Service tax refund to exporters: A mirage? – Feb 28, 2009

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THE Government would seem to have made a complete mockery of the statutory provisions related to the refund of service tax on input services, to exporters in general and services exporters, in particular.

Let's take a peep into history, in terms of the efforts of the Government over the last 18 months or so, in this regard.

It has been a long standing demand of the exporting community for refund of the indirect taxes paid/incurred by them, in terms of export of goods and services. The concept has always been that taxes cannot be exported, as upheld by the Hon'ble Supreme Court, in several cases. While there are provisions for refund of the central excise paid or incurred on exports, there were no clear provisions related to refund of the service tax paid on input services. The first step towards this step, was perhaps taken, when the Government issued a Notification bearing No. 40/2007 dated September 19, 2007 which was replaced by Notification No, 41/2007 dated October 11, 2007. The said Notification No. 41/2007 contained seven input services. The scope of Notification No. 41/2007 was expanded with the Government issuing Notifications bearing Nos. 42/2007, 03/2008, 19/2008, 24/2008 with the latest Notification No. 32/2008 being issued on November 18, 2008. In all, there are 19 input services which the Government has notified, for purposes of refund of service tax, in respect of exporters, in terms of the table given below..

S. No.	Notification No.	Date of Issue	Purpose
1.	40/2007-ST	September 19, 2007	Specified four services for purposes of refund of service tax
2.	41/2007-ST	October 6, 2007	Specified seven input services for purposes of refund of service tax and over-rided Notn. 40/2007
3.	42/2007-ST	November 29, 2007	Two more input services added
4.	03/2008-ST	February 19, 2008	Three more input services added
5.	19/2008-ST	April 1, 2008	Three more input services added
6.	24/2008-ST	May 10, 2008	Three more input services added
7.	32/2008-ST	November 18, 2008	Extending the time limit for filing the claim from 60 days to six months and further extending some more procedural relief for technical testing and analyzing services

It is ironical that the seven Notifications are all aimed at 'exporters' of goods, as these Notifications repeatedly talk of the necessity for the exporter of goods for proving that the input service was used for manufacturing the goods which were exported, etc.

Be that as it may… let's take a brief look at some of the critical issues concerning the refund provisions applicable to exporters….

1. Refund restricted to just 19 input services :

The annual supplement to the Foreign Trade Policy 2004-09 announced by Central Government on 19 th April'2007 clearly provides for providing relief to exporter of goods from service tax on services related to export by

- *exempting the services from ambit of service tax refund of service tax paid*

- *refund of service tax.*

Given the fact that the FTP has a legal validity, we can assume that the intention of the Government is to ensure that no service tax is exported.

Despite this clear intention contained in the FTP statement, it appears very strange that the Board has thought it fit to specify only 19 services, for purposes of refund of service tax, out of a total of around 106 services. Notable input services like ' rent paid on commercial premises', 'Management or Business Consultant's services' and 'Chartered Accountant's services, are conspicuously absent, in the list of the 19 services notified by the Government.

A generic view that has been taken by the Department while handling refund claims, seems to be that, except for these 19 services which have been specified in the Notifications, exporters are not entitled to refund of service tax paid on any other services. Refund applications are getting rejected, left, right and centre, on this ground. The view that only the 19 services are to be considered for service tax refund, is totally against the provisions of the Cenvat Credit Rules, 2004.

As per Rule 2(1) of the CCR, "input service" means any service,—

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

(ii) used by the 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 setting up, modernization, 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, activities relating to business, such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal.

Now, it is abundantly clear, given the inclusive definition, that, virtually, service tax paid on all input services would qualify for refund. Where is the justification to restrict the refund to just 19 services, most of which are insignificantly connected to the exporters' activities.

When Tribunals have repeatedly held that most of the input services would qualify to be considered for purposes of availment of cenvat credit, one does not understand the rationale behind the Board's decision to recognize only 19 services as being eligble for refund of service tax, for exporters.

2. Procedure for filing refund claims is too cumbersome :

With no specific list of documents having been notified, which are required to be filed by the exporters, while filing refund claims, the results are to be expected.

We have come across refund applications getting rejected, in many cases, due to the technical and trivial reasons, involving non-filing of documents, etc. It is not denied that the exporter has to show that the specific 'input service' in respect of which he is claiming refund, has been used for manufacturing the final product or rendering the taxable service which is exported, in terms of Rule 5 of the CCR. In most cases, the Departmental officers take the view that the exporter has 'failed to show that the input service has been used to manufacture the product/render the service exported'.

The problem perhaps lies in the different wordings used in Rules 5 and 2(i) of the CCR. Per se, it looks like that the concept of 'input service', as used in the specific context of granting refunds to exporters, in terms of Rules 2(1) and Rule 5, differ.

While, Rule 2(1) defines 'input service' in an 'inclusive manner' by using the words " used by the 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", Rule 5 talks of the 'input service' in a restrictive manner, by using the words " being used in the manufacture of the final product which is exported".

The Department would seem to cling to Rule 5 while disposing off refund applications from exporters and in most cases, refunds are rejected on the ground that the input services are not used for manufacture of the final product/rendering of the service exported. To my mind, this view is completely unjustified, given the fact that, Rule 5 is to be seen as sub-servient to Rule 2(1), which defines 'input service' in much broader terms and so long as there is even an indirect connection between the input service and the products/services exported, refund of the service tax paid on input services cannot be denied.

3. What are the Notifications supposed to achieve

The Government had issued Notification No. 41/2007-ST dated 6-10-2007 and the subsequent amendments resting with Notification No. 32/2008 under Section 93(1) of the Finance Act, 1994. One does not understand the rationale or justification of the Government to issue notifications under Section 93(1), which is, per se, meant for exempting certain services from the levy of service tax. Can the powers of Section 93(1) be appropriated for issuing notifications 'exempting' certain input services from the levy of service tax, for exporters? If the service tax on these 19 input services were really 'exempt', where then is the need for the hapless exporters to apply for refund of service tax paid on such input services, one wonders.

When Rule 5 of the CCR clearly talks about refund of cenvat credit in respect of service tax paid on all eligible input services, can the Notifications of the Government restrict the refund to just 19 services? Can the Government restrict a statutory benefit given to the exporters by the Rules, vis-à-vis refund of service tax?

4. Time limit for filing refund applications

If one thought that the mischief created by these Notifications ended here, he is thoroughly mistaken. Till the introduction of the amending Notification No. 32/2008 which increased the time frame for applying for refunds to six months, the upper time limit for filing the refund applications remained at 60 days from the end of the respective quarters. Now, the question is, is the Government empowered to specify a lower time frame for filing of refund applications, when Section 11B of the Central Excises Act, 1944 which deals with all refunds(and which has been made applicable to the service tax law) talks of a time frame of one year, from the relevant date for any refund application to be filed by any person? Can the Government, by issuing Notifications, restrict this period of one year for filing refund claims?

A lot of refund applications have been rejected by the Department, on the basis of the fact that refund applications were not filed within the two months specified by Notification No. 41/2007, which in my mind, is not legally sustainable. At least now, the Government would seem to have awakened to the fact that it would be virtually impossible for exporters to file refund claims within 60 days from the end of the quarter.

Taking this discussion forward, is the amendment of 6 months time being given to exporters, also applicable to claims filed (and perhaps, rejected by the Department) earlier to the 18-11-2008? In my strong view, the amendment is applicable for all refund claims filed on or after October 6, 2007, the date of the original Notification No. 41/2007.

5. Difficult conditions to meet

One of the almost impossible condition that is prescribed by the Notifications, is the condition that the exporter should adduce proof of the payment of service tax by the service provider, on the specified services for which claim for refund of service tax paid is filed. Many refund applications are rejected on the ground of non-fulfillment of this near impossible task.

As aforesaid, there is no standard procedure, in terms of the documents that are required to be submitted by the exporters, while submitting the refund applications. In many cases, refund applications get rejected on technical grounds, as we have seen.

In one instance, we came across a case where a Dy Commissioner of service tax, assigned the task of 'disposing off' refund applications, asked for justification of the cost plus 10% method adopted by the STP unit while billing its overseas holding company. One could not appreciate the need for the exporter to justify his billing pattern, which is essentially an income tax issue related to transfer pricing guidelines, in terms of an application for refund of service tax paid on input services.

The absence of a clear list of documents that can be asked for by the Department from exporters acts as a major problem for most exporters. Different officers ask for different documents and even in the case of repeat refund applications from the same exporter, it is found that the documents required by the Department differ from one refund application to another.

6. No time limit for disposal of refund applications

One critical issue relates to the time taken by the Department, while 'disposing off' refund applications. While there is no mention of the time that the Department should take to dispose off the refund applications in the successive Notifications issued, one is happy to come across an Instruction issued by Government of India, Ministry of Finance, Department of Revenue in F. No. 341/15/2007, dated April 17, 2008. According to this instruction, the refund has to be issued within 30 days and if the same is not issued, the departmental procedure for reporting the delay is also provided. One wonders if this instruction is being followed by the Department to any extent, as many refund applications filed since 2007 are pending for disposal. Despite that the Board has stated that the refund process should be made easier and 80% of the refund amount claimed must be given within 15 days, the actual experience is one of refund applications lying unattended to, for months together.

7. No specific provisions for services exporters?

The comedy or perhaps, the tragedy of the situation is that, the seven Notifications issued by the Government on service tax refunds, deal only with goods exporters. What about the unfortunate services exporters, Sir? Their problems are worse, as compared to the goods exporters. At least, the goods exporters can cite the Notifications and try and get refund in respect of the 19 services. With no specific notification meant for services exporters, it is a question of starting from the scratch, for every refund claim.

8. Some justice from the Tribunals

Some justice seems to be coming the exporters' way, though, from the Tribunals and Courts. The Karnataka High Court, in a very recent case involving ANZ International has held that, 100% Export Oriented Units are very much entitled to

refund of input taxes and duties, under Rule 5 of the Cenvat Credit Rules. In March 2008, the Bangalore CESTAT held in the Deloitte case (Commissioner of Central Excise, Hyderabad vs. Deloitte Tax Services India Pvt Ltd reported in **2008-TIOL-629-CESTAT-BANG** *had held that a taxable service exporter was entitled to obtain refund of unutilized cenvat credit in terms of Rule 5 of the CCR and that, the scope of 'input service' is very wide, indeed.*
One finds that these decisions are not acted upon by the Departmental officers, while disposing off refund claims.

Before parting …

a. I was rather amused to observe the 'never say die' approach of Mr Kamal Nath, our good Commerce Minister. In his Interim FTP speech released on Feb 26, 2009, he talks of 'continuing to press the Department of Revenue for early refund of service tax claims and further simplification of procedures'. One wishes that Mr Kamal Nath succeeds on an assignment which he has not been able to achieve for several years now.

b. The fact remains that, it's high time, that Finance Ministry, which is now headed by the PM himself, did something concrete to address the woes of exporters in the matter of refund of service tax. Despite all the notifications and rules, nobody can deny the fact that the provisions related service tax refunds have very largely remained impractical and of little value to exporters over the years.

c. The provisions related to claiming of rebate, are equally cumbersome and impractical, in most cases and hence, my comments on the refund procedures are largely applicable to rebate procedures, as well.

d. Hundreds of IT companies have come into the service tax net, with effect from May 16, 2008. The Department has been taking a view that, such Companies, having been exporting 'exempt services' till May 15, 2008, cannot claim refund of service taxes paid for the period of up to May 15, 2008. There can be no doubt for, whatever reasons (some might find fault with the faulty provisions of the Export of Services Rules), our IT Exporters have indeed been exporting 'taxes' in the form of duties and taxes paid on inputs, input services and capital goods, over the years. With the introduction of the service tax levy on Information Technology Software Services effective from May 16, 2008, one hopes that some justice is rendered to them.

e. The Board has taken a good step, in its recent Circular No. 111/05/2009-ST dated 24-02-2009, to clarify that service providers rending medical transcription services, call centers, etc. are entitled for refund of service tax, in terms of the Export of Services Rules, 2005. This is a highly welcome clarification, given the fact that, refund claims of most BPO players had been rejected by the Department on the premise that they had not exported services, within the meaning of the Export of Services Rules. I only hope that, the benefit of this clarification is given for all claims which had already been rejected, as this Circular only talk of 'all pending cases' being disposed off.

f. Can any enlightened TIOL netizen write a piece on the art of ensuring that the claims for refund of service tax do not get rejected by the Department?