Cenvat Credit – a tricky and sticky wicket for new service providers – Nov 19, 2007

Cenvat Credit – A tricky & sticky wicket for new service providers! MONDAY, NOVEMBER 19, 2007 By S Sivakumar

AS the Government keeps itself busy, bringing new 'service providers' into the service tax net, the availability of cenvat credit is an issue that keeps bothering these new service providers, especially in respect of eligible inputs, input services and input capital goods procured or received, prior to the date of the levy of service tax on the new taxable service. The common perception that seems to prevail amongst the service providers and the Department is that, no cenvat credit can be taken by the service provider in respect of eligible transactions involving receipt of eligible inputs / input services / input capital goods prior to the date of introduction of the new service. Thus, for example, in respect of the 'Renting of Immovable Property' services, which came into the service tax net from June 1, 2007, the view is that the lessor/service provider can avail of cenvat credit only in respect of eligible inputs/input services/input capital goods which are received on or after June 1, 2007.

A study of the Cenvat Rules, 2004, along with the judicial pronouncements given by the Courts and the Tribunals on the Modvat Rules would confirm that the **new service providers are indeed entitled to cenvat credit in respect of eligible inputs, input services and input capital goods received prior to the date of the introduction of the levy. Cenvat Credit Provisions in Brief**

The relevant portions Rule 6 of the Cenvat Rules, 2004, which deals with the availment of cenvat credit by service providers, is reproduced below:

6. (1) The CENVAT credit shall not be allowed on such quantity of input or input service which is used in the manufacture of exempted goods or exempted services, except in the circumstances mentioned in sub-rule (2): [**Provided** that the CENVAT credit on inputs shall not be denied to job worker referred to in rule 12AA of the Central Excise Rules, 2002, on the ground that the said inputs are used in the manufacture of goods cleared without payment of duty under the provisions of that rule.]

(2) Where a manufacturer or provider of output service avails of CENVAT credit in respect of any inputs or input services and manufactures such final products or provides such output service which are chargeable to duty or tax as well as exempted goods or services, then, the manufacturer or provider of output service shall maintain separate accounts for receipt, consumption and inventory of input and input service meant for use in the manufacture of dutiable final products or in providing output service and the quantity of input meant for use in the manufacture of exempted goods or services and take CENVAT credit only on that quantity of input or input service which is intended for use in the manufacture of dutiable goods or in providing output service on which service tax is payable.

(3) Notwithstanding anything contained in sub-rules (1) and (2), the manufacturer or the provider of output service, opting not to maintain separate accounts, shall follow either of the following conditions, as applicable to him, namely:–

(*c*) the provider of output service shall utilize credit only to extent of an amount not exceeding twenty per cent of the amount of service tax payable on taxable output service.

Explanation I .–The amount mentioned in conditions (*a*) and (*b*) shall be paid by the manufacturer or provider of output service by debiting the CENVAT credit or otherwise.

Explanation II.– If the manufacturer or provider of output service fails to pay the said amount, it shall be recovered along with interest in the same manner, as provided in rule 14, for recovery of CENVAT credit wrongly taken;

(4) No CENVAT credit shall be allowed on capital goods which are used exclusively in the manufacture of exempted goods or in providing exempted services, other than the final products which are exempt from the whole of the duty of excise leviable thereon under any notification where exemption is granted based upon the value or quantity of clearances made in a financial year.

(5) Notwithstanding anything contained in sub-rules (1), (2) and (3), credit of the whole of service tax paid on taxable service as specified in sub-clauses (*g*), (*p*), (*q*), (*r*), (*v*), (*w*), (*za*), (*zm*), (*zp*), (*zy*), (*zzd*), (*zzg*), (*zzh*), (*zzi*), (*zzk*), (*zzq*) and (*zzr*) of clause (*105*) of section 65 of the Finance
Act shall be allowed unless such service is used exclusively in or in relation to the manufacture of exempted goods or providing exempted services.

Understanding Cenvat Credit in the context of New Service Providers The two important relevant concepts that emerge out of the reading this Rule 6 of the Cenvat Credit Rules 2004, are '"exempted service" and "output service on which no service tax is payable". "Exempted Service" under Rule 2(e) is defined to mean *taxable services* which are exempt from the whole of service tax and includes services on which no service tax is leviable under Section 66 of the Finance Act, 1994. The definition of "exempted services" seems to be of wider as compared to "Exempted Goods" which cover only goods which are specifically
exempt or which are charged to Nil rate of duty. Applying this principle to the case of a newly introduced taxable service, say, Renting of Immovable Property service, can a view be taken that the newly introduced service was an "exempted service" or an " output service on which no service tax is payable" till the date of introduction of levy of service tax, i.e. June 1, 2007 and consequently the benefit of cenvat credit can be denied in respect of eligible inputs /input services / input capital goods for the period prior to June 1, 2007?

In my strong opinion, such a view would be totally against the provisions of the Cenvat Rules, 2004, which are largely based on the Modvat Scheme and remember, the Modvat Scheme has stood the test of time for the last two decades. There are several reasons which support my view.

Firstly, when a new service is brought into the service tax net from a particular date, the fact remains that, it is not a service at all till that particular date and consequently, the discussion on whether it is an "exempted" service or an "output price" on which no service tax is leviable, till the date of introduction of the service tax levy becomes irrelevant. Unlike the central excise law, where we have a long list of excisable items, whether exempt or not, under the service tax law, a particular service comes into the statute books only on the introduction of the service tax levy and there is no legality in holding it to be a service for any previous period. There is no merit then in holding that, at the time of receipt of the inputs/input services/input capital goods, the assessee was providing an exempt service or an output service on which no service tax is payable and consequently, deny cenvat credit.

Secondly, the emphasis of Rule 6 of the Cenvat Rules, 2004, is on utilization of cenvat credit. There is no doubt that, in the case of services, the utilization of the eligible inputs / input services / input capital goods can happen ***only*** when the taxable service is provided and this happens only from the date of introduction of levy tax on the new service. There is a lot of difference between " taking" of cenvat credit and " utilization" of cenvat credit. While "taking" happens at the time of receipt of the eligible inputs/input services/input capital goods, the "utilization" happens only when the taxable service is provided and there is no bar for utilizing eligble inputs/input services/input capital goods at the time of providing the taxable output service.
Thirdly, there are judgements from Tribunals which have held that if, at the point of the receipt of the inputs, a manufacturer is not in a position to visualize beforehand that the use of the inputs would be solely in the manufacture of fully exempted final goods, taking of credit cannot be objected to. [Yeast Alco Enzymes v CCE (2004-TIOL-1182-CESTAT-MUM).

Lastly, it is to be appreciated that there is no concept of 'user condition', in the case of inputs and input services, as contrasted to input capital goods. In one case, interestingly, the Delhi CESTAT held in *CCE v Surya Roshini Ltd* (2003-TIOL- 277-CESTAT-DEL) that the eligibility to cenvat credit must be tested at the time of receipt of the capital goods and if the capital goods are used exclusively in the manufacture of exempted goods at that point of time, credit would not be available to the manufacturer, even if the exempt product becomes dutiable at a subsequent point of time. Without going into the merits of this judgement, it is to be seen that the judgement has no implications for utilization of cenvat credit in respect of inputs and input

services and consequently, there is no basis for denial of cenvat credit on the plea that there was no taxable output service being provided, at the time of receipt of the input goods and input services.

We can draw a lot of relevant knowledge from the manufacturing sector, wherein, the question of allowing cenvat credit in respect of inputs used for manufacturing goods which are subsequently made excisable, have been comprehensively decided by the Courts and the Tribunals, in the context of the Modvat Rules. In several instances, the Tribunals have held that in respect of goods which had been cleared without payment of excise duty and which were subsequently held to be dutiable, Modvat credit on inputs used for manufacturing such goods cannot be denied under Rule 57A. Some of the decisions which have upheld this view include the Tribunal's decision under Rule 57A of the Modvat Rules in *Kesoram Cements Ltd v. CCE (*2002-TIOL-171-CESTAT-DELSB*)* rendered as far back as in 1989. Several subsequent Tribunal judgements have followed this principle, including Johnson & Johnson Ltd v CCE 2003 (154) ELT 729 (Mumbai Tribunal) and Punjab Tractors Ltd v CCE 2002 (2002-TIOL-383- CESTAT-DEL).

Now, let's come back to our typical example involving a service provider who is liable for service tax under 'Renting of Immovable Property' services. Let's assume that the Lessor has registered himself with the Service Tax Department in June 2007, in respect of 'Renting of Immovable Property' services. The

Lessor had started constructing the commercial property in January 2005 and had been paying service tax to his contractors since the commencement of the construction. The Lessor had not looked at cenvat credit in respect of eligible inputs/input services/input capital goods in respect of the period January 2005 to May 2007. Can the Lessor now avail of cenvat credit in respect of service tax paid to contractors who have built the commercial property, for the period January 2005 to May 2007?

The answer is 'Yes'. There is no bar for the Lessor to avail of cenvat credit, in respect of eligible inputs / input services / input capital goods, which have been utilized for the construction of the commercial property, in respect of the earlier years. The fact that the Lessor had not been registered with the Service Tax Department as a service provider in respect of the period prior to June 1, 2007, is not relevant and cenvat credit cannot be denied on the basis that he has not been registered with the Department.

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