also notice that offences regarding the dealers have not been detected though it is widely believed that there are many such cases. So intelligence based checks such as checking the numbers of trucks carrying the goods should be resorted to.

(iv) The Cenvat Rules have been simplified in this year's budget. This include doing away with declarations. It may be useful to issue a circular that procedural violations should not be punished as long as there is no revenue loss. The Assistant Commissioners and Commissioners should be given the power to condone such violations. At present all such cases travel up to the Tribunal.

d. Tariff Reform

(i) Rates of central excise:

The number of rates has come down over a period of time as desirable. There has been some discussions over moving towards a single rate of excise. However, a single rate, say, 20 percent is likely to end up with a large number of exemptions, while a two rate of structure should be feasible and administratively simple, as there will be fewer exemptions. It has not been feasible to work out a revenue neutral two rate structure due to lack of information. It seems, however, that 16 percent and 28-30 percent is a possible combination, especially in combination with removal of exemptions, as indicated below.

The second reform relates to a reduction in the number of exemptions. The enormity of exemptions can be seen from the fact that in any standard publication of Tariff of 720 pages, 220 pages are devoted to exemptions and 500 for the actual tariff. This is only a rough estimation. What is interesting to note is that while the exemptions are nearly

75, each exemption has so many entries that the actual coverage is quite large. For small scale alone there are 5 exemptions. For job work there are 5. For export purposes there are 20 exemptions. With respect to effective rates there are 259 entries for exemptions[8] with 52 conditions and 7 lists containing hundreds of items in each list. Even when conditions are not there, the descriptions are conditional such as " for use in leather industry".

An intensive effort is necessary to eliminate exemptions, many of which are given for populist purposes. It is also necessary to combine so many exemptions on the same subject. Undoubtedly, the exemptions when given initially work for some specific purposes, and this purpose would be best known to the Government. But it is quite likely that many of the exemptions, by now, would have outlived their utility. This is all the more so in view of full exemption limit of Rs. 1 crore under the small scale exemption scheme. Continuance of the full exemption would in fact be against the interest of small scale units. For example, full exemption for tooth powder, henna powder, pencil sharpeners etc. can only be to the disadvantage of SSI units making these products.

On textiles, generally SSI exemption is not available. But there are a very large number of exemptions with a view to provide relief to cottage sector, handlooms, processing without power, cooperative bodies, decentralised nature of fabrics and yarn processing. There is a need to look into the whole structure, and in this context, the Group's suggestion is that the earlier Modvat scheme for textile processors should be restored, and the production based levy should be withdrawn. The other full exemptions available to textiles can be brought under the SSI exemption scheme, and the full exemptions can be withdrawn.

Thus, recommendations for reform in the excise tariff are : (a) move towards a two-rate structure; (b) rationalise exemptions by abolition and merger; (c) reduce conditions in the exemptions; and (d) gradually cover more items under the 16 percent rate

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8 Notification no 6\2000 C.E dt 1.3.2000

so that classification problems are minimised.

(ii) Multiplicity of levies

The various types of duties have already been described above, as Central Excise duty (including CENVAT), Special Excise Duty, Additional Excise duty on motor spirit (Petrol) and diesel, Additional Excise duty on Textiles & Textile Articles 1978) on fibres, yarn, fabrics, AED (in lieu of Sales Tax on fabrics) Cesses leviable under miscellaneous enactments.

Separate accounts are to be maintained for each of these levies, which will increase both administrative and compliance costs. It is also difficult to work out the total effective duty in view of the fact that CENVAT credit is not given for all types of levies. It is suggested that there should be only one levy under the Central Excise Act. There is no reason why textile, sugar etc. should be outside the purview of sales tax levy. Just like any other excisable goods, only Central Excise duty should be charged, and states should be free to levy sales tax on these items also.

e. CENVAT and Service Taxation

Despite the growing share of services in GDP, only 5 percent of services is captured under the tax net currently, the rest escaping taxation. One reason for this narrow base has been the fact that services are not mentioned in the Constitution as a taxable entity. Even though services therefore fall in the residual category which lies with the Centre, the Centre never took up the matter until recently. The early choice of selected services for taxation met with severe opposition and led to a national strike by road transporters in 1997. Since then, a few other services have been included for taxation.

This selective approach to service taxation has to be given up in favour of a more comprehensive approach. Recently the Revenue Department constituted an advisory group to look into the matter which has submitted its interim report. It has suggested a uniform service tax rate structure at 5 percent and giving input tax credit/offset within the service sector only. The tax would apply over a threshold of Rs. 10 lakh turnover to keep out the unorganised sector and small service providers. Some rationalisation has been suggested in that the separate taxes on luxury hotels and restaurants, inland travel and foreign travel would be merged into the service tax. The additional revenue potential of the proposed new service tax is Rs. 3500 crore.

The tax would cover: rail, road, water and air transport and operators of goods and passengers; storage and warehousing; post and telecommunications; banking and financial services excluding lending, borrowing and other financial intermediary services; construction and maintenance of buildings, roads, rail, rail beds, bridges, waterways, reservoirs, hydroelectric projects and the like; construction (n.e.s.); hotels and restaurants; business services (except information technology related and enabled services); education services (excluding primary education when provided by government and government aided institutions); health and medical services (excluding primary healthcare provided by governemnt); and media services.

A distinct negative list--services that would not be taxed--is to be specified. These include: public services provided by government; public utility services--generation and distribution of power, water sewerage and other essential services; government owned medical hospitals and diagnostic and pathological laboratories; government run or aided schools, colleges, research laboratories, defence, space, atomic energy and oceanic research; government run or aided welfare organisation, refugee rehabilitation centres, earthquake and flood relief, jails and reformatories; transactions between employer and employee either as a service provider, recipient or vice versa; services which are exported outside India in respect of which payment is received in India in convertible foreign exchange and where such foreign exchange is not repatriated from or sent outside India.

These recommendations comprise a cautious beginning for comprehensive service taxation. It is a move in the right direction though it would be better to begin with a larger base and higher rate and to integrate services with the CENVAT right from the start. Several steps would remain to be taken during the Tenth Plan period. **The first is to integrate the service tax with CENVAT**. The group suggests that this be done by 2003-04, but it apparently does not specify details regarding the mechanisms. Until integration of goods and services under one taxable output base, allowing for input tax offset for the use of both goods and services as inputs, is achieved, the Centre would not have a meaningful VAT. The ramification would be a continuation of tax induced distortions and low revenue potential. Indeed, the revenue potential of the proposed service tax is quite low. A rapid expansion in the scope of the tax is therefore essential.

The second essential step is to address the issue of taxation of services by the states. This is important in the context of the VAT at the level of the states. Currently, several states are considering the introduction of the VAT on April 1, 2002 and the remaining states are expected to be brought into the fold. A remaining lacuna in the process is the transformation of the Central sales Tax (CST) on interstate trade. States have decided to abolish the CST over a period of four years and have indicated to the central government that the latter should compensate the revenue loss.

This is not necessarily a lasting solution, and alternative solutions need to be discussed. One would be for the Centre to share services with the states as a tax base. A second would be to include the Centre's service taxation in its shared revenue pool. It may be worth recalling that initiating the VAT in a limited way, with its application only to selected goods and to different baskets of goods by different states--with a stamp of approval from the Centre--has led to procrastination, slowdown, and confusion in the entire VAT process. To obviate similar problems **in integrating the service tax with CENVAT, an exact roadmap for the process of integration needs to be designed**. The eventual VAT structure would comprise a larger base and higher rate of tax. Only then the VAT itself would be appropriately revenue productive and services could be sufficiently brought under the tax net.

Thus, the role of services in revenue generation cannot be ignored even in the short run and this Group is of the opinion that the integration of services with CENVAT should be accomplished in the Budget of 2002-03. Once services are included in the tax base, no distinction should be made between service tax and CENVAT. All manufacturers should be allowed to take not only credit of CENVAT, but also credit of service tax paid. Similarly, a service taxpayer should be allowed to take credit of all excise duties, and also of the service tax paid. Unless this is done, a move towards unified goods and service tax, which is prevalent in all developed countries operating the VAT, would be difficult.

f. SSI Exemption Scheme

Under the small scale industry (SSI) exemption scheme, which covers almost all the items specified in the Central Excise Tariff, two separate streams of exemption have been given to small scale units depending on whether the manufacturer: (1) wants to avail of input tax credit under the CENVAT scheme or (2) not.

The two streams do not give the same amount of benefit. If we take the second stream, assuming that the input and the output both attract the same CENVAT rate of 16 percent, and taking the value addition to be of the order of 10 percent, it may be seen that the manufacturer can go up to Rs.130 lakhs and the duty liability can be discharged from the accumulated credit.

This is because the unit is paying a negative rate of duty on value addition, since, while his inputs have been taxed at 16 percent, the output pays a duty is 9.6 percent upto first Rs.100 lakhs. There is no reason why a subsidy should be given and why such units should have additional benefits, which are not available to units which have opted for full exemption.

To remove this aberration, our recommendations are:-

(a) There should not be any concessional rate of duty for SSI units opting to take CENVAT credit. They should be at par with any non-SSI unit.

(b) If the above suggestion is not acceptable, the duty payable for such SSI units upto Rs.100 lakhs should be so adjusted that when the clearance level reaches Rs. 100 lakhs, the input duty credit is more or less exhausted. This can be achieved by fixing the duty rate for units upto Rs.100 lacs at 85 percent – 90 percent of the normal duty.

(c) The third option is that the credit lying unutilised should be made to lapse as soon as the clearance from the unit crosses Rs.100 lakhs in a financial year.

The exemption for small scale units is meant only for small units and there is no reason why larger units should be given the benefit. At present, tax exemption for small-scale units is available so long as total clearance of excisable goods in the preceding financial year did not exceed Rs.3 crores. However, there is a rider that goods fully exempted from excise duty, including goods exported, will not be taken into consideration for determining the eligibility of Rs.3 crores. To illustrate, butter is fully exempted from excise duty. If a manufacturer of butter with a turnover of Rs.10 crores, starts manufacturing biscuits also, he need not pay, if he so chooses, any excise duty on biscuits upto a value of Rs.1 crore. It is proper that benefits of SSI exemption should depend on the total turnover and not on turnover of non-exempted goods only. So the suggestion is that there should be no exclusion of the exempted goods for determining the eligibility under the small-scale exemption scheme.

Further, it is recommended that if an item is covered under the small-scale exemption scheme, there should not be any other exemption for such items. It is also the Group's view that, in general, there should not be any separate unconditional exemption for goods which are covered under the SSI exemption scheme. This will of course, be subject to the condition that such goods are not generally made in the small scale sector. To illustrate, fertilizers are exempted and are also covered under SSI exemption scheme. But since fertilizers are generally made in large units, and there is also the price retention scheme, it may not be possible to withdraw this particular exemption. But subject to similar exceptions, generally SSI exemption scheme should replace the individual exemptions.

In the working of the SSI exemption scheme, there is decidedly a great risk to revenue—not because of the high exemption limit—but because of the complete absence of documentation. Today, a SSII unit, whose clearances wee less than Rs. 90 lakhs last year (or less than Rs. 90 lakhs this year for new units), does not have to make any declaration to the Cental Excise Departments. This means that the unit need not keep any record of production, clearance at all, facilitating availment of exemption even beyond Rs. 1 crore. There is revenue loss on other account also. As explained earlier, the exemption to SSI units is a great source of Modvat misuse, whereby the Modvat invoices are traded without movement of any goods. It is imperative that exempted SSI units must maintain all records of production, clearance etc. though they need not file any returns. But they must declare at least once to the Department about their existence, products etc. Such units will not be visited by excise officers so long they are exempted, without a specific information of misuse. To help really small units, which are basically a family affair, it can be provided that the exemption from declaration/maintenance of records will apply only to unit with a turnover of say Rs. 15-20 lakhs. All other units must maintain full accounts, even though they are exempted upto Rs. 1 crore.

g. Valuation

Under the new valuation provisions, excise duty is to be charged on the basis of transaction value. This is a fundamental departure from the past, when valuation was based on the concept of normal wholesale price. Section 4 now seeks to accept different transaction values so long as these are based on purely commercial considerations. Consistent with principles of the VAT, it enables valuation of goods for excise purposes on value charged as per commercial practices. The applicability of transaction value for the purpose of assessment requires the following:-

(a) The goods are sold by an assessee for delivery at the time of place of removal. The term "place of removal" has been defined basically to mean a factory or a warehouse;

(b) The assessee and the buyer of the goods are not related; and price is the sole consideration for the sale.

Transaction value is the price actually paid or payable for the goods when sold. It includes any amount the buyer is liable to pay to or on behalf of the assessee by reason of or in connection with the sale This payment may be made at the time of sale or at any other time. Such payments include but are not limited to: (i) advertising; (ii) publicity; (iii) marketing and selling organisation expenses; (iv) storage; (v) outward handling; (vi) servicing; (vii) warranty; (viii) commission, or (ix) any other matter. It does not include amount of excise duty or sales tax or any other taxes actually paid or payable on such excisable goods.

Though the new valuation provisions appear to be adequate, there are still some problems in respect of goods which are cleared from a factory to its depots where the sale will take place. But the duty is to be paid only at the factory. In a proper VAT, the duty should be on the basis of the price at which the goods will be sold from the depot. But, probably because of administrative considerations, some simplifications have been made. It can be appreciated from the departmental instructions reproduced below.

If the goods are not sold at the factory gate or at the warehouse but are transferred by the assessee to his depots or consignment agents or any other place for sale, the assessable value in such case for the goods cleared from factory/warehouse shall be the normal transaction value of such goods at the depot, etc. at or about the same time on which the goods as being valued are removed from the factory or warehouse.

By way of illustration, if an assessee transfers a consignment of paper to his depot from Delhi to Agra on 5-7-2000, and that variety and quality of paper is normally being sold at the Agra depot on 5.7.2000 at a transaction value of Rs.15,000 per tonne to unrelated buyers, where price is the sole consideration for sale, the consignment cleared from the factory at Delhi on 5.7.2000 shall be assessed to duty on the basis of Rs. 15,000 per tonne as the assessable value. Assuming that on 5.7.2000 there were no sales of that variety from Agra depot but the sales were effected on 1.7.2000, then the normal transaction value on 1.7.2000 from the Agra depot to unrelated buyers, where price is the sole consideration, shall be the basis of assessment.

This creates an aberration, as it is difficult to verify or know at the time of clearance of goods from a factory to its depot as to what the value was at the depot at the point of clearance from the factory. This is a deemed value. The solution lies in making the depots duty paying agencies, so that, as and when the goods are cleared from a depot, duty is paid on the transaction value. The number of depots may be large, but the checks would be account-based only, and could be checked by audit groups at regular intervals.

In such cases, the movement of goods from factory to depot can be regulated in two ways:-

(i) On payment of duty on a notional value, and the depot will take credit of this duty.

(ii) Without payment of duty, and duty will be paid by the depot on clearance.

The administration should not be difficult as a large number of SSI units have gone outside excise control in view of the increase in exemption limit to Rs. One crore. This step will facilitate the movement towards a full-fledged VAT.

Not all goods are covered by this transaction value. There is a number of goods which are assessed on the basis of the MRP. A certain percentage is allowed as abatement from the MRP for determining the value on which the duty is to be paid. The system of abatement is probably based on weighted average calculations. The authorities need to look into whether any abatement is needed at all, or consider a uniform abatement to take care of the duty element alone.

h. Dutiability of Complete Plant Erected at Site

An issue which has become controversial is the excisability of a plant which has been erected on site, even though the individual parts have already paid duty. In order to attract excise duty the goods manufactured must be marketable. If they are intermediate products that are not marketable, or if they are embedded on the earth like immovable property, they are not marketable. Then they do not have to pay excise duty. Paper plants and power plants, for example, were regarded as immovable property and so not marketable, being embedded on the earth. All the judgements of Tribunal and even Supreme Court were along these lines. Chemical plants embedded on the earth were held to be immovable property and thus not excisable.[9] There are similar judgements about lifts, elevators, escalators, weighing machines, overhead travelling cranes and many others where the Tribunal and Courts had invariably taken the view that the plants and machinery being fixed on the ground are immovable property and are not marketable and so not excisable. This was the settled law.

The Supreme Court unsettled this proposition in the case of Sirpur Paper Mills vs CCE 1998(97)ELT 3 SC by holding that paper making machine is not "immovable property as something attached to the earth like a building or a tree" though it was "embedded on a concrete base to make a permanent fixture" .The Court observed that some parts were bought out items and some manufactured at site, and the whole turn key project was erected at site. The implication of this judgement is that, since all plants are erected at site from some bought out items and some manufactured items, and since they are also mounted on concrete base, they will all attract duty once again after they are assembled at site as a plant.

The Central Board of Excise and Customs, issued a circular (Order no 53\2\98 cx dt 2.4.98) under Section 37B of the Excise Act, which has a binding effect on the officers. It asks the officers to charge duty if the plants are not embedded on the earth like a "building or a tree". All factories and plants are partially like building or tree, as they cannot be removed without breaking them. This has resulted in issuing demands by officers. Litigation is rife. How much of breakage is permissible so as to call it marketable is a question of fact, which is now before the officers and Tribunal.

However, in the meantime, some other parties have gone to the Supreme Court which has effectively reversed the position taken by the Sirpur judgement in three

[9] In the case of Gujarat Machinery vs CCE, 1983 ELT 825(T) and also in the case of Chemical Vessels Fabricators Ltd 1982ELT 92. Mono Vertical Crystallises attached to the earth were adjudged as immovable property by the Supreme Court in the case of Mittal Engineering Works, 1996(88) 622SC. Mechanical plants and machinery were held as immovable property in the case of Tata Robins Fraser vs CCE m 1990(46)ELT 562(T) . Steel tube mill was held as goods attached to earth and so immovable property by the Supreme Court in the case of Quality Steel Tubes vs CCE, 1995(75) 17SC.

subsequent judgements namely (i) Duncan Industries vs State of U.P. JT 1999 (9) SC421; (ii) Silical Case ELT Vol. 108 Page A58; (iii) Tribuni Engineering vs CCE 2000 (120) ELT 273 (SC).

The criterion followed in these later judgements being different and contrary to the one in the Sirpur case, the net effect is that the Sirpur judgement is superseded for all practical purposes.

Since a very large number of demands, running into hundreds of crores, is still pending, the immediate action that the Central Board of Excise and Customs should take is to change the Circular (Order no 53\2\98 cx dt 2.4.98) under Section 37B of the Excise Act and issue a fresh one indicating that when the plant and machinery are embedded on the earth permanently and not on a common base, they should be considered as immovable property and not be charged to excise duty. It should be clarified that the Sirpur judgment has been practically superseded. At the same time it should be made clear that it would be applicable to all pending cases. In fact, the problem would appear to be confined to only areas where the plant and machinery are not installed/erected in a factory. This is because there is already an exemption for capital goods manufactured in a factory and used within the factory of production. Government may, to remove all doubts, issue an exemption for plant and machinery installed/erected at site.

i. Frequency of Tax Payment

The new system of payment of excise duty which has delinked payment of duty from clearances is a welcome step consistent with administration of VAT. But this may not be enough, and it may be considered whether the present system of fortnightly payment should be replaced by one of monthly payment. This will enhance liquidity of the manufacturing units. The monthly payment of duty will also ensure fewer accounting problems both for the Department and for manufacturers, since today there is a provision for excluding a taxpayer from the fortnightly payment scheme if he fails to pay within the stipulated dates. Thus an officer is to check every fortnight that the amounts have been paid within the statutory period for each fortnight. The fortnightly payment scheme highlights the commitment of the authorities to make accountal simple for the assessee and to rely entirely on his documents. This certainly indicates a movement towards an account based audit. The CBEC has already introduced a new auditing system known as E.A 2000 based on sound accounting and auditing principles. With liberalisation, the emphasis has shifted to audit and anti-evasion, rather than interfering in the day to day business activities of the manufacturers. Further simplification is needed in some areas in this regard.

In selective cases like removal of defects in goods supplied to the user, there is a set procedure allowing entry of such goods subject to maintenance of proper accounts. But, there are instances where goods manufactured by an assessee are returned to the factory on various considerations like rejection by buyer, break down of the transport etc. In these cases, the party has to obtain approval of the Chief Commissioner before such goods can be brought to the factory. This is a time consuming process and the assessee has to be constantly in touch with the central excise officers before he can bring those goods into the factory. When the records of the assessee are considered good enough for accountal of all manufacture and clearance, there is no reason why permission should be needed before re-entry of goods in specific circumstances. Accounts should be maintained for all such re-entry and, on the basis of self declaration or simple intimation to the Department, the manufacturer should be able to bring back duty paid-goods into the factory for any reason.

Another important issue which arises today is that large manufacturers procure parts/components which are used both for manufacture and also for sale as spares. They would like to get these goods, and subject them to quality checks before they are used or sold. This is to ensure that all spare parts adhere to the specifications. Such manufacturers would like to maintain a certain quality for all their spare parts. There is no specific provision for entry of such goods which are meant for further sale (trading activities). Approval of the Department is needed, which generally is not given. There is a need for relaxation and, so long as proper accounts of goods for use and for sale are maintained , the purpose will be served. There can be a deterrent penalty in case of misuse.

j. Exports—Multiplicity of Schemes

The aim of export promotion schemes is to strip export goods of all duties (both Excise and Customs). But to achieve this, there is a multiplicity of schemes and procedures which certainly result in administration difficulties in monitoring. The following schemes are available to achieve duty free status for export goods :

(i) Payment of drawback on exports. There can be an “all industry rate” which is worked out by averaging the value of inputs and rates of duties on such inputs, and input-output ratios. Any exporter can claim this drawback at these prescribed rates. Another route is brand rate for those exports where no all industry rate is available or where the all industry rate is inadequate for a particular manufacturer. These rates can have both excise and customs duty components.

(ii) Exports under bond. Here the goods can be exported without payment of excise duty on the finished goods and also on inputs for such finished goods.

(iii) Exports under claim for rebate of duty.

(iv) Export Promotion Scheme : New capital goods, including computer software systems, may be imported under the Export Promotion Capital Goods (EPCG) Scheme.

(v) Duty Exemption/Rermission Scheme : The Duty Exemption Scheme enables import of inputs required for export production. The Duty Remission Scheme enables post export replenishment/remission of duty on inputs used in the export product.

Under the Duty Exemption Scheme, an advance licence is issued for duty-free import of inputs subject to actual user condition. They can be issued for : (a) physical exports; (b) intermediate supplies; and (c) deemed exports.

The Duty Remission Scheme consists of the duty-free replenishment certificate (DFRC) and the duty entitlement passbook scheme(DEPB).

Duty Free Replenishment Certificate (DFRC) is issued to a merchant-exporter or manufacturer-exporter for the import of inputs used in the manufacture of goods without payment of Basic Customs Duty, Surcharge and Special Additional Duty. However, such inputs are subject to the payment of Additional Customs Duty equal to the Excise Duty at the time of import.

(vi) Duty Entitlement Passbook Scheme (DEPB) : For exporters not desirous of going through the licensing route, an optional facility is given under DEPB. The objective of DEPB is to neutralise the incidence of customs duty on the import content of the export product. The neutralisation is provided by way of grant of duty credit against the export product.

Under the DEPB, an exporter may apply for credit, as a percentage of FOB value of exports, made in freely convertible currency. The credit is available against such export products at rates specified by the Director General of Foreign Trade.

The holder of DEPB has the option to pay additional customs duty, if any, in cash as well.

The exports made under DEPB are not entitled for drawback. The additional customs duty paid in cash on inputs under DEPB can be adjusted as CENVAT credit. However, where the additional customs duty is adjusted from DEPB, no benefit of CENVAT is admissible.

An EOU/EPZ/EHTP/STP unit may import without payment of duty all types of goods, including capital goods, as defined in the statute, required by it for manufacture, services, trading etc. provided they are not prohibited items of imports in the ITC(HS). EOU/EPZ/EHTP/STP units may procure goods required by them for manufacture, services, trading or in connection therewith, without payment of duty from bonded warehosues in the DTA set up under the statute. They may import, without payment of duty, all types of goods for creating a central facility for use by software development units in STP/EHTP/EPZ. The central facility for software development can also be accessed by units in the DTA for export of software.

In our view, too many options tend to create problems for administration as it is difficult to monitor the exemptions linked to export obligations over the years. For instance, when there is a facility to export under bond, the option to clear on payment of duty which is subsequently rebated may not be necessary, particularly where the drawback route is also available. Besides, the payment of rebate also takes time.

Similarly, in the case of exports, the DEPB route does not appear to be necessary when the DFRC, DEEC, and Drawback are available. Besides, this may not be compatible with WTO conventions. There is a need to evaluate whether the duty foregone on these schemes (around 35-40 percent of net Customs revenue) is really compatible with export growth. With the introduction of special economic zones, and the scheme for EOU/FTZ, it needs to be considered if only the following schemes should suffice: (1) DERC; (2) DEEC; (3) export under bond; (4) Drawback; (5) EPCG schemes; and (6) special scheme for gem/jewellery/diamonds.

k. Introduce Explanatory Definitions where Necessary

CCCN classifications applicable to the customs tariff are harmonised with excises. Nevertheless, since excises relate to the concept of manufacture which is not the case in CCCN, some indefiniteness in the identification of particular products tends to arise on the excise side. In these selective cases, the tendency for such matters to end up in litigation would be minimised if appropriate and specific definitions are included in the excise tariff. For example, in the case of “waste and scrap”, the interpretation of “waste” has created some confusion which should be resolved with appropriate definition.