

## Increase the service tax rate but ensure a seamless cenvat credit scheme – Jan 30, 2013

By S Sivakumar, Advocate

A senior Advocate specializing in indirect taxes in the Supreme Court (whom, many of us consider as our 'guru') recently told me that, after having travelled widely and studied the VAT systems prevalent in the European countries and Australia, he has come to the conclusion that, India's indirect tax system is perhaps the most complicated, in the world.

Taking specifically of the cenvat credit provisions, most countries provide for a seamless credit mechanism. The system works so well in countries like UK and Australia that, even foreigners find it very easy to get the VAT refund, often on the basis of e-mails sent to the Tax Departments of these countries. In India, the situation related to the credit mechanism is far from satisfactory and one is actually seeing a significant increase in complexity, brought

As we know, some of the definitions contained in the Cenvat Credit Rules remind one of the English that was prevailing under the Victorian era. Look at the main part of the definition of 'input service', under Rule 2(I) of the CCR (emphasis supplied by me)...

2(I) "input service" means any service,-

(i) used by a provider of *output service* for providing an output service; or

(ii) used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal,

and includes services used in relation to modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, security, business exhibition, legal services, inward transportation of inputs or capital goods and outward transportation upto the place of removal;

but **excludes** -

*[(A) service portion in the execution of a works contract and construction services including service listed under clause (b) of section 66E of the Finance Act (hereinafter referred as specified services) in so far as they are used for-*

*(a) construction or execution of works contract of a building or a civil structure or a part thereof; or*

*(b) laying of foundation or making of structures for support of capital goods,*

**except** for the provision of one or more of the specified services

Now, look at, specially, the exclusion part ...

On the face of it... it looks that, the definition of 'input service' excludes the service portion of a works contract and construction services... but behold... the word 'excludes' would need to read in conjunction with the word 'except'.

Since two negatives result in a positive, the usage of the words 'excludes' and 'except' would need to be interpreted to mean that, the exclusion clause is not applicable when the output service is works contract or construction services. Would it not be much simpler if the definition stated that, the definition of 'input service'

would not cover works contract services and construction services in so far as they are not used for output services which are works contract services and construction services.

As we know... much of the litigation related to service tax law, is on cenvat credit. The definition of 'input service' underwent a major change with effect from 1-4-2011, with the deletion of the all-important words "activities related to business" and "such as", which is resulting in a manifold increase in service tax related litigation, with the Department taking the view, that, most services would not be covered under the revised definition of 'input service' effective 1-4-2011. Of course, there have been some more changes that have taken effect from 1-4-2012. In many cases involving software players, the Department has taken the stand that, rent paid for the facility cannot be treated as an input service, as there is no direct nexus between the renting service and the output service. One would wonder if the Department would expect the employees of software companies to operate from the beautiful gardens of Bangalore, using their laptops.

Apart from the totally unclear definitions and the frequent statutory changes, the major contribution towards the confusion in the cenvat credit law has come from the Board, which has been working overboard, to deny credit to Industry and service providers, by issuing circulars and notifications, which are against the spirit of the very cenvat credit scheme.

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 rendered on the basis of the law that prevailed prior to 1-4-2011, ineffective..

With the new service tax law having come into force 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 Notification, one would have expected the cenvat credit scheme also to keep pace. Unfortunately, the cenvat credit law continues to be restrictive, despite the accepted principle that, the levy of tax and the availability of credit are two inter-linked concepts in the indirect tax. I feel that the litigation related to cenvat credit, under the new service tax law, could increase manifold.

Given the fact that much of the confusion and the inevitable litigation are related to the cenvat credit scheme, especially, as it related to services, I have this suggestion to make to the Hon'ble FM...

++ Make the cenvat credit scheme seamless and allow for credit to be taken without any restrictions on all services on which, service tax has been paid by the service recipient.

++ Since, this could and would result in an overall drop in the tax revenues, the FM could think of increasing the service tax rate to perhaps 13% or 14%.

#### **How would this suggestion help the Government ...**

The existing manpower infrastructure in the Service Tax Departments could be cut into less than half... in my view, a new service tax law based on a seamless credit mechanism can be administered with one-third of the present force. The Government could save hundreds of crores of rupees in terms of salaries of the displaced Babus including the officers from the Preventive, Anti-Evasion and the Audit Wings, who seem to be doing preciously nothing more , finding ways and means to deny cenvat credit to assessees.

There would be lesser litigation and lesser need for brilliant Assistant, Deputy, Joint, Additional Commissioners, who are currently burning the mid-night and the mid-afternoon oil in perversely interpreting the cenvat credit law, as aforesaid.

And of course, there would be a much less burden on the Courts and the CESTAT Benches. The Government can even think of closing down some of the Benches, perhaps.

Increasing the service tax rate would ensure that the Government still gets the revenues, despite the higher availment of cenvat credits.

### **Before closing ...**

To Mr PC's credit... the cenvat credit scheme spanning goods and services is, after all, his brain child. There is no reason why he should not look at simplifying the credit scheme, despite that, this would not be to the liking of the tax bureaucracy.

Under a 'seamless' cenvat credit scheme, many of the Advocates like me and Consultants, might go out of work. The drop in practice related to indirect taxes could be more than compensated by the increase in work from the new branches of law like IP, Cyber Law, etc.

The Finance and Tax Managers of many companies would be able to deploy their resources in a more productive manner, in improving upon and increasing their output, rather than spend time on tax related litigation related to cenvat credit.

Many of the top class Indirect Tax Advocates might find it difficult to maintain their plush offices spread across the cities of the country.

And... TIOL's data base could become much thinner.