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# Destruction / Rejection: Excise duty implications

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This document contains a brief on Destruction / Rejection: Excise duty implications

The general sequence of excise-related events for a manufacturer is

- manufacture,
- entry in daily stock account,
- removal on excise invoice and debit to daily stock account,
- payment of excise duty after the close of the month.

When this proceeds smoothly, no need arises to identify the legal framework behind the procedures.

However, if there is a hiccup at any point in the sequence, the issue of payment or refund of excise duty raises many legal questions. The normal procedures can be interrupted on account of

- Cancellation of invoice after the goods are made ready for despatch;
- Rejection of goods by the customer, resulting in either diversion to another customer or return to the factory;
- Destruction of manufactured goods in-house for quality reasons;
- Destruction of manufactured goods by natural causes like fire or storm;

In such situations the manufacturer has to know whether excise duty will be payable / refundable; whether Cenvat credit will have to be reversed; and the related documentation. This can be decided in each case on the basis of a conceptual understanding of what excise duty is levied on, and the prescribed manner of its payment.

**The levy of central excise duty, postponement of actual payment, and excise control**

Central excise duty is levied on goods that are manufactured in India (section 3 of the Central Excise Act). Thus 'manufacture' is the taxable event; but the obligation to actually pay the duty is usually deferred to the moment of removal of the goods from the factory. Thus, under rule 4 of the Central Excise Rules 2002, duty is payable on removal of goods:

> **"RULE 4. Duty payable on removal.** — (1) Every person who produces or manufactures any excisable goods, or who stores such goods in a warehouse, shall pay the duty leviable on such goods in the manner provided in rule 8 or under any other law, and no excisable goods, on which any duty is payable, shall be removed without payment of duty from any place, where they are produced or manufactured, or from a warehouse, unless otherwise provided :"

Under Rule 8, the duty on goods removed during the month is to be paid to the credit of the central government by the fifth day of the following month (or sixth day if the payment is made by internet banking). Thus, the goods become excisable when manufacture is complete; the duty on them became payable upon their removal from the factory, and is actually required to be paid only by the fifth day of the following month. Unlike the old days, when every excise "gate-pass" (under rule 52A of the erstwhile Central Excise Rules 1944) accompanying the goods carried immediately verifiable payment details, in today's scenario the central excise officer has to track the goods through the prescribed documentation to establish whether excise duty was paid on them.

Excise documentation of goods consists of a Daily Stock Account maintained under rule 10 of the Central Excise Rules 2002, and the excise invoice issued under rule 11 *ibid*, which contains information on the goods removed and the name and address of the consignee. If Cenvat credit is being taken, an account of that too is to be maintained.

The rules require that-

- Goods manufactured in a day are entered in the stock account each day;
- Goods removed under invoice are debited in the stock account with reference of the invoice.
- The invoice will reveal the consignee details.
- The invoice will also show the rate and amount of excise duty on the goods, or whether it was not payable for some reason, including export.

This means that when an excise invoice is made, there is simultaneously a debit in the stock account.

Central excise auditors will commonly compare the excise invoices with the commercial invoices for the period, to discern whether there were despatches that do not find place in the central excise series.

With this framework in mind, let us look at the common deviations from the routine procedure.

**Cancellation of invoice**
Sometimes it happens that the order is cancelled for some reason after the excise invoice has been made and the stock register debited.

In such a case, the invoice is to be cancelled and the stock credited back, both with remarks explaining the circumstances, authenticated by the person in charge of the factory. The next invoice issued will be the next serial number in the sequence. Under the erstwhile Central Excise Rules 1944, rule 173G prescribed the procedure for cancellation of invoices. There is no such prescribed procedure now. The assessee has only to take care that he maintains a credible and authentic record of events, which he can produce for the inspection of the excise officials if necessary.

**Rejection of goods by the customer and diversion to another customer**
If the goods are rejected by the customer, or if the order cancellation happens after the goods have left the factory under excise invoice, the manufacturer may try and find another customer. If he is successful, the goods are diverted to the new customer. However, the invoice shows the goods as consigned to 'A', while now the goods are going to 'B' and the commercial invoice will be on 'B'.

In the pre-liberalisation era this was called 'transit sales' and called for a special procedure. CBEC circular no. 207/11/96-CX dated 1 May 1996 recapitulated the procedure for 'transit sales', thus:

> It has been represented that the assessees often face problems when the goods consigned by the manufacturer are not accepted by the customer in whose favour the invoice in made out on account of certain changes in the consuming pattern or other problems at the customer's end.
>
> 2. In the above connection, it has been reported that Board's Circular No. 96/7/95-CX dated 13.2.95 provides under the heading "Transit Sale" that where the end user refuses to receive the goods, the registered person could approach the Range Supdt. of the original consignee for endorsing the duplicate and triplicate copy of the invoice to the new destination and thereafter the goods could be so diverted.

The 1996 circular thus required that if goods that were originally consigned to 'A' are subsequently sent to 'B' instead, the documents must be authenticated by the jurisdictional Superintendent of 'A'. Presenting the consignment for verification with the documents may be feasible in cases of rejection; but in cases of order cancellation in transit it would seem wasteful to transport the consignment till the location of 'A' or his central excise range. Does this really have to be done?

The circular has not been rescinded. Though it was issued under the Central Excise Rules 1944, which were rescinded in 2001, and replaced by three successive sets of rules, each of these has a 'transitional' or saving clause for circulars and instructions issued under the rescinded rules. Rule 33 of the current Central Excise Rules 2002 says:

> Any notification, circular, instruction, standing order, trade notice or other order issued under the Central Excise (No. 2) Rules, 2001 by the Board, the Chief Commissioner or the Commissioner of Central Excise, and in force as on the 28th day of February, 2002, shall, to the extent it is relevant and consistent with these rules, be deemed to be valid and issued under the corresponding provisions of these rules.

The Central Excise Rules 2001, which replaced the Central Excise Rules 1944, and the Central Excise (no. 2) Rules 2001, which in turn replaced the Central Excise Rules 2001, had similarly worded clauses, so that circulars issued earlier were, in effect, legitimised with each new set of rules. However the transitional clause requires that the circular should be consistent with the provisions of the new rules.

After the 1996 circular, the rules were changed to provide for payment of excise duty after the close of the month instead of with every consignment. The particulars of duty payment could not then be entered in the invoice. The invoice no longer functioned as contemporaneous evidence of payment of excise duty. In view of this important change we can safely say that the 1996 circular quoted above is not consistent with the rules as they stand now, and need not be followed.

In case of diversion of goods to another buyer the assessee may cancel the invoice issued to 'A' and issue another one on 'B', with explanatory remarks in the excise records.

**Return of goods to factory**

If duty-paid goods are brought to the factory for any reason, including for the purpose of being re-made or re-conditioned, the situation is governed by rule 16 of the Central Excise Rules 2002. The assessee may take Cenvat credit of the duty paid on the goods as if the goods were inputs. If the goods are thereafter subjected to processes amounting to manufacture, duty will be payable when they are removed from the factory, and a fresh invoice will be issued. If the processes to which the goods are subjected do not amount to manufacture, the Cenvat credit taken shall be reversed at the time of their removal from the factory.

The document on which Cenvat credit is taken under rule 16 has to be the excise invoice under which the goods were originally removed from the factory of production. It is this document that will establish eligibility to rule 16. It is noteworthy that the benefit of the rule is not restricted to goods manufactured in that very factory. Goods manufactured in some other factory too may be brought into a factory under the provisions of rule 16.

**Destruction of goods**

Goods can be destroyed after they are fully manufactured but before they are removed from the factory, for reasons of quality control, or by unavoidable causes like accident or natural disasters. Fires, cyclones and floods are examples of accidents and disasters.

As seen earlier in this piece, excise duty is attracted to goods when they are manufactured. It is only the actual payment that is postponed, for convenience, till after the close of the month in which they are removed from the factory. In the cases of destruction, the excise duty liability on the goods does not thereby go away. Once manufactured, the excise duty liability on the goods has to be discharged or otherwise dealt with as per central excise law. Destruction of goods so that they cannot be removed from the factory will not take away the duty liability automatically.

However, the Central Excise Rules 2002 provide for remission of duty:

> **RULE 21. Remission of duty.** — Where it is shown to the satisfaction of the Commissioner that goods have been lost or destroyed by natural causes or by unavoidable accident or are claimed by the manufacturer as unfit for consumption or for marketing, at any time before removal, he may remit the duty payable on such goods, subject to such conditions as may be imposed by him by order in writing :

There is no automatic waiver; but if the officer is convinced that goods

- have been lost or destroyed by natural causes or by unavoidable accident; or
- are claimed by the manufacturer as unfit for consumption or marketing;

he may "remit" (meaning 'waive') the excise duty on the goods. This covers situations where the goods fail quality control and (for example, in the case of edible products) have to be destroyed. As the duty is not payable, the Cenvat credit related to those goods has to be reversed. Rule 3(5C) of the Cenvat Credit Rules 2004 provides for this, as follows:

> **Rule 3.**
> (5C) Where on any goods manufactured or produced by an assessee, the payment of duty is ordered to be remitted under rule 21 of the Central Excise Rules, 2002, the CENVAT credit taken on the inputs used in the manufacture or production of said goods and the CENVAT credit taken on input services used in or in relation to the manufacture or production of said goods] shall be reversed.

We may note that remission is applicable if the goods are destroyed or become unfit for consumption or marketing at any time before removal. In a recent decision a reference bench of the CESTAT ruled on a point of law referred to it by allowing remission in respect of goods that were destroyed by fire at the port from where they were to be exported. This was based on earlier decisions that the port of export is the 'place of removal' for the goods. This order dated 4 September 2014 in central excise appeal number 371 of 2009 (Ahmedabad bench) can be accessed by entering this information in 'case number' search at http://judis.nic.in/dist_judis/Cestat_Delhi/Retrieve/CaseNo_Qry.asp

The department tends to quibble about what constitutes 'unavoidable accident' in Rule 21. This tendency was scotched by the CESTAT in a case in which the Commissioner had denied remission on the ground that the factory and goods were destroyed by a mob of miscreants, which was "very much a man-made situation" and not an accident. The CESTAT observed as follows:

**3.** I find that the fact that the appellant's factory was set ablaze by 4000 to 5000 people, during the riots, it has to be held as an unavoidable accident. The Commissioner has not discussed as to how the appellant could have avoided the above mob and as to how he has himself contributed to the said situation. The expression used in Rule 21 is not only in respect of goods lost or destroyed by natural causes but the same also relates to the goods destroyed on account of unavoidable accident. In view of the peculiar circumstances, it has to be held that the setting ablaze of the factory by a mob was an unavoidable accident inasmuch as it was not in the hands of the appellant to adopt any measures to safeguard the factory at that point of time. As such, I am of the view that the remission was required to be granted. The impugned order is accordingly set aside and appeal allowed with consequential relief.

[CCE versus Roopalee Dyeing & Packing Works, 2008 (230) ELT 0536 (Trib-Ahmd)]

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