Is CBEC's view on 'exempted services' legally sustainable? – Nov 25, 2008

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THE Board is at it again. This time around, it is a controversial view on what would constitute an 'exempted service' … a view will have a significant bearing on the industry and service providers in terms of their eligibility to avail of cenvat credit.

In its letter No. F.No.137/120/2008-CX.4 dated June 24, 2008 and made available very recently by TIOL, the Board has clarified that cenvat credit cannot be availed by Hindustan Construction Ltd ('HCCL') in respect of the CVD paid on an aircraft imported in 2007 and which was let out by HCCL on hire basis without transferring the right of possession and effective control. As we know, the taxable service, viz. ''Supply of tangible goods for use, without transferring right of possession and effective control' was brought under the service tax net from May 16, 2008 and HCCL started paying service tax under this head from this date.

Firstly the facts of the case … it was requested that HCCL should be allowed to take credit of the CVD paid on the aircraft and utilize it for paying service tax in respect of the hire charges collected by it. The modality suggested was to amend the Cenvat Credit Rules, 2004 so as to specifically include aircraft within the definition of capital goods, as has been done in case of motor vehicles for providing specified services. The Board rejected the request, taking the view that till May 15, 2008, HCCL's services related to the hiring out of the aircraft is not included in the list of services covered by Section 66 of the Finance Act, 1994 and*thus is* covered under the definition of exempted services under the Cenvat Credit Rules, 2004. The Board goes on to say that as per Rule 6(4), no Cenvat Credit can be taken on capital goods, which are used in providing only exempted services and therefore, *ab initio*, HCCL was not eligible to take credit of CVD. Such being the case, the credit which was *ab initio* ineligible, does not become eligible, after the service tax is imposed on the service at a later date. The Board 'therefore clarifies' that no Cenvat credit of the CVD paid on the said aircraft should be taken, even if it is specifically included within the definition of 'capital goods'.

The Board's clear view then is that, whatever is not a taxable service covered by Section 66, should be, by default, an 'exempted service'? Is this as simple a concept as that?

Let's discuss the concept of an 'exempted service'. In terms of the Cenvat Credit Rules, the two important relevant concepts that need to understood are 'exempted services and output services on which no service tax is payable. Exempted Services under Rule 2(e) of the CCR 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 is, of course, 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 the newly introduced taxable service, viz, 'Supply of tangible goods for use, without transferring right of possession and effective control' can a view be taken by the Board 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. May 15, 2008 and consequently the benefit of cenvat credit is to denied in respect of CVD paid on capital goods during the period prior to May 15, 2008, as is the issue in the instant case?

In my strong opinion, such a view would be against the provisions of the Cenvat Rules, 2004, which are largely based on the Modvat Scheme. The Modvat Scheme has stood the test of time for the last two decades, let's bear in mind. There are several reasons to support my view that the Board is not correct in denying cenvat credit to HCCL.

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. The fact remains that the all important term 'service' has not been defined, while there are definitions for the terms 'taxable service' and 'exempted service' under the service tax law. First and foremost, that a 'service' has been rendered has to be

proved, before getting into a discussion on whether such 'service' constitutes a 'taxable service' or an 'exempted service'. I can understand 'software engineering services' being treated as an 'exempted service' for the period prior to May 16, 2008, in the light of a specific exemption notification prevailing during this period. So is the case with services rendered to SEZ Units or SEZ Developers, which are specifically exempted from the levy of service tax. 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 a prior period. There is no merit then in the Board holding that, at the time of receipt of the capital goods, HCCL was rendering an exempt service or an output service on which no service tax was payable and consequently, cenvat credit is to be denied.

Secondly, the emphasis of the cenvat credit scheme is more on utilization of credit. There is no doubt that, in the case of services, the utilization of the credit 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 big 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 judgments 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 before hand 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-1180-CESTAT-MUM)**. In my view, this view is equally applicable to capital goods. Who can deny that HCCL could have visualized using the aircraft partially for its own purposes in which case, it cannot be held that the use of the capital goods, viz. the aircraft was exclusively meant for providing exempt services?

Fourthly, we can draw a lot of relevant knowledge from the manufacturing sector, wherein, the question of allowing cenvat credit in respect of inputs and capital goods 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-DEL-SB)*** rendered as far back as in 1989. Several subsequent Tribunal judgments have followed this principle, including in Johnson & Johnson Ltd v CCE 2003 (154) ELT 729 (Mumbai Tribunal) and Punjab Tractors Ltd v CCE (**2002-TIOL-383-CESTAT-DEL**).

Fifthly, how does one go about, vis-à-vis 'using capital goods' for providing 'services', as is the situation in the instant case and how does one attribute a time limit? Assuming that, for the sake of argument, HCCL had imported the aircraft, let's say, on May 14, 2008, will the Board stick to its view that, cenvat credit can still not be given on the premise that the services have been used for providing an 'exempted service' even for one day. Taking such a narrow view would defeat the very purpose of the Cenvat Credit Rules, 2004, a legislation which is meant to extend the benefit of cenvat credit across goods and services, in the words of the Finance Minister in his speech made on July 8, 2004 while presenting the Budget Proposals for the financial year 2004-05. It is legally unsustainable to take a view that the capital good (the aircraft, in this particular case) has already been used for providing the exempted service, i.e. hiring out of the aircraft.

Sixthly, how does the Board conclude that the aircraft has been used exclusively to provide 'exempted services'? Assuming that, for the sake of argument, that the aircraft had been used also to carry HCCL's top management, let's say, wouldn't it establish the fact that the aircraft has not been 'exclusively' used for providing exempted services. Will the Board then hold the view that, using the aircraft by the service provider for his own purposes is also an 'exempted service'?

And, lastly, let's bear in mind that the Cenvat Credit Rules, 2004, in reference to which the Board has sought to deny credit to HCCL, in the instant case, is not a taxing statute but a statute aimed at giving a significant benefit to the assessee, in the form of cenvat credit. The Board's denial of cenvat credit amounts to taking away with the left hand, what the law has given to the assessee with the right hand. We can refer to the Hon'ble Supreme Court's judgment in Union of India vs Suksha International and Nutan Gems and Another reported in 1989 (39) ELT 503 (SC) and in several

other cases.
Before

Concluding …

- At least, from a common sense point of view, one cannot appreciate that anything and everything could be an 'exempted service' as and so long as service tax is not levied in terms of Section 66 of the Finance Act, 1994. Notwithstanding the fact that the Service tax law does not have a schedule of services (unlike the Central Excise law), one will have to go by the basic presumption that there exists no 'service' until such 'service' gets included under Section 66.
- The concept of inputs or input capital goods or input services being used exclusively for providing exempt services, has to be understood in perspective, vis-à-vis the Board's view. Even if for the sake of argument, one were to agree with the Board that 'taxable services' could be treated as 'exempted services' for the period prior to the introduction of the service tax levy in terms of Section 66, for purposes of denial of cenvat credit, the fact remains that such denial is possible only if the capital goods are used '*exclusively*' for providing exempt services. In the instant case, even if the aircraft had been used once, let's say, for transporting some of HCCL's management team, the test of 'exclusivity' in terms of the usage of the capital goods for providing 'exempted services' would fail and so will the Board's view. After all, the Board cannot take the view that using the aircraft by the service provider for his own purposes would also constitute ' exempted service'.
- In my view, this view is bad in law and will not sustain judicial scrutiny. Nevertheless, the Department would use this to deny cenvat credit to service providers.