INTERDEPARTMENTAL TRANSFERS

Transfer of goods or services by one department to another department are called inter departmental transfers. When one department transfers goods to another department, the transaction should be considered as a sale for the supplying department and a purchase for the receiving department. As such, the supplying department should be credited and the receiving department should be debited with the value of goods supplied.

Goods may be transferred either at cost price or at selling price. If goods are transferred at selling price by the transferor department and such goods are unsold at the end of the accounting year by the transferee department, then profit charged on such unsold goods by the transferor department is treated as unrealized profit and it should be debited to the general profit and loss account as stock reserve. In the balance sheet stock reserve should be deducted from closing stock. **If unrealized profit is contained in the opening stock, such reserve should be credited to the general profit and loss account.**

Calculation and Treatment of Unrealized Profit

To calculate Stock Reserve, the following steps must be followed:

Step 1:	The value denotes the Value of IDT stock included in Transferee dept. Now calculate the GP (Gross Profit) ratio at which transferor dept sells goods to transferee. i.e. this amount is at selling price. GP ratio is to be calculated on SP to eliminate Unrealized Profit i.e. Stock reserve with the help of following formula: **GP ratio on sales = (Gp of Transferor Dept / Total sales) /100** **Where Total sales = Normal sales + IDT sales**
Step 2:	Calculate the value of **IDT (Inter Department transfer)** by using the following formula: **Closing Stock of Transferor dept x IDT / Total Direct expenses excluding op stock**
Step 3:	Result of **Step 1** x Result of **Step 2**

Treatment:

The following journal entry is to be passed to eliminate the amount of unrealized profit:

General P & L A/c ....   Dr.

To Stock Reserve A/c

Note: In next year the stock reserve of current year will become realized and to be credited to P & L A/c

Illustration 1:

A firm has two departments — Piece goods and readymade dresses. All goods purchased by the readymade department from Piece goods department are charged at the usual selling price.

From the following particulars prepare departmental trading and profit and loss accounts for the year ended Dec. 31, 2014:

Particulars	Piece Goods (₹)	Readymade (₹)
Stock as on 01.01.2014	1,00,000	25,000
Purchases	10,00,000	7,500
Sales	11,00,000	2,25,000
Transfer to Readymade	1,50,000	-
Expenses:		
- **Manufacturing**	-	30,000
- **Selling Expenses**	10,000	3,000
Stock as on 31.12.2014	1,00,000	30,000

The stocks in the readymade department are considered as consisting of 75% cloth supplied from Piece goods dept. and 25% expenses and cloths from outside. The Piece goods department earned gross profit in 2013 at the same rate as in 2014. General expenses of the business as a whole in 2014 amounted to ₹ 45,000.

Dr.   Departmental Trading and Profit and Loss Account   **Cr.**
For the year ended 31.12.2014

Particulars	Piece Goods (₹)	Ready made (₹)	Total (₹)	Particulars	Piece Goods (₹)	Ready made (₹)	Total (₹)
To, Opening Stock	1,00,000	25,000	1,25,000	By, Sales	11,00,000	2,25,000	13,25,000
To, Purchases	10,00,000	7,500	10,07,500	By, Transfer to Ready made	1,50,000		1,50,000
To, Transfer from piece goods	-	1,50,000	1,50,000	By, Stock closing	1,00,000	30,000	1,30,000
To, Manufacturing Exp	-	30,000	30,000				
To, Gross Profit c/d	2,50,000	42,500	2,92,500				
	13,50,000	**2,55,000**	**16,05,000**		**13,50,000**	**2,55,000**	**16,05,000**
To, Selling Expenses	10,000	3,000	13,000	By, Gross Profit b/d	2,50,000	42,500	2,92,500
To, Net Profit c/d	2,40,000	39,500	2,79,500				
	2,50,000	**42,500**	**2,92,500**		**2,50,000**	**42,500**	**2,92,500**

Step1: Rate of Gross profit on sales (Piece goods) =

$$\frac{\text{Gross Profit} \times 100}{(\text{Sales} + \text{Transfer})}$$

$$= \frac{2,50,000 \times 100}{12,50,000}$$

$$= 20\%$$

Step 2: 75% of ₹30,000 (Closing) is from piece goods = ₹22,500

Therefore, unrealized profit

$$\text{Provision for closing stock} = \frac{22,500 \times 20}{100} = ₹4,500$$

$$\text{Existing Provision (opening stock)} = \frac{25,000 \times 75}{100} \times \frac{20}{100} = ₹3750$$

Therefore, Unrealized profit = ₹ (4,000 -3,750) = ₹ 750

Illustration 2:

Department X sells goods to department Y at a profit of 25% on cost and to department Z at 10% profit on cost Department Y sells goods to X and Z at a profit of 15% and 20% on sales, respectively. Department Z charges 20% and 25% profit on cost to department X and Y respectively.

Department managers are entitled to 10% commission on net profit subject to unrealized profit on departmental sales being eliminated. Departmental profits after charging manager's commission, but before adjustment of unrealized profit are as under:

	₹
Department X	**36,000**
Department Y	**27,000**
Department Z	**18,000**

Stock lying at different departments at the end of the year is as under:

	Department X (₹)	Department Y (₹)	Department Z (₹)
Transfer from Department X	---	15,000	11,000
Transfer from Department Y	14,000	---	12,000
Transfer from Department Z	6,000	5,000	---

Find out the correct departmental profit after charging manager's commission.

Solution:

Statement showing Correct Departmental Profits

	Department X (₹)	Department Y (₹)	Department Z (₹)
Profits after charging managers' commission (but before adjusting unrealized profits)	36,000	27,000	18,000
Add back: Managers' commission (10/90)	4,000	3,000	2,000
	40,000	30,000	20,000
Less: Unrealized profit on stock (see Note)	4,000	4,500	2,000
Profits before charging managers' commission	36,000	25,500	18,000
Less: Manager's Commission @ 10%	3,600	2,550	1,800
Correct departmental profits	32,400	22,950	16,200

Working Note:

Unrealized profit on stock:

	₹
Profit of department X:	
On stock held by department Y : - 25/125 × ₹ 15,000	3,000
On stock held by department Z : - 10/110 × ₹ 11,000	1,000
	4,000
Profit of department Y:	
On stock held by department X : - 15/100 × ₹ 14,000	2,100
On stock held by department Z : - 20/100 × ₹ 12,000	2,400
	4,500
Profit of department Z:	
On stock held by department X : - 20/120 × ₹ 6,000	1,000
On stock held by department Y : - 25/125 × ₹ 5,000	1,000
	2,000

ECONOMIC ORDER QUANTITY (EOQ)

❖ EOQ or Fixed Order Quantity system is the technique of ordering materials whenever stock reaches the order point.

❖ Economic order quantity deals when the cost of procurement and handling of inventory are at optimum level and total cost is minimum.

❖ In this technique, the order quantity is larger than a single period's requirement so that ordering cost & holding costs balance.

❖ EOQ is the size that minimizes the sum of the costs of ordering stock, the costs of holding stock and shortage costs.

Examples for Inventory Costs are

➡ **Order Cost**
➡ **Holding Cost**
➡ **Shortage Cost**

➡ **Costs of Ordering Stock** are incurred each time an order is placed. These include clerical cost, stationery, postage and some handling and transportation costs. These costs are incurred whenever an order is placed irrespective of the quantity ordered. Cost is same (whether 1 unit or 100 units are ordered). These costs directly vary with the number of orders placed – not by size of the orders.

➡ **Costs of Holding Stock (Carrying cost)** are incurred for keeping items in stock throughout the accounting period. It is expressed as a percentage of cost of material or per unit. Holding cost generally consists of:
  ➢ Rent of storage space;
  ➢ Insurance premium paid for the value of the units held in stock;
  ➢ Wages of stores staff;

➢ Lighting, heating or air-conditioning of the storage space;
➢ Cost of damages, loss or obsolescence;
➢ Opportunity cost of investment in stock;
➢ Opportunity cost of space of storage.

➡ **Shortage Costs** result from not having sufficient stock to meet production needs/ customers' needs. Some assembly processes are such that work cannot continue if a particular part is not available.
For example, in a mobile phone manufacturing factory, the 'microphone' used in the mobile is out of stock. It is not possible to assemble the mobile phone without microphone. A shutdown, in all probability, will lead to certain costs such as:
➢ Workers wages for idle time;
➢ Lost sales resulting in dissatisfied customers;
➢ The costs of expediating supply (e.g., air lift at high cost);
➢ Loss of discounts on purchase (through bargain);
➢ Loss of future sales because the dissatisfied customers will advice future customers to buy other manufactures' products.

Assumption of EOQ

➡ Prior knowledge of annual usage (consumption) of inventory
➡ Constant rate of usage
➡ Constant ordering costs
➡ Constant carrying costs, and
➡ Zero lead-time/delivery period

Limitation of EOQ

➡ Only applicable to Non-Perishable products with staple demand.
➡ Ignores delivery quantities and discounts.
➡ Assumes storage space is unlimited.
➡ Assumes retailer controls delivery scheduling.

Computation of EOQ

$$EOQ = = \sqrt{\frac{2AO}{C}}$$

Where,
EOQ = Economic Order Quantity
A = Annual demand or usage of the material item in units
O = Ordering cost per order
C = Cost of carrying stock of one unit for a year

It can be generalized as follows:

$$= \sqrt{\frac{2 \times \text{Annual requirement} \times \text{Ordering cost}}{\text{Carrying cost per unit}}}$$

The result of EOQ calculation can also be used for:
➢ **Calculating the number of orders;**
➢ **Frequency of order/ time gap between two orders;**
➢ **Total ordering cost; and**
➢ **Total holding cost.**

➡ No. of orders per year $= \dfrac{\text{Total annual Consumption}}{\text{Order Size}}$

➡ Frequency of Orders $= \dfrac{365 \, \text{days}}{\text{No. of orders}}$

➡ Total Ordering Cost $= \dfrac{\text{Annual Consumption}}{\text{Order Size}} \times \text{Ordering Cost per order}$

➡ To Carrying Cost $= = \dfrac{\text{order Size}}{2} \times \text{Carrying Cost per unit p.a.}$

➡ Total Annual Carrying & Ordering Cost =

$$= \left[\left(\frac{\text{Annual Consumption}}{\text{Order Size}} \times \text{Ordering Cost per order} \right) \right] + \left[\left(\frac{\text{Order Size}}{2} \times \text{Carrying cost per unit p.a} \right) \right]$$

Alternatively

Total Annual Carrying and Ordering cost at EOQ $= \sqrt{2AOC}$

With the help of example we can explain more clearly:

Example: 1
From the following information, calculate **(a)** Economic Order Quantity **(b)** for EOQ, the number of orders per year **(c)** for EOQ how frequently should orders be placed, **(d)** for EOQ, Total Ordering Cost **(e)** for EOQ, Total Carrying Cost and **(f)** Total Annual Carrying and Ordering cost at that quantity.
Annual Consumption of input = 48,000 units,
Purchase price of input unit = ₹25
Annual Carrying cost = 12%
Ordering cost per order = ₹180

Answer:

(a) $EOQ = \sqrt{\dfrac{2 \times \text{Annual requirement} \times \text{Ordering cost}}{\text{Carrying cost per unit}}}$

$= \sqrt{\dfrac{2 \times 48{,}000 \times ₹180}{₹3}}$

$= 2{,}400$ units

(b) No. or of orders per year $= \dfrac{\text{Total annual Consumption}}{\text{Order Size}}$

$= \dfrac{48{,}000 \text{ units}}{2{,}400}$

$= 20$ orders

(c) Frequency of orders $= \dfrac{365 \text{ days}}{\text{No. of orders}}$

$= \dfrac{365 \text{ days}}{20 \text{ Orders}}$

$= 18.25$ Days

(d) Total Ordering Cost $= \dfrac{\text{Annual Consumption}}{\text{Order Size}} \times \text{Ordering Cost per order}$

$= \dfrac{48{,}000}{2{,}400} \times ₹180$

$= ₹3{,}600$

(e) Total Carrying Cost $= \dfrac{\text{order Size}}{2} \times \text{Carrying Cost per unit p.a.}$

$= \dfrac{2{,}400}{2} \times ₹3$

$= ₹3{,}600$

(f) Total Annual Carrying & Ordering Cost $= \left[\left(\dfrac{48{,}000}{2{,}400} \times ₹180\right)\right] + \left[\left(\dfrac{2{,}400}{2} \times ₹3\right)\right]$

$= ₹3{,}600 + ₹3{,}600$

$= ₹7{,}200$

Example with discount: 2

ABC Limited manufacturer of a special product follows the policy of EOQ (Economic Order Quantity) for one of its components. The component's details are as follows:

Purchase Price per Component	₹200
Cost of an order	₹100
Annual Cost of Carrying one Unit in Inventory	10% of Purchase Price
Total cost of Inventory and Ordering per Annum	4,000

The company has been offered a discount of 2% on the price of the component provided the lot size is 2,000 components at a time.
You are required to:
(a) Compute the EOQ
(b) Advise whether the quantity discount offer can be accepted
(Assume that the inventory carrying cost does not vary according to the discount policy)
(c) Would your advice differ if the company is offered 5% discount on a single order?

Answer:
(a)

Formula for EOQ = $\sqrt{\dfrac{2 \times \text{Annual cosumption} \times \text{Buying cost per order}}{\text{Cost per unit} \times \text{Storage and carrying cost rate}}}$

- Purchase price per component   ₹200
- Cost of an order   ₹100
- Annual cost of carrying one unit in inventory = 10% of purchase price or 10% of ₹200 = ₹20
- Total cost of carrying inventory and ordering per annum= ₹4,000

Let Annual consumption = S

Therefore: $\sqrt{2S \times ₹100 \times (10\% \text{ of } ₹2,000)}$ = ₹4,000

Or $\sqrt{2S \times 100 \times 20}$ = ₹4,000; Squaring both sides

Or   S = 4,000 units

$EOQ = \sqrt{\dfrac{2 \times 4,000 \text{units} \times ₹100}{200 \times 10\%}}$ = 200 units

(b) When order size is 2,000 units
No. of orders = 4,000 ÷ 2,000 = 2
Total cost = Ordering cost + Carrying cost
= (2 x ₹ 100) + 1/2 x 2,000 units x ₹ 20 = 200 + 20,000 = ₹20,200
∴ Extra cost = ₹ 20,200 - ₹ 4,000 = ₹ 16,200
Quantity Discount = 2% x 4,000 x ₹ 200 = ₹ 16,000

Advice to Management = The quantity discount offered should not be accepted, as it results in an additional expenditure of ₹ 200 i.e. ₹ 16,200 - ₹ 16,000

(c) When order size is 4,000 units
No. of order = 1
Total Cost =1 x ₹ 100 + 1/2 x 4,000 units x ₹ 20 = ₹ 40,100
Extra Cost = ₹ 40,100 - 4,000 = ₹ 36,100
Quantity discount received = 5% x 4,000 units x ₹ 200 = ₹ 40,000

Advice to Management: The quantity discount should be accepted. It will result in reducing the total cost of carrying and ordering inventory by ₹ 3,900 i.e. ₹ 40,000 - ₹ 36,100.
Note: It is presumed that, total cost of inventory and ordering is the total cost of carrying inventory and ordering per annum.

Practical steps involved in the determination of EOQ according to Graphical Method

➡ **Step 1** → Take order sizes on X-axis and costs on Y-axis.

➡ **Step 2** → Draw carrying cost line going upward indicating carrying cost increases as order size increases.

➡ **Step 3** → Draw ordering cost line sloping downward indicating ordering cost decreases as order size increases.

➡ **Step 4** → Draw total cost line which first slopes downward and then goes upward after a certain minimum point.

➡ **Step 5** → Locate the point at which both the carrying cost line and ordering cost line cut each other and draw a perpendicular from this point on X-axis.

➡ **Step 6** → Locate the point at which the perpendicular touches X-axis. This point gives us the Economic Order Quantity.

➡ **Step 7** → Locate the point at which the perpendicular (when extended upward) cuts the total cost line. This point gives us the minimum total cost at economic order quantity.
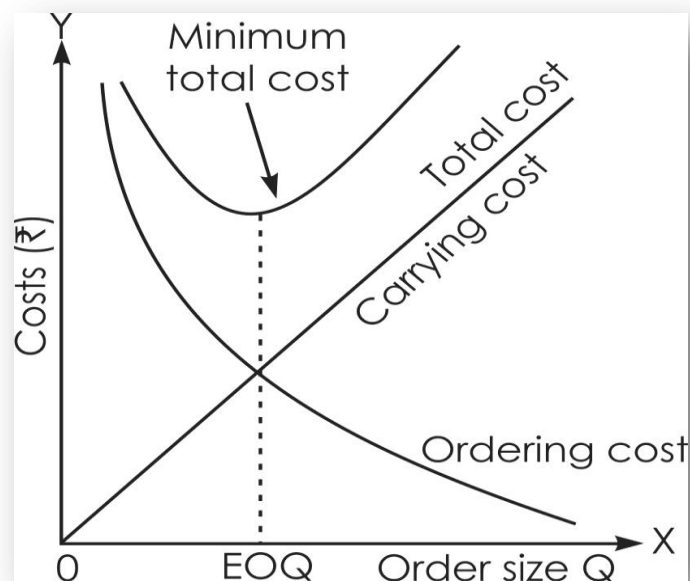
➡ Annual total cost of ordering and carrying is minimum at EOQ order size.
➡ Carrying cost and ordering cost are equal at EOQ order size.

CAPACITY PLANNING

Capacity planning is the process of determining the production **capacity** needed by an organization to meet changing demands for its products.

Capacity. of a facility is referred to as its capability to produce. Capacity should be able to meet the present and future demand.

Capacity Planning is a scientific work and should be done very cautiously and carefully. Capacity planning decision involves the following considerations:

- What is the present capacity?
- What is the expected future capacity needs in the projected planning period? This could be in terms of product, manpower or technological factors.
- What are the options to meet the demand and how the capacity could be modified to meet the need?
- Evaluation of various options of capacity from financial, economical and technological considerations
- Selection of the most appropriate option for the capacity to achieve the objectives.

Effective capacity is the maximum amount of work/load that an organization is capable of completing in a given period.

The load can be expressed in terms of the amount of input or output. For example, the capacity of a sugar mill can be expressed in terms of the tones of sugar cane (input) crushed per day or in terms of the tones of sugar (output) produced per day. Hence, we may say that the measure of capacity is dependent upon the suitability of the situation.

Input

Output
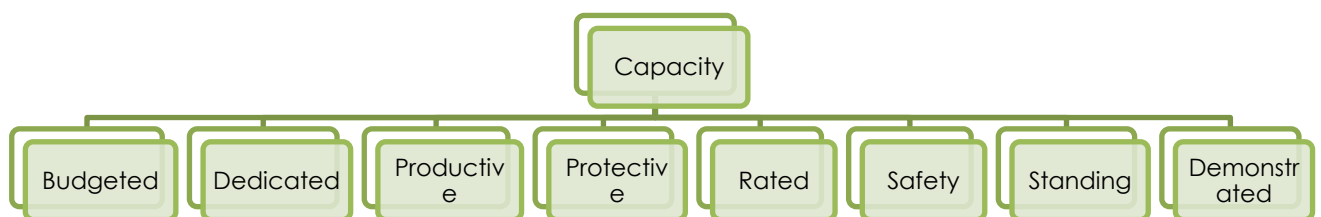
Units of Measure for Capacity

Capacity is expressed by a particular unit. The choice for a particular unit differs based on the business or on the product.

Capacity is also measured in terms of the inputs or the outputs of the conversion process.

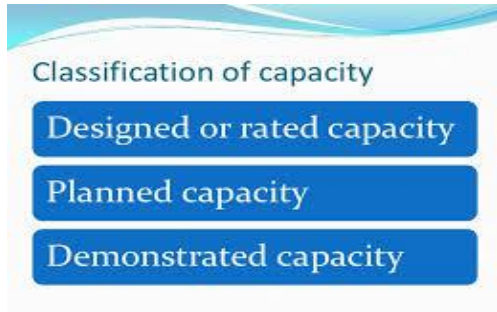Units of measure in different facilities based on input and output is given in the following table:

Base	Facilities	Unit of measure
Output	1. Cement Plant	➢ Tonnes per day(tpd)/Tonnes per year (tpy)
	2. Electric supply company	➢ Mega Watts
	3. Dairy plant	➢ Litres of milk
Input	4. Roads	➢ KM of road
	5. Rail network	➢ KM of rail line
	6. Aeroplane	➢ Number of seats
	7. Research organization	➢ Number of scientists

Classification of capacity

Capacity

Budgeted | Dedicated | Productive | Protective | Rated | Safety | Standing | Demonstrated

But mainly the classification of capacity is talked in terms of:

Classification of capacity
- Designed or rated capacity
- Planned capacity
- Demonstrated capacity

Designed capacity defines the highest normal output that a process could achieve. Designed capacity is usually higher than the normal output rate.

The designed capacity of a process is calculated by taking into account the following:

- Number of machines available
- Capacity of each machine
- Number of shifts operated
- Duration of each shift
- Number of workdays in the period under consideration.

Capacity of the process is expressed as
Capacity of the process = $CN_1N_2N_3H$
Where C= Capacity of machine per hour
N_1 = Number of machines
N_2 = Number of shifts per day
N_3 = Number of days in the time period
H = Hours in each shift

MAXIMUM CAPACITY can be changed by changing the basic parameters. The maximum capacity is increased by the following actions:

- Increase the number of machines
- Increase the number of operating hours in the shift
- Increase the number of shifts, if possible
- Deploy trained manpower
- Avoid loss due to scrap or damages
- Control waste of time by workers
- Give incentives to worker to perform at a higher rate
- Outsource part of the work load.

Planned capacity is the capacity, which is maintained or achieved in normal operations. Production plans and schedules are worked out based on planned capacity. Planned capacity is usually less than the designed capacity due to the following reasons:
- Unexpected demand comes from some customers.
- Preventive and predictive maintenance need time and influence the available time for production.
- Corrective repairs need time to take care of the unexpected breakdowns, which adversely affect the capacity of the process.
- Running at maximum capacity could be sustained for short time as both men and machines are strained, if they have to operate at maximum capacity.

Efficiency measures the ratio of planned resource allocation for a process and the actual resource consumed by the process. Efficiency = Standard time/Actual time.

Another important factor in determining the planned capacity is Utilization Factor. Utilization is the percentage of a resource's maximum capacity, which is expected to involve in production.
Utilization = Actual hours/scheduled available hours.

Planned capacity is therefore calculated by determining the designed capacity and multiplying the same with the utilization factor and efficiency.
Planned capacity = Designed capacity × Efficiency ×Utilization factor

Demonstrated Capacity

The actual level of output for a process over a period of time is known as the demonstrated capacity. Demonstrated capacity deals with the actual production over a time rather than the calculated designed capacity or planned capacity. Demonstrated capacity is determined by averaging the recorded figures of actual output over a period of time.

It differ from both the designed and the planned capacities for various reasons, such as
- Product mix
- Operator skill and experience
- Health of equipment or machines
- Type of jobs
- Quality of materials
- Inaccurate standards for process performance
- Idle time
- Rejection due to poor quality
- Training time of the operators
- Other factor

Example

1. Standard time for a task is 8 hours. Calculate the efficiency of a workman if he completes the job in 7 hours.

   Solution:

   $$\text{Efficiency} = \frac{\text{Standard hours}}{\text{Actual hours}} = \frac{8 \text{ hours}}{7 \text{ hours}} \times 100 = 114.3\%$$

2. Worker works for 8 hours in each shift but during that time he had worked for 7 hours on the job. Calculate his utilization.

   Solution:

   $$\text{Utilization} = \frac{\text{Hours worked}}{\text{Hours available}} = \frac{7 \text{ hours}}{8 \text{ hours}} \times 100 = 87.5\%$$

3. A workshop operates on 2 shifts for 8 hours per day. It has 20 machines. It works for 5 days in a week. Machine utilization is 90% and the efficiency of the machines is 85%. Calculate the designed/rated capacity of the workshop in standard hours.

   Solution:
   Rated capacity of the workshop = No. of shifts × No. of hours in each shift × No. of days/week × No. of machines × Utilization factor × Efficiency
   = 2 × 8 × 5 × 20 × 0.90 × 0.85 = 1224 standard hour per week

4. An assembly line of an item X has the following output in a 8 week period:

Week Number	1	2	3	4	5	6	7	8
Standard hours produced	240	280	420	400	360	320	380	400

Calculate the demonstrated capacity of the assembly line per week.

Solution:

Demonstrated capacity is the average of the total standard hours produced over a number of periods.

Total number of weeks =8, total standard hours produced = 2800 standard hours.

Average per week = 2800/8=350 standard hours.

SOME ISSUES RELATING TO INDIRECT TAX

First Stage Dealer (FSD)

As per rule 2(ij) of CENVAT Credit Rules, 2004 "first stage dealer" means a dealer, who purchases the goods directly from, -

(a) the manufacturer or importer, or

(b) the depot of the said manufacturer or importer, or

(c) premises of the consignment agent of the said manufacturer or importer, or

(d) any other premises from where the goods are sold by or on behalf of said manufacturer,

under the cover of an invoice issued in terms of the provisions of Central Excise Rules, 2002.

Second Stage Dealer (SSD)

As per rule 2(s) of CENVAT Credit Rules, 2004 "Second stage dealer" means a dealer, who purchases the goods from a first stage dealer.

First Stage and Second Stage dealer are required to obtain registration under Central Excise, so that they can issue CENVAT-able invoices as per Rule 9(1) of the CENVAT Credit Rules, 2004 enabling the buyer to take credit thereon.

Example.1 – ABC Ltd has a factory at Mumbai and one Branch at Bangalore. Branch sells dutiable goods after receiving from factory. Under Central Excise branch is considered as a dealer. Therefore, such branch must register under Central Excise as dealer, so as to pass CENVAT credit to buyer manufacturer.

Distribution of Credit on Inputs/Capital goods by the Office or any other premises of Output Service Provider

As per the provisions of rule 7A(2) or any rules made under CEA, 1994, as made applicable to a first stage dealer or a second stage dealer, shall apply to such office or premises of the provider of output service. Thus, such office or premises can pass on pro rata credit to the extent they are sent to a particular branch office, etc.

Issue of Invoice

As per Rule 9(4) of CENVAT Credit Rules 2004, the CENVAT credit in respect of input or capital goods purchased from a first stage dealer or second stage dealer shall be allowed only if such first stage dealer or second stage dealer, as the case may be, has maintained records indicating the fact that the input or capital goods was supplied from the stock on which duty was paid by the producer of such input or capital goods and only an amount of such duty on *pro rata* basis has been indicated in the invoice issued by him.

Provided that provisions of this sub-rule shall apply *mutatis mutandis* to an registered importer who issues an invoice on which CENVAT credit can be taken.

Example.2 – If First Stage Dealer purchases 1,000 Kg. goods on which duty of ₹1 lakh is paid and he sells 300 Kg. goods, then, pro rata credit of ₹30,000 should only be indicated in invoice.

First Stage and Second Stage dealer are only eligible for passing the CENVAT Credit. They cannot levy the central excise duty.

Example.3 – If First Stage Dealer purchases 1,000 Kg. goods @ ₹500/ Kg on which duty liability is @14% has paid i.e. ₹70,000 is paid as duty liability and he sells 300 Kg. goods @ ₹800/Kg where the rate of excise duty is same, then, as per the provision of the act, the first stage dealer can pass the CENVAT Credit on pro rata basis of ₹30,000 (i.e. 70,000/1000x 300) should only be indicated in invoice. The first stage dealer cannot levied excise duty on his selling price rather he can only eligible for pass the duty on pro rata basis to the buyer (i.e. manufacturer).

Example.4 - The machinery was purchased through Mr. D (dealer) and not from the manufacturer. The dealer's Invoice No. 207, dated 8.11.2013 marked 'original for buyer' certified that the Excise duty paid by the manufacturer of machinery was ₹24,000. The dealer is registered with the Central excise Authorities. In this case, the buyer (i.e. manufacturer) is eligible to avail the CENVAT credit benefit of ₹24,000.

Return to be Filed

Rule 9(8) of CENVAT Credit Rules 2004 provides that a first stage dealer or a second stage dealer or a registered importer, as the case may be, shall submit within fifteen days from the close of each quarter of a year to the Superintendent of Central Excise, a return in the form specified, by notification, by the Board.

Provided that the first stage dealer or second stage dealer or a registered importer, as the case may be, shall submit the said return electronically.

Illustration. –

Veer Traders imports 10 tons of steel bars from a foreign manufacturer of steel bars. Veer Traders has paid CVD equal to excise duty of ₹10,000 on the steel bars, along with BCD ₹25,000 and EC/SHEC on import duty ₹1,050 (Special CVD is ₹6,000 but invoice issued by Veer Traders bears an indication that credit of Special CVD cannot be taken.). Veer Traders sells 2 tons of steel bars to XYZ Ltd., a manufacturer who uses the steel bars in his factory for the manufacture of the final product. XYZ Ltd. wishes to avail the CENVAT credit on the steel bars. You are required to advise XYZ Ltd. whether it can claim the CENVAT credit on the steel bars. How much CENVAT credit it can avail, if allowable?

Solution :

The following points are relevant —

♦ Veer Traders is an importer and it appears that it is registered under Central Excise law so that it can issue Cenvatable invoices.

♦ Veer Traders has to comply with provisions of Rule 9 of the CENVAT Credit Rules, 2004 and can therefore,

pass on pro rata credit to buyer M/s. XYZ Ltd.

- ♦ Pro rata credit that can be passed on = ₹10,000 CVD for 10 ton = ₹1,000 per ton. (BCD&EC/SHEC on imports cannot be passed on as credit. Further, since invoice issued bears an indication that credit of Special CVD cannot be taken, hence, same cannot be taken).
- ♦ Credit that can be availed by XYZ Ltd. for 2 tons = ₹ 1,000 per ton X 2 tons = ₹ 2,000.
- ♦ Purchases from registered importer are also eligible for Cenvat credit on the basis of invoice issued by such importer.

Note:

Same principle would apply to purchases made from:

(a) FSD buying goods from domestic manufacturer, or,

(b) SSD buying from FSD.

Input Service Distributor under Central Excise and Service Tax

Manner of distribution of credit by input service distributor [Rule 7]

The input service distributor may distribute the CENVAT credit in respect of the service tax paid on the input service to its manufacturing units or units providing output service -

Maximum distribution	The credit distributed against a document referred to in rule 9 does not exceed the amount of service tax paid thereon.
Exclusively used service to be distributed to that unit	Credit of service tax attributable to service **used wholly by a unit** shall be distributed only to that unit.
Services exclusively used in exempted goods/services – No distribution	Credit of service tax attributable to service **used by one or more units** exclusively engaged in manufacture of exempted goods or providing of exempted services shall not be distributed.
Commonly used services for 2 or more units	Credit of a unit = $\dfrac{\text{Credit of service tax attributable to service used by more than one unit}}{\substack{\text{Total turnover of all its units, which} \\ \text{are operational in current year,} \\ \text{during relevant period}}} \times \text{Turnover of such unit during relevant period}$ **Total Turnover**: Total turnover is determined in the manner specified in Rule 5.

	Relevant Period: The 'relevant period' shall be,— **(a) Last financial year data**: If the assessee has turnover in the 'financial year' preceding to the year during which credit is to be distributed for month or quarter, as the case may be, the said financial year; or **(b) Last quarter's data, if last F.Y.s data not available in respect of one or more units**: **If** the assessee does not have turnover for some or all the units in the preceding financial year, the last quarter for which details of turnover of all the units are available, previous to the month or quarter for which credit is to be distributed.

Analysis:

(A) Turnover of all units to be considered irrespective of whether or not service is used by such unit [Circular No. 178/4/2014-ST, dated 11-7-2014]: Credit of service tax attributable to service used in more than one unit shall be distributed *pro rata* —

♦ on the basis of turnover of all operational units ; and

♦ turnover ratio will be determined for all operational units irrespective of the units to which service relates.

Example: An Input Service Distributor (ISD) has four units operational in the current year (₹) —

A (Manufacturing excisable goods)	25,00,000
B (Manufacturing excisable and exempted goods)	30,00,000
C (providing exclusively exempted service)	15,00,000
D (providing taxable and exempted service)	30,00,000
TOTAL	1,00,00,000

Common input service credit pertaining to more than one unit (say, only A, B and C): ₹12,000 (service was not used for unit D).

Solution:

Credit will be distributed to all the four units, even if service has not been used for Unit D. Hence, credit distributed would be —

- ♦ Unit A : 25% of 12,000 = ₹ 3,000
- ♦ Unit B : 30% of 12,000 = ₹ 3,600
- ♦ Unit C : 15% of 12,000 = ₹ 1,800
- ♦ Unit D : 30% of 12,000 = ₹ 3,600

(B) Turnover period: Turnover ratio will be taken based on turnover of the last financial year (i.e., for April 2015 to March 2016, turnover ratio of 2014-15 will apply); thus, the turnover ratio would remain static for entire financial year. Only in case where aforesaid details are not available for all the units, the turnover data of the last quarter shall be taken.

"Unit" includes the premises of a provider of output service and the premises of a manufacturer including the factory, whether registered or otherwise.

Distribution of credit on input goods and capital goods by the office or any other premises of output service provider [Rule 7A]

A provider of output service shall be allowed to take credit on inputs and capital goods received, on the basis of an invoice or a bill or a challan issued by an office or premises of the provider of output service, which receives invoices, issued in terms of the provisions of the Central Excise Rules, 2002, towards the purchase of inputs and capital goods.

Cenvat credit on input goods and capital goods can be distributed by the service provider only if such person is registered as first stage or a second stage dealer.

Sub-rule (2) provides that the provisions of these rules or any other rules made under the Central Excise Act, 1944, as made applicable to a first stage dealer or a second stage dealer, shall mutatis mutandis apply to such office or premises of the provider of output service.

Return to be filed by ISD [Rule 9(10) and 9(11)]:

Return	Submitted to -	For	Due date
Half-yearly return giving the details of credit received and distributed during the said half year	Superintendentof Central Excise	Form ST-3	By end of month following the half year. [E-filing]
REVISED RETURN to correct a mistake or omission	Superintendent of Central Excise	Form ST-3	Within 60 days from date of submission of original return [E-filing]

Illustration: *A manufacturer has Head Office registered as input service distributor and four units. It furnishes following details and asks you to determine Cenvat Credit distributable under Rule 7 of Cenvat Credit Rules, 2004 for the month of April, 2015—*

	Unit 1: Potlan	Unit 2: Mumbai	Unit 3 : Jaipur	Unit 4: Ahmedabad	Unit 5: Surat	Total
Turnover for the year 2014-15	₹50 crores	₹15 crores	₹10 crores	₹55 crores	₹10 crores	₹140 crores
Credit of service tax on security services (used at Jaipur only)						₹ 3 lakh
Credit of service tax on consultancy services (for Potlan)						₹ 2 lakh
Credit of service tax on Cleaning Services (for Potlan, Jaipur and Ahmedabad unit)						₹ 6.5 lakh
Credit of service tax on other services (common for all)						₹19.5 lakh

You are informed that Unit 1 (Potlan) is exclusively engaged in manufacture of exempted goods. You are also informed that Unit 5 (Surat) was closed on 31-3-2015.

Solution:

Credit of service tax to be distributed as per Rule 7

	Unit 1: Potlan (wholly exempt)	Unit 2: Mumbai	Unit 3 : Jaipur	Unit 4 : Ahmedabad
Turnover for the year 2014-15	₹ 50 crores	₹ 15	₹ 10	₹55 crores
Security Services - Since they are used at Jaipur only, credit will be distributed to Jaipur only	-	-	₹ 3,00,000	
Consultancy Services - It relate exclusively to Potlan Unit	₹ 2,00,000			
Credit of cleaning and other common services ₹ 26 lakh (₹ 6.5 lakh + ₹ 19.5 lakh) will be distributed in ratio of turnover viz. 50 : 15 : 10 : 55 **[See Note 1]**	₹ 10,00,000	₹3,00,000	₹ 2,00,000	₹ 11,00,000
Total Credit (₹)	**NIL (Note 2)**	**3,00,000**	**5,00,000**	**11,00,000**

Notes:

1. As per Rule 7 of the CENVAT Credit Rules, 2004, in case of credit of service tax attributable to service used by more than one unit, credit is distributed to all operational units, whether such service relates to that unit or not. In other words, credit of cleaning services will be distributed over all the four units, even if it relates only to Potlan, Jaipur and Ahmedabad units and not to Mumbai unit. Therefore, for ease of computation, cleaning services credit ₹ 6.5 lakh and other services credit ₹ 19.5 lakhs has been distributed in totality of ₹ 26 lakh — **[Circular No. 178/4/2014-ST, dated 11-7-2014].**

2. Since Potlan unit is engaged in manufacture of exempted goods only, no credit can be taken/ distributed to such unit. Hence, total credit will be NIL.

3. Since Unit 5 (Surat) was discontinued on 31-3-2015 *i.e.,* it is not operational during the current financial year; therefore, the turnover of Surat Unit would not be considered for determining the turnover ratio under Rule 7 of the Cenvat Credit Rules, 2004.