

## **Cenvat Credit Scheme continues to lag far behind the march of service tax law – June 23, 2012**

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JUNE 21, 2012

By S Sivakumar, CA

I propose to take a major step in towards integrating the tax on goods and services. Accordingly, I propose to extend credit of service tax and exciseduty across goods and services.

Para 148 of FM's speech while introducing 2004-05 Budget

We have seen, how this 'so called' intent of providing seamless cenvat credit to Industry has been greatly undermined by the changes to the Cenvat Credit Rules, 2004 and the Notifications/Circulars issued by the Board, which have resulted in a highly restricted flow of credit.

A very major step in restricting the flow of cenvat credit was taken in the 2011-12 Budget, when the definitions of 'input' and 'input service' were amended, to deny the availability of cenvat credit to corporates in general and the Commercial Realty Sector, in particular. As we know, the revised definitions made effective from 1-4- 2011, quietly deleted certain words including the words 'such as' as used in the then existing definitions to deny cenvat credit in respect of 'activities related to business', 'setting up of factory' etc. The revised definitions of 'inputs' and 'input services' also

resulted in the denial of credit in respect of input construction services to the Commercial Realty Sector, in respect of construction of commercial or shopping complexes which are proposed to be let out. It was also in the 2011-12 Budget that the then existing Rule 6(5) of the Cenvat Credit Rules, 2004 was abolished, resulting in a large scale restriction of cenvat credit to Industry in respect of 17 essential services, in respect of which, credit was available without any restrictions.

For its part, the Board has been working overboard, even under the cenvat credit law prevailing for the period prior to 1-4-2011, to deny credit to Industry and service providers, by issuing circulars and notifications which were against the spirit of the cenvat credit scheme. Not to be undone, the Department has been the largest litigant, seeking to deny credit on some pretext or other.

There has been so much litigation driven by Revenue and the absolute lack of clarity in respect of cenvat credit scheme that it took, no less than the Apex Court to lament on the quantum of litigation and the lack of clarity in the cenvat credit scheme, in the Maruti Suzuki decision... Be that as it may...the fact of the matter is that, post 1-4-2011, cenvat credit is denied on many inputs and input services, resulting in a highly restricted flow of credit to Industry, rendering most of the decisions of the High Courts ineffective, post 1-4-2011.

With the new service tax law coming in from 1-7-2012, with a simple definition of 'service' to include, practically, any activity which is not covered by the Negative List and Exemption Notifications, one would have expected the cenvat credit scheme also to keep pace. After all, levy of service tax and availability of credit are two inter-linked concepts in the indirect tax.

A reading of Notification No. 28/2012-CX., (N.T.), Dated : June 20, 2012 makes a highly disturbing, disappointing and depressing reading. Instead of massively expanding the scope of cenvat credit scheme to allow credit on all inputs and input services, the attempt is to further restrict the cenvat credit scheme to Industry. In terms of the changes brought about to the definition of 'inputs' and 'input services', to take effect from 1-7-2012, cenvat credit of the duties and input services connected to construction of the building or laying of foundation or making of civil structures, etc. would now be available only if the output service is either works contract service or

construction service, as defined in Section 66E(b) of the Finance Act, 1994. Under the current law, cenvat credit on these activities is also available

to certain other output service providers like Architects, etc.

The Government seems to be eager to generate revenues from service tax at any cost, without understanding that, cenvat credit is also an important ingredient of any indirect law. While cenvat credit is getting restricted and restricted, the Government is on the march to garner more revenues by introducing a new service tax law, under which, as aforesaid, every activity under the sun, excluding a few specified activities, is subject to the levy of service tax.

One is rather amused to go thro' the press release issued by the Government yesterday, relevant extracts from which are reproduced below: Releasing the new guidance paper, the Finance Minister assured that the new approach was not a revenue augmentation measure but intended to make compliance simple and administration of service tax law easier. He also hoped that the new effort should reduce the chances of litigation and minimise the possible areas of conflict between the revenue and the tax payers.

As is known....the current Cenvat Credit Rules, 2004 are extremely complicated and unfriendly. Rules such as 6(3) are very difficult to comprehend. One would have expected the Government to go in for a simple cenvat credit law, to keep pace with the new service tax law, meeting the intent behind the FM's statement while introducing the new credit scheme in 2004. But, this hope has been completely dashed, it seems.

Before concluding.....

As most of us know, many of the current ingredients of the new service tax law are largely borrowed from the British law. While we have happily borrowed the concepts related to levy of service tax on almost all activities, we have chosen not to follow the British concepts related to availability of credits in a really seamless manner, in terms of which, credit is available on a very wide basis and even on personal expenses of employees who claim reimbursements from their employers, etc. All that is required to be shown under the British law is that, GST has been paid and this automatically qualifies for the credit to be adjusted against the output tax. Where is the justification to continue to deny cenvat credit on business related expenses when service tax is charged on these activities on the service providers? If an 'activity' is an output service for the person rendering the 'service', should it not be an 'input' service for the person receiving the service?

Service tax is fastly acquiring the characteristics of a direct tax, with the flow of cenvat credit getting highly restricted. Instead of having a highly restricted and highly litigated cenvat credit scheme, the Government can think of abolishing the cenvat credit scheme. After all, the Government wants to reduce 'chances of litigation and minimize the possible areas of conflict between the revenue and the tax payers', in terms of the press release dated June 20, 2012. This could be best achieved by abolishing the cenvat credit scheme. The Industry would also tremendously benefit... instead of working under a scheme under which every

attempt is made to deny credit on some pretext or other and where the Revenue drives litigation resulting in the consequent confusion about the availability of credit, the Industry would be much better off working under a scheme with no credits and treat the service tax paid on input services as part of cost.

Abolishing cenvat credit scheme (at least, in respect of input services) would also help the Government massively reduce its indirect tax related infrastructure and also help Industry save wasteful expenditure in terms of fees paid to Advocates and Consultants... After all... there would be no need to issue innumerable show cause notices, pass adjudication orders invariably denying credit and litigate each and every case.....the Government can do with fewer officers in Central Excise and Service tax Commissionerates, after all...

(The Author is Director, S3 Solutions Pvt Ltd, Bangalore)

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As we know, the revised definitions made effective from 1-4-2011, quietly deleted certain words including the words 'such as' as used in the then existing definitions to deny cenvat credit in respect of 'activities related to business', 'setting up of factory' etc. The revised definitions of 'inputs' and 'input services' also resulted in the denial of credit in respect of input construction services to the Commercial Realty Sector, in respect of construction of commercial or shopping complexes which are proposed to be let out. It was also in the 2011-12 Budget that the then existing Rule 6(5) of the Cenvat Credit Rules, 2004 was abolished, resulting in a large scale restriction of cenvat credit to Industry in respect of 17 essential services, in respect of which, credit was available without any restrictions. 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