AMENDMENTS TO CENVAT CREDIT RULES, 2004, BY FINANCE ACT, 2011: A CRITICAL STUDY

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Penal provisions and interest related new provisions in service tax have been made more stringent by the Finance Act, 2011 including prosecution. Similarly, interest has also been considerably increased. Since these amendments have been made effective from 1st April, 2011 in some cases and from 1st May, 2011 generally, it has become necessary for all those concerned to understand the relevant provisions properly. This article is an attempt by the author to discuss these provisions critically.

1. Introduction

As we all know that there was a lot of litigation on this subject because of the term, "Activities relating to business", used in the definition of the term "input service", in Rule 2(*l*) of the CENVAT Credit Rules. It was a general understanding that Department was wrongly interpreting this term to disallow genuine CENVAT credit taken by the Assessees in case of such services which were used by them for activities related to business. In the Finance Act, 2011, the Central Government has tried to make these rules very specific by including some more services and excluding some services which are used for construction, for employees' personal use or consumption and those relating to vehicles. Similarly, the definition of the term "Input" has been amended:

> in such a manner that "any goods which have no relationship whatsoever with the manufacture of a final product, shall remain out from the definition of the term input" as per Rule 2(*k*) of these rules.

Thus, it appears that Fringe Benefit tax, a tax payable by employers and which was taken out from the statute book before a couple of years is being brought back in the shape of disallowance of CENVAT credit for services relating to employees' welfare and car facilities etc. we should not forget that vehicles are used in connection with manufacturing activities also. So is the case of facilities like canteen etc. for employees working in factories. The author feels that these factors have not been considered by the lawmakers in these cases.

There are some other amendments also, so now we shall proceed to discuss the same one by one with comments.

2. Amendments in Definitions

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1. Rule 2(*a*) of the Rules which defined the term "capital goods" is amended to state that the specified goods named in the definition, now, even if used –

> outside the factory of the manufacturer of the final products for generation of electricity for captive use within the factory – shall be included in the definition of this term.

This is a welcome measure. In a famous case of a cement company it was judiciary's decision that in case of cement factories, mines although situated far from the factory sites, were treated as part of factories, considering the use of such mines for manufacturing activity. Such cases could also have been considered while making this amendment.

Secondly, there are different policies of various State Governments regarding manufacture of power for manufacturers' own use in their factories. One such case is the case of *Wind Power*. The State Governments take the power so manufactured by private party in its grid and permit the same free at its plant elsewhere in the State after deduction of some wheeling charges that is in the power bills of such parties adjustment for such power purchase is considered. A question that arises here is: can such transaction be treated as manufacture of power for captive use? This issue should be clarified at the outset only to avoid litigation in future.

2. In Rule 2(*d*), the word "exempted goods" was defined. This has been amended as under:

> "exempted goods" means excisable goods which are exempt from the whole of the duty of excise leviable thereon, and includes goods which are chargeable at "nil" rate of duty and "goods in respect of which the benefit of conditional exemption Notification No.1/11–C.E., dated 1st March, 2011 has been availed."

According to this definition, even if duty at the rate of 1 per cent has been paid vide exemption notification referred to above, the goods shall be treated as exempted goods and no CENVAT credit of duty so paid by him shall be available. Here there is something unique in law, where even if duty is paid, it is treated as exempted.

3. In Rule 2(*e*) of the Rules, the term "exempted services", was defined. Now the definition shall be as under:

> "exempted services" means taxable services which are exempt from the whole of service tax leviable thereon, and includes services on which no service tax is leviable under Section 66 of the Finance Act and taxable services whose part of the value is exempted on the condition that no credit of inputs and input services, used for providing such taxable service shall be taken.

Explanation: for the removal of doubts it is hereby clarified that exempt service includes trading.

In this amendment, also the services on which service tax has been paid although at reduced value shall be treated as exempted service, and the disadvantages of such a treatment shall follow to the service providers. The activity of trading shall henceforth be treated as exempted service. We fail to understand how dealing in sale and purchase of goods can be regarded as service and also as elsewhere stated its value shall be the difference between cost of sales and sales price. It appears to be totally illogical. It might have been provided for some financial benefit to the Department, but law should be logical. As we all know that the sale and purchase of goods attract VAT and not service tax as per the main object of these laws. Now since they are to be planned as one GST, they might like to treat both at par but still the concept of taxation for these activities have to be properly defined and to be made the law in a proper manner and that does not mean that in the mean time we shall for a short period make such provisions in law to complicate the things in advance.

2.1 Definition of the term "Input"

This term was defined in Rule 2(*k*) of these Rules. The amendment substitutes the following for the current definition:

"Input" means–

(2) all goods used in the factory by the manufacturer of the final products; or

(3) any goods including accessories, cleared with the final product, the value of which is included in the value of final product and goods used for providing free warranty for final products; or

(4) all goods used for generation of electricity or steam for captive use; or

(5) all goods used for providing any output service;

but excludes–

A. Light diesel oil, high-speed diesel oil or motor spirit, commonly known as petrol;

B. Any goods used for–

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

(*b*) laying of foundation or making of structure for support of capital goods, except for the provision of any taxable service specified in sub-clauses (*zn*), (*zzl*), (*zzm*), (*zzq*), (*zzzh*) and (*zzzza*) of Clause 105 of Section 65 of the Finance Act;

(C) Capital goods except when used as parts and components in the manufacture of a final product;

(D) motor vehicles;

(E) any goods, such as food items, goods used in the guesthouse, residential colony, club or a recreation facility and clinical establishment when such goods are used primarily for personal use or consumption of any employee; and

(F) any goods which have no relationship whatsoever with the manufacturer of a final product.

Explanation– For the purpose of this clause, free warranty means a warranty provided by the manufacturer, the value of which is included in the price of the final product and is not charged separately from the customer.

What we understand from the above is that there are clear-cut inclusions and exclusions. Inclusions are welcome but so far exclusions are concerned complete prejudice is shown towards employee benefit related goods. "Primarily for personal use or consumption" are the words used. In effect, whatever facilities the factory managements shall have to provide to the employees during their working hours as required by other laws of the land either free or at concessional rates will add to the cost of products of the manufacturers and if such costs will not be considered for CENVAT credits (since they will not be considered even inputs) certainly the cascading effect shall remain and the ultimate sufferer shall be the consumer. The author humbly suggest for considering this aspect.

Exclusion under the head F is welcome one as it clearly states that if there is no relationship of any type of the input and the manufacture, it shall not be considered as input. But here the question will arise as to is to decide about this relationship.

2.2 Definition of Input Service

Clause (*l*) of Section 2, which defines this term, is to be replaced by the following new definition. The Department's opinion for this major amendment is that it is so done to bring greater clarity, but when we shall proceed to read it, we shall observe that this definition is amended with a view to defeat many of the important judicial orders. The terms earlier used in this definition like, construction of factory, for the purpose of business etc. which were very widely understood and were useful for the purpose of running the business of manufacturers had been removed. Legal services have been brought in the inclusive part of this definition which was earlier not there but certainly it was technically included because of being incurred for the purpose of business.

In this definition also certain services are excluded. They are as under:

A. Architect Services, port and other port services, Airport Authority services. Both Construction services and Works Contract Services, in so far as these services are used for:

(*a*) Construction of a building or a civil structure or a part thereof; or

(*b*) Laying of foundation or making of structure for support of capital goods, except for the provision of one or more of the specified services; or

B. General Insurance Service, rent a cab service, Authorised service station service, supply of tangible goods for use service, in so far they relate to:

a motor vehicle except when used for the provision of taxable service for which the credit on motor vehicle is available as capital goods; or

C. such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of club, health and fitness centre, life-insurance, health insurance and travel benefits extended to employees on vacation etc., when such services are used primarily for personal use or consumption of employees.

The last line above is very clear to show the legislative intention that is these disallowances are purely to tax such services – instead of charging fringe benefit tax – now removed from income tax provisions. In other words, the CENVAT credit will not be allowed on such services which are purely for the use of employees and have got nothing to with the manufacturing activity directly or indirectly. That is what appears to be the Department's intention. But whether it is rightly so?

2.3 Amendments in Rules

Rule 3 of these Rules is amended to:

(*i*) disallow CENVAT credit of duty of Excise paid on any goods in respect of which the benefit of an exemption Notification No.1/2011-C.E. dated 1st March, 2011 is availed. As we know these are the products on which there was no duty of Excise so far and are covered for the first time and a nominal rate of duty that is one per cent is made payable. However by this amendment in Rule 3(1)(*i*) the CENVAT on such duty paid is denied.

(*ii*) to restrict the credit to 85 per cent of the additional duty of customs paid under Section 3(1) of the Customs Tariff Act, on ships, boats and other floating structures for breaking up falling under tariff item 8908 00 00 of the first schedule to the CTA.

(*iii*) to allow credit of the service tax leviable under Section 66A, retrospectively from 18th April, 2006 (earlier such credit was allowed by a clarification only but now it is brought as part of enabling rules for such credit).

(1) Sub-rule 3 of these Rules, which provides for the utilisation of CENVAT credit, is amended to provide that CENVAT credit shall not be utilised for any duty of Excise on good on which the benefit of exemption Notification No.1/2011 C.E., dated 1st March, 2011 is availed.

The purpose of this amendment to make sure that the payment of duty of Excise for the Assessees availing the benefit of this notification is made through PLA only and not through CENVAT credit.

(*ii*) Sub-rule 5B of the Rules is amended to provide that if the value of any input or capital goods before being put to use on which CENVAT credit is taken is written off fully or partially or where any provision to write off fully or partially has been made in the books of accounts then the manufacturer or service provider, as the case may be, shall pay an amount equivalent to the CENVAT credit taken in that respect.

In this sub-rule the word "partially" is added so now in case of partial write off also such payment of amount shall be required. The second portion of the sub-rule regarding subsequent use etc. shall continue as it is.

(*iii*) There is an important amendment in Rule 4(2)(*a*) of the Rules. This sub-rule provided for credit of capital goods received in the factory or in the premises of the output service provider. Now the credit will also be available for receipt of capital goods outside the factory of the manufacturer of the final products for generation of electricity for captive use within the factory.

Thus, this is very useful amendment for the Assessees who want to go for manufacture of power for their self-use even if the capital goods like generators are received outside the factory, where they want to run the same.

(*iv*) The most important amendment is made in Sub-rule (7) of Rule 4 vide Notification No. 13/2011-C.E., dated 31st March, 2011.

According to this amendment, the CENVAT credit in respect of input service shall be allowed, on or after the day on which the invoice, bill or, as the case may be, challan referred to in Rule 9 is received.

In case when the service tax is paid on reverse charge by the service receiver the CENVAT credit in respect of such input service shall be allowed on or after the payment is made of the value of invoice etc.

However, in case the payment of such invoice etc. is not made within three months from the date of invoice etc. an amount equal to CENVAT credit so taken must be paid by the person concerned. But then this credit shall be again available on making the payment of invoice etc.

For return of any amount towards any invoice etc. or receipt of credit note the manufacturer or service provider has to pay the amount equal to such return/refund etc.

(*v*) There is a major amendment in Rule 6 of these Rules – this will be discussed in another work.

(*vi*) Rule 9(7) is also amended to provide for submission of quarterly return by small-scale industries within 10 days after the close of the quarter to which the return relates. Earlier they were to file the return within 20 days after the close of quarter.

(*vii*) Rule 9(*b*)(*b*) is also introduced in these rules to provide that a supplementary invoice etc. will also be an eligible document for CENVAT credit if any further amount is payable towards service provided. In case of fraud etc. however there shall not be such facility of credit.

3. Conclusion

In this budget, considerable amendments have been made on this most controversial topic of CENVAT credit. Even at the time of passing the Finance Bill it continued and still there is enough scope after the all amendments are well understood by all those concerned including the judiciary. Let us hope that justice will prevail. The main mission of the VAT, that is the tax on value addition, must remain for the ultimate consumer. Just in the interest of revenue, the basic structure of this concept of VAT must not be tampered by the lawmakers.