Latest circular on service tax refunds for exporters could actually create more difficulties – Feb 5, 2010

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THE exporting community needs to profusely thank the CBEC for issuing Circular No. 120/1/2010-ST dated January 19, 2010 which aims at simplifying the process involved in the disbursement of refund of excess cenvat credit. The fact that the Board has had to come out with this kind of a circular, despite having issued numerous earlier circulars on the subject matter, is proof of the fact that its earlier circulars have completely failed to achieve anything significant.

While the Board's intent that exporters should get their refunds on an expeditious manner is indeed laudable, it would seem that this Circular does suffer from certain serious limitations and this piece is an attempt discussing four such major limitations.

Firstly, the Circular talks of refund claims to be filed on a quarterly basis, by referring to the base Notification 5/2006-CE. With Section 11B of the Central Excise Act clearly stipulating a one year period for filing of refund claims, the reiteration of the stipulation to file quarterly refunds could create a lot of problems for exporters. The Board needs to clarify that refunds can be filed within the one year period stipulated by Section 11B of the CEA read with Rule 5 of the Cenvat Credit Rules. This clarification is required especially for the smaller and mid sized exporters, for whom it would make more economic sense to bunch up export claims for more than a quarter.

Secondly, the Circular, while talking of which input services can be treated as relatable to the output services would seem to end up creating fresh controversies on a subject, which has already seen a lot of litigation over the last few years.

The relevant para of the Circular is reproduced below:

Quote:

3.1.2 Therefore, the phrase, "used in" mentioned in Notification No. 5/2006-CX (NT) to show the nexus also needs to be interpreted in a harmonious manner. The following test can be used to see whether sufficient nexus exists. In case the absence of such input/input service adversely impacts the quality and efficiency of the provision of service exported, it should be considered as eligible input or input service. In the case of BPOs/call centers, the services directly relatable to their export business are renting of premises; right to use software; maintenance and repair of equipment; telecommunication facilities; etc. Further, in the instant example, services like outdoor catering or rent-a-cab for pick-up and dropping of its employees to office would also be eligible for credit on account of the fact that these offices run on 24 x 7 basis and transportation and provision of food to the employees are necessary pre-requisites which the employer has to provide to its employees to ensure that output service is provided efficiently. Similarly, since BPOs/call centers require a large manpower, service tax paid on manpower recruitment agency would also be eligible both for taking the credit and the refund thereof. On the other hand, activities like event management, such as company-sponsored dinners/picnics/tours, flower arrangements, mandap keepers, hydrant sprinkler systems (that is, services which can be called as recreational or used for beautification of premises), rest houses etc. prima facie would not appear to impact the efficiency in providing the output services, unless adequate justification is shown regarding their need.

Unquote:

It would seem that the Board is trying to give an entirely new meaning to what would constitute a valid input service for purposes of cenvat credit, in terms of such input service contributing to the 'quality and efficiency' of the provision of the services exported. This attempt to reinvent the wheel in so far as cenvat credit is concerned is quite unnecessary and uncalled for, at a juncture when the Tribunals and Courts have been repeatedly holding that service tax paid on any expenditure which forms part of the cost of the final product or service is eligible for cenvat credit. The Departmental officers are likely to literally interpret this para to the detriment of the exporters and we can look forward to a lot of issues arising out of the new interpretation of the Board concerning 'input service', especially in respect of input services such as travel expenses, certifying fees, Chartered Accountant's services, Management Consultant's services, Business Support Services, Maintenance & Repair services, etc. The Departmental officers are likely to take the safe path and allow refund only in respect of the specific input services referred to in the Circular, leading to litigation.

Thirdly, the format prescribed for the self certification is bound to create fresh controversies and problems, especially in terms of the need for production of documents evidencing payment of service tax by the service provider (to the exporter). There are already reports that the Department is insisting on production of the ST-3 returns and GAR-7 challans of the service providers as proof of the service tax having been paid in cash by the service provider (after having collected the service tax from the exporter). Once the exporter has already paid service tax to the service provider, where is the need for producing documents evidencing payment of the service tax by the service provider. In most cases, this is an impossible condition to be met and the Departmental Officers would surely use this requirement to reject refund claims of exporters. Tribunals have held that, once the service receiver has paid the service tax amount to the service provider, cenvat credit can be availed notwithstanding that the service provider may not have remitted the tax to the Government and this being the case, requirement to produce documents to prove that the service provider has paid the service tax to the Government is totally uncalled for.

Lastly, the Circular talks of refund claims of over Rs 5 lakhs to be 'certified' by the exporter's statutory or the tax auditor, who has also got to certify the 'co-relationship between the input service and the output service which is exported', in terms of the requirements of this Circular. This requirement could lead to tricky situations, as the certifying function of the auditor (as contrasted to the auditing function which only involves expressing an opinion on the financial statements) can be undertaken only on the basis of hard and undisputed facts. In the case of export claims for service tax refunds, a view would need to be taken on what would constitute an input service involving several borderline cases and while the exporter can always fight out the issues, the certifying auditor could have professional issues by certifying the 'co-relationship' between the input services and the output relationship. Notwithstanding these, my personal experience has been that the self certification scheme which is already in vogue in the case of refund of service tax paid on specified services, has largely failed to produce any tangible results. Wouldn't it have been appropriate for the Board to ask the statutory/tax auditor to certify that the cost of all transactions involving payment of service tax have gone into the costing of the final product/service, instead of asking the auditor to certify the accuracy of the refund figures, a nearly impossible task?

Before parting…..

I would like to re-iterate my appreciation of the efforts of the Board in bringing out this Circular. In a lighter vein, I must admit that the Board does not provide many opportunities these days to write something nice about it and I, for one, do not want to miss such an an opportunity which comes once in a while.

The Circular contains the highly welcome clarification that the cenvat credit can be carried forward to the next quarter, in the event of zero exports in the previous quarter, which should help exporters in a big way. Under the current dispensation, the Department is rejecting refund claims on the basis that no export invoices have been raised or that, no forex inward remittances have come into India, in respect of the particular quarter. Hopefully, this Circular would put an end to these issues.

The Circular also makes a bold statement that there cannot be different yardsticks for establishing the nexus for taking of credit and for refund of credit and goes on to state that, even if different phrases are used under different rules of Cenvat Credit Rules, they have to be construed in a harmonious manner. I am thrilled by this view of the Board which could

come to the rescue of exporters asking for refund of service tax paid on input services which are used for ‘deemed exports’. The current situation is that, while cenvat credit can be availed in respect of ‘deemed exports’, refunds are denied under Rule 5 on the premise that Section 5 talks only of physical exports. Now, this Circular states that a different yardstick cannot be taken between ‘availment of credit’ and ‘refund of credit’, vis-à-vis exporters. There are contradicting decisions of the Tribunals on this subject matter and the Board’s view could tilt the scales in favour of the exporter, in respect of cenvat credit refund claims related to ‘deemed exports’.

Despite the good intent behind issuing the Circular, we cannot underestimate the ingenuity of the Departmental officers dealing with refund claims, who could still come up with innovative strategies to circumvent this Circular. For instance, the Departmental Officers have already started sending out communications to the hapless exporters who have filed refund claims to the effect that, if the auditor’s certificate is not filed in 7 days time, the refund claim “ shall be treated as unsubstantiated and would be taken up for decision with the available records on merits”. Hence, instead of helping the exporters, this Circular could actually result in large scale rejection of service tax refund claims of exporters, as it would be impossible for exporters to file the auditor’s certificates in 7 days’ time.