

Tax Planning & Cost Control _Central Excise

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Introduction:

- i. **Central Excise:** Entry 84 of the Union list to the [Constitution of India](#) empowers the Central Government to levy excise duty on goods manufactured or produced in India. Thus excise is levied on the activity of manufacture or production of excisable goods in India, clearance is not relevant for the purpose of levy. Duties of excise are not applicable on manufacture of alcoholic liquors for human consumption, opium, hemp, narcotic drugs as States are being empowered to levy excise duty. Further duty of Excise is not applicable on salt. The liability under excise law accrues on the activity of manufacture/production, but collection is at the time of clearance from the factory for administrative convenience.
- ii. **Tax Planning, Tax Avoidance & Tax Evasion**

Tax Planning: Tax planning is arrangement of financial activities in such a way that maximum tax benefits, as provided in the Central Excise Act and Rules made under are availed by the assessee. It envisages use of certain exemption, selections of valuation method, structuring the transaction and selection of various benefits available under the law thereby minimizing the tax burden without violating legal provisions. Detailed discussion on Tax Planning under Central Excise is made in the later part of the material.

Tax Avoidance: Tax Avoidance refers to the legal means so as to avoid or reduce tax liability, which would be otherwise incurred, by taking advantage of some provision or lack of provision in the law. Thus, in this case tax payer tries to reduce his tax liability but here the arrangement will be legal, but may not be as per intent of the law. Thus, in this case, tax payer does not hide the key facts but is still able to avoid or reduce tax liability on account of some loopholes or otherwise. The Hon'ble Supreme Court in the case of [McDowell & Co Limited v CTO 1985 \(4\) TMI 64 - SUPREME Court](#) held as follows.

"Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid payment of tax by resorting to dubious methods."

Illustrative list of Tax Avoidance under Central Excise are as follows.

- a. Taking a plea of Bona fide belief or relied on Case laws for intentional short / nonpayment of Taxes.

- b. There are 2 notifications which appear to be equally applicable. Choosing the one which is favourable.
 - c. There are decisions on availing credit fully even though some amount of trading done. This position existed upto 2011. Availing full credit.
 - d. There are conflicting decisions on includability or otherwise of expenditure in assessable value. Paying duty on lesser value.
 - e. Availing credit and discharging duty on traded goods assuming that duty applicable as a deemed manufacturer.
- **Evasion:** Tax Evasion term is usually used to mean 'illegal arrangements where liability to tax is hidden or ignored i.e. the tax payer pays less than he is legally obligated to pay by hiding income or information from tax authority. Thus, here the tax liability is reduced by **"illegal and fraudulent" means**. However, the short payment of Taxes / hiding of Income should be intentional to constitute as a Tax Evasion. Under Central Excise, as the law is interpretive and based on notifications and case laws, there may be situation where the assessee acted on a bona fied belief on the particular transactions which may be result in evasion of tax. Hence, the intention of the assessee on short payment of Taxes would play a major role in determining whether the short payment is of Tax Evasion or interpretational issues.

Illustrative examples for Tax Evasion under Central Excise are as follows:

- a. Clandestine removal of Excisable Goods without payment of Central Excise Duty.
- b. Availment of Exemption which is not available to the assessee. Eg: Claiming of SSI exemption even though using the brand name of the others.
- c. Intentional availment of CENVAT Credit which is not eligible / availment of Credit more than charged in the Invoice. Also availment of CENVAT Credit without having the receipt of goods.
- d. Not following the Valuation provisions of Central Excise. Eg: Non following of Rule 6 of Valuation Rules in case free material received from the customer.
- e. Transfer of CENVAT Credit from one Unit to another Unit by raising dummy Stock Transfer Invoice.
- f. Non following of [Rule 6](#) of [CENVAT Credit Rules, 2004](#) for trading activity after to 01-04-2011.
- g. Claiming of SSI Exemption by creating two or more different entities and by two **benami** persons and claiming SSI Exemption to both the entities.
- h. Mixture of Goods / Classification: When there is a doubt / ambiguity in the classification of the Goods under Central Excise, the assessee would classify the goods which is commercially favorable to him by nomenclating as different goods.
- i. Manufacturing and clearing goods without obtaining Central Excise Registration.

- j. Suppression of production – manufacturing of goods without properly accounting the same in the records.
- k. Mis-declaration/under-valuation of the product.

Note: These types of transactions can theoretically lead to prosecution for the doer and the advisor.

- iii. **Cost Control**: There is no exact rule or definition of cost control. The term, cost control, implies the usage of policies and internal rules that help the entity to reduce the cost of a particular management process. Cost control methods target the reduction of cost, and maintenance of quality and quantity of a particular production process or service generation. Under Central Excise, there are many ways to reduce the cost of Purchases and Overheads which is used in the manufacturing process. The detailed discussion on the same is made in later part of the material.

TAX PLANNING UNDER CENTRAL EXCISE:

For a manufacturing entity, the Central Excise plays one of the major roles in determining the Selling price of the company's product to the ultimate buyer and also plays a major role in determining total cost of goods sold for the entity.

To illustrate:

If the turnover of the manufacturing company is around 100 crores, the total Duty payable on such sales would be around 12.5 crores. Further, if we take a material cost as 65 percent and overheads as 20 percent, then there would be an element of CENVAT Credit of around 6 to 7 crores. Hence, we can say, the Central Excise Duty constitutes around 20 percent of the total turnover of the company.

However, the Management and even the Statutory Auditors are not looking in depth in this area. This is due to lack of expertise knowledge and is on the assumption that there is no room for Tax planning / Cost Control in this area. Further, the company would be having a strong internal control where to pay even Rs.1,000/- to an third party, it involves authorization from various persons and will take minimum of two days. However, the Accountant who is handling the Central Excise transactions can reverse the CENVAT Credit of Rs.1 crores without any authorization and the same is possible by just one entry in the CENVAT register.

Presently, after the expansion of Service Tax from the past 5 to 6 years, now the management has started focusing on Tax Planning under Central Excise. As explained earlier, as the Central Excise law is built on interpretation and case laws, the manufacturer can save the Tax by having a proper planning. However, the planning should be done at the initial stage. Further, it

requires the help of Expert who is aware of the all the latest developments under the Law. Also we can say that, the Tax Planning under Central Excise is a customized reading of provision of Central Excise Act, for one's business and there is no hard and fast rule for Tax Planning and it is purely dependent on the circumstances and facts of each case. In this material illustrative list of possible Tax Planning for some transactions are provided which are as follows:

i. **Availment of SSI Exemption Vis-à-vis Payment of Duty:**

Under the Central Excise law, there is an exemption from payment of Central Excise duty for Small Scale Manufacturers up to the clearance of Rs.1.5 crores in a financial year subject to satisfaction of conditions prescribed in the notification 08/2003 CE. The one of the conditions is the assessee is not eligible to avail the CENVAT Credit on Inputs and Input Services which is used in manufacturing of Excisable goods.

Before adopting the exemption, the assessee requires to do the feasible study whether to avail the exemption or to pay the duty from Re.1. The various factors to be considered in the feasible study are as follows.

- a. Type of Contract – Whether Inclusive of Duty / Exclusive of Duty
- b. Sources of Purchase of Inputs – Whether from Manufacturers / Dealers / Traders
- c. Eligibility of CENVAT Credit to the Customer
- d. Quantum of CENVAT Credit available on the Capital Goods used in the course of manufacturing

After considering the above facts, the manufacturer would come to a conclusion whether to claim exemption or to pay the duty. Following table summarizes how Tax Planning can increase profit to the manufacturer in claiming of exemption.

Sl. No	Particulars	Option I : To claim the Exemption (in Rs)	Option II: To pay Duty from Rs.1 (in RS)
1.	Basic Value of goods cleared	Rs.10 lakhs	10 lakhs
2.	Excise Duty (at the rate of 12 percent)	-	1.2 lakhs

3.	Total Selling price to the customer	Rs.10 lakhs	Rs.11.2 lakhs
4.	Purchase value of the material	Rs.6 lakhs	Rs.6 lakhs
5.	Value of the Overheads	Rs.2 lakhs	RS.2 lakhs
6.	CENVAT Credit involved in 4 & 5	Rs.0.6 lakhs	Rs.0.6 lakhs
7.	Cost of Goods Sold	Rs.8.6 lakhs	Rs.8 lakhs
8.	Profit to the manufacturers (in Tax Extra Contracts)	Rs.1.4 lakhs	Rs.2 lakhs
	Decision:	Not to claim the exemption and pay Duty from Rs.1 as it saves Rs.0.6 lakhs for 10 Lakhs	
9.	Profit to the manufacturer (in Tax Inclusive Contracts)	Rs.1.4 lakhs	Rs.0.80 lakhs
	Decision:	Claim the exemption and not to pay the Duty up to 1.5 crores	

From the above analysis, it is clear that the aspect of Tax Planning depends on facts and circumstances of the each case and there is no hard and fast rule to determine the same. In the above table, if the contract is of inclusive type, the manufacturer can claim the SSI Exemption and in case of Tax Extra contracts, the manufacturer can pay duty from Re.1. However, this decision may vary if the CENVAT Credit element involved in the purchase cost is reduced.

ii. **Tax Planning for Central Excise duty paid under Rule 6 of Central Excise Valuation Rules:**

[Rule 6](#) of [Central Excise Rules, 2002](#) reads as follows.

“Where the excisable goods are sold in the circumstances specified in [clause \(a\) of sub section \(1\) of section 4](#) of the [Act](#) except the circumstance where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value

and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee”

By virtue of the above Rule, any free supply of material from the buyer which is used in the manufacturing of Excisable goods requires to be included in the transaction value on which Excise duty is paid. However, the buyer is not eligible to avail the CENVAT Credit on the material which is issued to the manufacturers as the same is not used in the manufacturing of finished goods in his factory and such CENVAT Credit would become a cost to the Buyer.

However, to avoid these, the buyer can make a Tax Planning at the initial stage of the transaction where such goods (which is issued as a free supply to the manufacturer) can directly be delivered to the manufacturer instead of receiving in its factory and also by disclosing Consignee as manufacturer so that the manufacturers can avail the CENVAT Credit and the benefit of CENVAT Credit can be considered for fixing the transaction price and the same would be resulting in usage of CENVAT Credit.

iii. **Inter Unit Transfer:**

In earlier business scenario, there used to be only one Unit which would be engaged in all the processes required for manufacturing of a particular product and used to clear the Finished goods from the factory. However, due to rapid development in the technology and also considering the technical and commercial feasibility, many companies are now having more than one unit for manufacture of a particular product. To say, Unit I would do the manufacturing activity up to certain level and the same would be dispatched to other units for further processing say to Unit II. In Unit II, the goods would be manufactured and the same would be sent to Unit III for further manufacturing. In Unit III, the product would be completed and has the following options.

- a) Sell directly from Unit III to final customer.
- b) Send to Unit II and removal to final customer from Unit II.
- c) Send to Unit I and removal to final customer from Unit III.

In these situations, the manufacturer requires to comply with the various provisions of Central Excise Valuation Rules, 2006 and he has various options to execute the above transaction. For this, initial Tax Planning requires, otherwise, the company can face many problems viz. accumulation of CENVAT Credit in one branch, Over-pricing / under pricing of Stock Transfer which leads to unnecessary blockage of working capital or harassment from the department. If at the initial stage, proper planning was made, the company can run these transactions smoothly without any trouble and the same would increase the profitability of the entity.

iv. **Tax planning in selecting appropriate status of the entity:**

At the stage of incorporating the company / unit, the company can do Tax Planning to avail the various benefits available under law. To illustrate, the company has the option to set up as an EOU / SEZ/ also as a Large Tax Payer Unit. Further, the company can also do Tax Planning to set up a unit under Northern states where there would be exemption from payment of Central Excise duty.

v. **Tax Planning for the Export Transactions:**

As the intention of the government is not to export the Taxes and Levies, the Government has introduced various Tax Incentives for the manufacturer who is exporting the goods abroad. The illustrative lists of schemes available are;

Pre-Export benefits:

- a) Procurement of Duty free Imports under Advance License and DFIA scheme.
- b) Procurement of Capital goods under EPCG Scheme
- c) Procurement of goods at concessional rate of Duty

Post Export benefits:

- a) Refund under [Rule 5](#) of [CENVAT Credit Rules, 2004](#)
- b) Rebate Option for Export of Goods under [Rule 18](#) of [CER, 2002](#)
- c) Duty Drawback for the Exports made and also supply made to EOU
- d) Benefits for registered as a Star Status Export House

However, the Exporter is not eligible to avail all the benefits at a time and only few of the benefits would be available. However, the benefits available would not be the same under each scheme and the same may vary. Accordingly, the manufacturer / Exporter requires to do a feasible study and should determine the best scheme / set of scheme considering the commercial and procedural feasibilities and the same may be adopted. It may not be out of place to mention that the restrictions under Rule 6 of the CCR are not applicable to clearances to 100 percent EOU/EHTP/STP or to unit in an SEZ or SEZ Developer and the credits on the concerned inputs or input services used in such clearances can be claimed.

vi. **Tax Planning for Leasing Transactions:**

The facts of the transactions are as follows:

- a) XYZ Ltd has entered an agreement with Leasing Company B for financial lease of Machinery.
- b) The Leasing company is imported the machinery from abroad and directly delivered such machine to company A.
- c) The customs duty paid at the time of Import would be a cost to the Leasing Company and in turn the same would be recovered from XYZ Ltd leading to increase in cost for XYZ Ltd.

Possible Tax planning in this transaction:

- a) Such Machinery imported can be directly delivered to M/s XYZ Ltd and the CENVAT Credit on CVD and SAD can be claimed by M/s XYZ Ltd leading to reduction of cost of machinery to the company. However, the Bill of Entry should be in the name of M/s XYZ Ltd or the same should be endorsed by leasing company to M/s XYZ Ltd.
- b) The leasing company can take registration as a dealer and can pass the Credits to M/s XYZ Ltd.

vii. **CENVAT Credit on Capital Goods i.e. Machinery which is used for Exempted products:**

As per [Rule 6 of CENVAT Credit Rules, 2004](#), the CENVAT Credit is not eligible on Capital goods if the same is exclusively used for manufacture of Exempted Goods.

To Illustrate: CENVAT Credit available on Imported machinery is Rs.70 lakhs and if the same is used for the Job work activity which is exempted under notification 70/92 CE, the manufacturer is not eligible to avail the CENVAT Credit on such Capital goods. However, if the company has engaged in manufacture of any other capital goods, then the company can think of using the said machinery (only for little process) in any of the process of other product where Central Excise Duty is paid and can avail the CENVAT Credit on the machinery. However, the company should maintain adequate internal document say production lag to prove that the said machinery is used in manufacture of Excisable goods.

viii. **Adoption of Method under Rule 6 of CENVAT Credit Rules, 2004:**

[Rule 6 of CENVAT Credit Rules, 2004](#), provides various methods for availment of CENVAT Credit if the manufacturer is engaged in both Dutiable as well as non dutiable products. The manufacturer can adopt any one method after doing the feasibility study which reduces the

quantum ineligible CENVAT Credits.

ix. **Intimation to the department:**

Now-a-days, as inmost of the transactions there will be an ambiguity in getting the benefit / reducing the cost, in such a situation it is always better to intimate the department on understanding of the transactions. Now a days, such intimation provided to the department can also be considered as one of the Tax Planning methods as it safeguard the manufacturer from the department alleging suppression of facts and invoking extended period of limitation.

x. **Facing the departmental Audit:**

Now-a-days, the facing of departmental audit and furnishing of information to the department plays an important role as there would be both pros and cons in this. Furnishing of wrong information / non furnishing of information leads to unnecessary notices from the departments which have an adverse effect on the company. Hence, the speaker is of the view that, facing / interacting with the department audit / executives should be planned in advance and it is also to be considered as one of Tax Planning of the company.

Cost Control under Central Excise:

As explained earlier, the objective of the Cost Control is to reduce the Purchase Cost of the goods used in the manufacturing of Excisable goods. Under Central Excise, there are many rooms for Tax Planning to reduce the burden of Tax by way of availing the same as CENVAT Credit. The illustrative list of cost control measures under Central Excise law are as follows.

i. **Receiving quotation from more than one supplier and comparison before placing the order:**

It is feasible to get quotations from more than supplier and the same may be compared before placing an order. Further, the company should also have the alternative supplier list to ensure the enquiry is made to all the suppliers. Further, the list of alternative suppliers and taking of quotation should be reviewed at regular intervals and the same would reduce the purchase cost to the Manufacturer.

ii. **Purchase from the manufacturers Vs Purchase from the dealers**

As per the provisions of [CENVAT Credit Rules, 2004](#), the manufacturer is eligible to avail the CENVAT Credit on the Inputs used in production of Excisable goods. Usually, the manufactured goods would be cleared to Dealers and from dealers the same would be cleared to distributors and then to Retailer. If the company purchases the Inputs required for manufacturing of goods

from the Retailer, the cost of such goods would be high when compared with price charged by manufacturer. If the goods were purchased from the manufacturer, the price would be low and the assessee is eligible to claim the CENVAT Credit. Hence, it is always better to purchase the goods from the manufacturer as the goods would be available at a reduced price and Excise Duty would be available as a Credit leading to reduction in the Cost of Production.

iii. **Analysis of Dealers Margin:**

As per the provisions of Central Excise, the dealer requires to disclose the details of manufacturers in the dealer invoice which would be issued to pass the Central Excise involved. The assessee who is procuring the goods from the dealer, can easily analyze the profit margin of the dealer. In case, if the profit margin found abnormal, then the assessee can think of purchasing directly from the manufacturer / other dealers as the same would result in reduction in Purchasing price of the goods.

iv. **Inclusion of Excise Duty clause in the Purchase Order:**

It is always advisable to the assessee to have the taxation clause in the Purchase Order as it clears the Tax to be charged in the Invoice. If the Purchase Order of the assessee has a clause in the PO as '*price mentioned is inclusive of Excise Duty*', then the supplier will not be able to claim any additional amount from the assessee. Further, the assessee can shift the burden of Tax risk to the supplier and can avoid unnecessary additional claims. Hence, the executives who handle the Purchase and Sales department should aware the basic concepts under Central Excise so that, they can add value to the company by cost control.

v. **Standard Operation Procedure for availment of CENVAT Credit on Input Services**

With the introduction of negative based Service Tax law, majority of the overheads of the company (except salary & wages) would be leviable for Service Tax. However, in some cases, due to ignorance of availment of CENVAT Credit, the assessee would lose the benefit of CENVAT Credit. To illustrate, many assessees are not availing the CENVAT Credit on Banking charges, Service Tax paid under reverse charge etc. To avoid this type of loss of benefits, the company should have a proper SOP and also an internal check so that they do not miss out any CENVAT Credit.

vi. **Removal of Goods from Job Worker Place:**

Normally, now-a-days, the manufacturer is not able to engage in all the process required for manufacturing of a product and certain process would be outsourced to a Job worker. If in case, the Job worker is doing the Finishing process of the manufactured product and product is completed at the Job worker place, the manufacturer has an option to remove the finished

goods directly from the Job worker place subject to satisfaction of conditions provided in the Rules. By this way, the manufacturer can cut the cost of freight from Job worker place to the manufacturer and the same would result in cost control to the company. This would also entail the job worker to claim cenvat credits where the activity in question amounts to manufacture.

vii. **Fixing of Re-order level Stores:**

The manufacturer should have the policy of fixing the reorder level and also re-order quantify in the Stores department as the same would help the company in reduction of accumulation of Working capital in the Stock maintained. Further, the manufacturer can also implement ABC category in the stores where the focus would be given only on the high value items and cost of maintaining the stock would be reduced and the same would result in decrease in Cost of Production to the company.

viii. **Scrap Lying with the Job Worker:**

As explained earlier, now a days it is common for the manufacturer to outsource some of the process to the Job worker. In most of the cases, the Job worker would keep the Scrap generated during processing and the same would not be received back by the manufacturer. In such a situation, the manufacturer should estimate the amount of scrap lying with the Job worker place and the same should be considered while fixing the Job work charges which will be payable to the Job worker for the process done.

ix. **Applying for Rebate / Refund together:**

If the manufacturer is availing the benefits of Rebate / Refund or any similar benefits, the applications for the same should be made only once as per the provisions of Central Excise. If the assessee has made two or more refund claims for the same period (when there is an option for submitting at once), then the same would increase the legal cost to the company. Also all the other departmental correspondence should be filed within the due dates as the same would reduce the possible legal cost to the company.

Conclusion:

To conclude, the above list of Tax Planning and Tax Cost Control is only illustrative and for each and every transaction there is a possibility of Tax Planning and Cost Control. However, there is no hard and fast rule for this and the same is depending on the facts and circumstances of each case. Further, these policies should be reviewed at regular intervals to equip with latest developments under Central Excise and the same would result in growth of the company.