Amendment to Rule 6(3) of CCR – expect serious trouble! – Mar 6, 2008

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THE FM would need to be complimented for trying to bring about some clarity on the contentious issue related to availment of cenvat credit by and service providers on services or input used in respect of exempted services. As has been reported, Rule 6 of the Cenvat Credit Rules is being amended, interalia, to provide the following options to a provider of output services, using common inputs or input services for providing taxable as well as exempted services and opting not to maintain separate accounts, namely:-

(i) either reverse the credit attributable (to be worked out in a manner prescribed in the rule) to the inputs and input services used for providing exempted service, or

(ii) pay 8% amount of the value (to be determined in accordance with section 67 of the Finance Act, 1994) of the exempted service;

As is obvious, the FM is trying to extend the time tested methodology involving manufacturers to the domain of service providers, vis-à-vis availment of cenvat credit. But, my greatest fear is that, the new move might result in greater confusion as compared to the current dispensation involving capping of the cenvat credit to 20% of the output service tax payable, for the very simple reason, of the way, 'exempted services' has been defined under the CCR. Not withstanding the fact that, under the current dispensation, a service provider using inputs or input services for providing taxable and exempt output services does not lose any portion of his total cenvat credit, the new scheme could raise a lot of contentious issues.

As per Rule 2(e) of the Cenvat Rules, 2004, which has not been touched in this Budget,

"exempted services" means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under Section 66 of the Finance Act. "Exempted Services", in terms of the first part of the definition would essentially mean taxable services which have been exempted from the service tax levy. The exemption could possibly come from a notification issued under Section 93 of the Finance Act and nobody has an issue here. But, the second part of the definition is rather confusing and complicated, wherein, "exempted services" is defined to also include services on which no service tax is payable under Section 66 of the Finance Act. As

is well known, Section 66 specifies the services covered in Section 65, on which, service tax is leviable.

The second part of the definition conveys the feeling that any "service" on which no service tax is payable (under Section 66 which is the charging Section) would be an "exempted service". It terms of the wordings used here, there need not be an "exemption" element, for a service to be considered as an exempted service. The criterion is that, no service tax should be leviable under Section 66 of the Act, for a "service" to be treated as an "exempted service". Thus, a 'service' which could perhaps never get taxed, would still be treated as an 'exempted service'. With "service" not having been defined in the Finance Act or in the Rules or by way of an explanation, anything and everything could become an 'exempted service", notwithstanding that in common parlance, such an activity could not be treated as a "service" at all in the first place.

Let's take another example of an Advocate, who owns a huge commercial property and gets lease rentals of over Rs 20 lakhs per month. Let's also assume that the said Advocate also earns around Rs 20 lakhs- from his professional services. In terms of its current definition, 'exempted services' in my opinion would include the professional services rendered by the said Advocate, as no service tax is leviable on the Advocate's professional services. In terms of the amended Section 6 of the CCR, as proposed, the Advocate would be required to either reverse the proportional cenvat credit on the basis of the formula specified or worse still, pay 8% service tax on Rs 20,00,00/- being the value of 'exempted services' provided by him.

Given the fact that a service provider would find it impracticable to maintain separate accounts for each input service, he would per se, be forced to opt for Rule 6(3). In the absence of a clear definition of 'exempted services', I don't see any great merit in the new methodology proposed.

I am inclined to contrast this confusion prevailing in respect of "exempted services" with the clarity that is available in respect of "exempted goods". As per Rule 2(d) of the Cenvat Credit Rules, "exempted goods" is defined to mean goods which are chargeable to nil duty and goods which are exempt from the whole of duty. There is little scope for confusion here as "exempted goods" cannot include goods which are not included in the Excise Tariff. In the absence of a similar 'tariff' or 'list' for services, it is but natural that "exempted services" cannot fall into any straight jacket definition. But to have the prospect of almost every commercial activity being included under the head "exempted services" and to face the risk of being forced to reverse credit or pay up 8% would be a rather unjust dispensation for service providers, especially in an environment wherein new taxable services are getting notified by the day.

The only saving grace in the Cenvat Credit Rules 2004 for service providers who provide both taxable and exempted services comes in the form of Rule 6(5), which states that the restricted cenvat credit would not apply in the case of 17 input services, but this is too much of a restricted list and does not cover most major input services. We should thank the FM for not having touched Rule 6(5), however.

I really wish the Government had gone in for a clear definition for ‘exempted services’ simultaneously, with its proposal to amend Rule 6(3). All that is requires to do is to add the word ‘ taxable’ before the words ‘ services on which no service tax is leviable under Section 66 of the Finance Act’. Without this amendment, I am afraid, service providers and manufacturers should look forward for trouble from the Department, which might consider a host of receipts and credits as gross amounts received towards ‘exempted services’ and ask the service providers to reverse proportionate credit or pay up 8% tax on these amounts/credits.