Rule 6 of Cenvat Credit Rules -CBEC latest Circular does give relief to IT Sector but fails to answer many questions! – May 10, 2008

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By S Sivakumar, CA

THE CBEC has come out with a very important clarificatory Circular No. 868 dated May 9, 2008 on Rules 6(3) and 6(3A) of the Cenvat Credit Rules, 2004.

One major welcome clarification relates to the treatment of exported services. Writing in TIOL earlier, I had expressed the view that 'exempted services' as defined in Section 2(e) of the CCR is wide enough to cover 'exported services' also as no service tax is payable on exported services. Our concerns have probably fallen on the ears of the Department. The Board in a highly welcome move, has clarified that 'exported services' will not be treated as 'exempted services', for purposes of the adjustment to be effected in the cenvat credit, in terms of amended Rule 6(3). The Board needs to be complimented for bringing out this much-needed clarification, which will be of great interest to the IT industry, which is largely export centric. The Board clarification paves the way for the IT companies to successfully claim refund of the cenvat credit availed by them and used for providing services that are exported.

Except for this welcome clarification, the Board Circular, unfortunately, fails to address a lot of practical and relevant issues which have cropped up, post the introduction of the amended Rule 6(3). Let's discuss some of these issues, in this hurriedly written piece for TIOL.

On a query whether an assessee availing option (i) or option (ii) under rule 6(3) is allowed to take CENVAT Credit of duty paid on inputs and input services which are used for both dutiable and exempted goods or services, the Board has clarified that credit on such inputs and input services is allowed. The Board has however stated that an assessee following option (i) or (ii) under rule 6(3) shall not be allowed to take CENVAT credit of duty paid on those inputs and input services which are used exclusively for the manufacture of exempted goods or provision of exempted services. This clarification leads to be a very pertinent question. If, in the Board's view, inputs or input services which are used exclusively for manufacture of exempted goods or provision of exempted services are to be excluded for purposes of the formula under Rule 6(3) as amended, what happens to an assessee who uses certain inputs or input services exclusively for manufacture of excisable goods or provision of taxable services. Is he entitled to take 100% cenvat credit in respect of duties and taxes such inputs or input services and then opt for either of the options laid down by the amended Rule 6(3) for the balance of the input duties or taxes? Let's discuss this important issue with the use of an example.

Let's assume that I, as a practising CA, has taken a commercial property on lease from a landlord and have sub let the same to a company. Apart from being liable for service tax under 'Renting of Immovable Property' services, as a practising CA, I'd also be liable under 'Chartered Accountant's services'. The input services, in the nature of the leasing of the commercial property taken by me, are used exclusively for providing a taxable output service under the sub-letting scheme discussed above under 'Renting of Immovable Property' services. Am I then entitled to avail of 100% cenvat credit in respect of the service tax paid be me to the landlord and take the rest of the service tax paid on the remaining input services which are used for providing two taxable services, viz. 'Renting of Immovable Property' services and "CA's services" for purposes of the options given by Rule 6(3)? Though the Board has not clarified this very important issue, in my opinion, such an

approach is fully in tune with the scheme of the cenvat credit law. ***After all, the logic for disallowing credit on an input or input service used exclusively for manufacturing an exempted product or providing an exempted service has***

got to be applied inequal measure in respect of allowing credit on an input or input service used exclusively for manufacturing a dutiable product or providing a taxable service.

In response to a query whether an assessee availing option (i) of Rule 6(3) in respect of certain exempted goods/services can also avail option (ii) of Rule 6(3) in respect of other exempted goods or services simultaneously, the Board has categorically stated that the same assessee cannot avail both option (i) and option (ii) simultaneously during a financial year since the option once exercised during a financial year (F.Y.) cannot be withdrawn during the remaining part of the Financial Year. It is well known that there is no time limit by which, the assessee is required to inform to the Department of the option under Rule 6(3) exercised by him. While the Rule 6(3A) states that the option, once exercised, cannot be changed during the remaining part of the financial year, there is absolutely no clarity in a case, when an assessee exercises his option, let's say, at the middle of the financial year.

The newly introduced Rule 6(3A) has been drafted in a rather clumsy manner allowing an assessee to elect to opt for either of the options, at any time during the financial year and the assessee has also the option to exercise the option from any date. What would happen in a typical case, when an assessee exercises his option, let's say, on January 1, 2009 in respect of FY 2008-09 with effect from April 1, 2008? Such a situation is very much possible under the newly introduced Rule 6(3A). There is no clarity on the treatment that would be meted out to the cenvat credit availed between April 1, 2008 and December 31, 2008, in this instant case.

One more important issue which has not been addressed by the Board Circular relates to the details of the accumulated cenvat credit to be provided to the Department as on the date of exercising of the option under Rule 6(3A). This rule, in its present form, requires the assessee to inform the Department, at the time of exercising the option, of the cenvat credit of inputs and input services lying in balance *as on the date of exercising the option*. Now, this is in complete contrast with the other provision of the Rule 6(3A) which allows the assessee to opt exercise the option from *any date*. What would happen to an assessee who exercises his option, let's say, on June 1, 2008 with effect from April 1, 2008 and declares details of the accumulated cenvat credit as on May 31, 2008, the date of exercising his option? He is still entitled as per the Rule, to go under the option exercised by him with effect from April 1, 2008 and in which case, what is relevant is the accumulated cenvat credit on March 31, 2008 and not on May 31, 2008? ***Quite clearly, not enough care has been taken in drafting the Rule 6(3A), which is bound, as aforesaid, to lead to litigation.***

And finally, the Board Circular does not address the very important issue of the status of the accumulated cenvat credit available to an assessee as on the date of exercising of the option under Rule 6(3). It is presumed that, with the old Rule 6(3) having already been sent to the gallows as of April 1, 2008, ***the entire accumulated cenvat credit standing to the credit of the assessee to the assessee under Rule 6(3) would be available for being utilized against output duty/service tax liability arising after April 1, 2008, without being subjected to any restriction in its utilization.*** In a typical case, in my strong opinion, the accumulated balance of the cenvat credit available to an assessee under Rule 6(3) would merge with the balance that he may have, under Rule 6(5) and the entire cenvat credit would be availed for being utilized against the output excise / service tax liability, without being subjected to the formula laid down in the new Rule 6(3). This is the only logical and legal view that is possible, in my opinion, in the light of the fact that the new Rule 6(3) is applicable only in respect of cenvat credit availed from April 1, 2008.

While congratulating the Board for this Circular, let's hope that it will come out with another clarificatory Circular on the issues discussed in this piece.

(The author is Director of S3 Solutions)