Amendments to CENVAT Credit Rules– Union Budget 2016 - 17

The set off journey started with proforma credit in 1986 then MODVAT in 1987 and CENVAT Credit Rules, 2001. This was superseded by the CENVAT Credit Rules, 2004 to provide cross sectional availment and utilisation of credit under excise and service tax. Union Budget 2016-17 has removed few restrictions and extended the scope of credit by allowing credit on equipment and appliances used in office, wagons in case of railway and capital goods up to ₹10, 000 will now be considered as input to provide 100% credit in the same year. Further, to facilitate ease of doing business, clarity on disputed issues and procedural relaxations were many. Rule 6 has been redrafted with all good intentions but there are a few slips between the cup and the lip. Regarding movement towards GST with seamless and unrestricted credit, much needs to be done. In this article, the author examines the implications of Union Budget amendments made in CENVAT Credit Rules. Read on…

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History

L. K. Jha Committee[1] way back in 1978 had recommended that VAT (value added tax) was required for India to be competitive internationally. This was due to the fact that in the chain of manufacture and sale where goods move through various stages, they were suffering tax on tax

[1] Indirect Taxation Enquiry Committee headed by RBI ex-Governor Shri Lakshmi Kant Jha had submitted its report in 1978.

of central as well as State levies. At the time of import, there were customs duty, additional duty of customs, (also referred to as countervailing duty (CVD)), which is equal to the duty of excise on like goods and special additional duty. On removal after manufacture, there was excise in the form of basic excise duty and special excise duty (on luxury/sin products). At the time of sale, there was a central sale tax on goods sold in inter-State trade and when sold within the State, the State sales tax. At each stage, the tax paid at earlier stages was not available for set off/ deduction. This led to taxes as a proportion of cost of products being very high. For cosmetics or cars, it could be as high as 50-60% in total. This was called the cascading effect of multi point levy. Obviously, the grey/ parallel economy was having the lion's share of the business where ever possible as evasion was worth the risk of such high tax saving.

Later only in 1986, in a very limited manner, the concept of set off was bought in for inputs as pro forma credit for the manufacturers. In 1987, the then Finance Minister Shri V. P. Singh expanded this by including majority of inputs. This was called the MODVAT (modified value added tax) which increased the collection by 23% in its first year of implementation. In 1994, the capital goods credit was enabled as well as the registered dealers (under central excise) were allowed the facility of passing on the duty paid at the time of purchase. Service tax was also introduced in a small way at that time. Credit of service tax was allowed within the same services in August 2002 and across services in May 2003. In 2004, the CENVAT Credit Rules were introduced that allowed for credit across central excise and service tax. Credit could be utilised for discharge of either excise duty or service tax.

Cascading—Impact in 2016

The proposal to bring in GST in April 2017 would need the pure credit or seamless credit to be implemented. Cascading needs to be completely removed/eliminated for real seamless credit to be in place. Major areas where cascading takes place presently, making India uncompetitive are briefly explained:

1. Local VAT can only be set off within the States. The CST which now is 2% with Form "C" and the State rate (could be up to 14-15%) without the form is not available for set off.
2. Traders are not eligible for central excise duty credit for their capital goods and consumables. They are also not eligible for credit of the service tax paid on services consumed for business.
3. All petroleum products are eligible for credit. It is understood that in 2015-16 more than 30% of the total revenue of the State and Central governments were from this sector. Major items of petrol and diesel that run the cars and buses in our country are not eligible for credit either under CENVAT Credit Rules or State VAT laws. (These products continue to be under the Sales Tax.)
4. Electricity is "goods" and the industry sees huge investments where dutiable and taxable capital goods are used. There is no duty/tax on the same on which credit can be availed by the trade or industry.
5. Motor vehicles' credit is not available under the State VAT laws and to a restricted extent on vehicles used for transportation allowed for specified user after the advent of service tax.
6. Over a period of time, the Centre and the State found that when they could not increase the tax rates, the tinkering of credits was an equally good measure for tax augmentation. This was done and rarely rolled back. Therefore, a number of artificial restrictions exist in the Central and State laws.

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All the above restrictions on credit have led to the uncompetitive nature of goods manufactured in India. The exporters get some amount of set off in the form of export incentives which in my opinion is inadequate as on date considering the difficulties in doing business and compliances under so many restrictive laws.

Budget 2016 - 17 - Expanding the CENVAT Basket

In this budget, many measures to move towards GST like increase in tax rate, moving items from negative list, removing exemption, rationalising abatements and their conditions were taken, all of which led to some revenue gain. However, there is

hardly any direction to enhance this credit basket, and remove some of the restrictions. The enabling of capital goods, input and input service credit used for business/profession has not been marked. Considering that the budget, as far as indirect taxes are concerned, is normally a revenue augmentation exercise, we can expect the expansion of credits only to be reality when GST is promulgated. Few measures were as under:

i. The enabling of credit on office equipment within a factory, tools under Chapter 82 used in job worker or 3rd party manufacturer premises, capital goods for pumping water installed outside the factory are credits which were held as eligible by the Courts now being made part of law. {*Sterlite Industries– maintained by Bombay High Court (2009 (244) ELT A 89*)}. However, this clarification would result in reduction in audit objections/disputes to some extent. (Ref: Rule 2(a) of the CENVAT Credit Rules 2004).
ii. The eligibility of credit on wagons under Heading 8606 92 for transportation by rail is a genuine expansion but the passenger coaches being excluded is a mystery. (Ref: Rule 2(a) of the CCR 2004).
iii. The capital goods below ₹10,000/- being considered as "input" would ensure that 100% credit can be claimed. However, the ineligibility of inputs for service providers may be a cause of concern. (Ref: Rule 2(k) of the CCR 2004).

The above changes would come into effect from 01.04.2016.

Procedural Relaxations - Ease of Doing Business

There have been welcome measures in procedural compliances which would certain ease the doing of business in CENVAT credit rules as under:

a. Tools used in job worker or 3rd party manufacturers can be sent directly from the supplier of tools to those factories. [Ref: Rule 4 (5) of the CCR 2004].
b. Specifically manufacturers were enabled to remove the finished goods directly from the premises of the job worker by obtaining a permission from the Assistant/Deputy Commissioner for 1 year. This period has been increased to 3 years. [Ref: Rule 4 (6) of CCR].
c. The concept of Input Service Distributor is being expanded to allow for distribution to 3rd party/outsourced manufacturing units. These units have been defined to be those who pay the excise duty on the removal of goods under Valuation Rule 10 A or under Section 4A (MRP) [Ref: Rule 7 of CCR].
d. There were some disputes on manner of distribution which has been rationalised. It is now being provided that an Input Service Distributor shall distribute CENVAT credit in respect of service tax paid on the input services to its manufacturing units or units providing output service or to outsourced manufacturing units subject to, *inter alia*, the following conditions:
   i. Credit attributable to a particular unit shall be attributed to that unit only.
   ii. Credit attributable to more than one unit but not all, shall be attributed to those units only and not to all units.
   iii. Credit attributable to all units shall be attributed to all the units.
   iv. Credit shall be distributed *pro rata* on the basis of turnover as is done in the present rules.

   Note: Such outsourced manufacturing unit shall maintain separate account of credit received from each of the input service distributors and shall use it for payment of duty on goods manufactured for Input Service Distributor concerned. The credit of service tax available with the ISD as on 31st of March, 2016 shall not be distributed to an outsourced manufacturing unit. Thankfully, the reversal of credit in respect of inputs and input services used in manufacture of exempted goods or for provision of exempted services, shall apply to the units availing the credit distributed by ISD and not to the ISD. [Ref: Rule 7 of CCR].
e. Manufacturers with multiple manufacturing units enabled to maintain a common warehouse for inputs and distribute inputs with credits to the individual manufacturing units. Procedure applicable to a first stage dealer or a second stage dealer would apply, *mutatis mutandis*, to such a warehouse of the manufacturer. [Ref: Rule 7B of CCR].
f. The invoice issued by a service provider for clearance of inputs or capitals goods shall also be a valid document for availing CENVAT credit. [Ref: Rule 9(1) of CR]
g. Rule 14(2), a recent amendment, had FIFO method for determining whether a particular

credit has been utilised or not, which was not in the scheme of CENVAT. This sub-rule is being omitted.

The above changes would be effective from 01.04.2016.

h. The transportation of goods by a vessel from customs station of clearance in India to a place outside India is being excluded from the definition of "exempted service". This would allow shipping lines to take credit on eligible inputs and input services used in providing the services which are for export. This change would be effective from 01.03.2016. [Ref: Rule 2 (e) of CCR].

Restrictive Measures that may be Revisited

a) Service tax paid by such receiver of service of spectrum, mines, *etc.*, cannot be taken in the year of payment like other input services but only be available on *pro-rata* basis for the period it is spread over. Once the whole amount is collected, why there is restriction on credit [Rule 4(7) of CCR]. However if resold/assigned, balance can be availed subject to a maximum of service tax payable.

b) Annual Return has been prescribed to replace ER- 5 and ER-6 [Ref: Rule 9A of CCR].

c) Definition of "exempted service" expanded unreasonably to include all non taxable activities. [Ref: explanation to Rule 6 (3) and (3A)]

d) Restriction of utilisation of Krishi Kalyan Cess only against KKC means that the manufacturers who are not service providers would not be able to avail the credit. Swachh Bharat Cess credit was also not enabled in the past year. The credit on infrastructural cess similarly is restricted (with immediate effect from 1st March 2016). Too much of nitpicking observed in this bit of revenue garnering effort which could have been made fair and reasonable. [Ref: Chapter VI, clause 158 of Finance Bill 2016].

Rule 6 of CENVAT Credit Rules, has had a dubious distinction of creating and fermenting high pitched and unreasonable disputes in almost all audits and department officers searches/ surveys in the last decade. The Tribunals and Courts have moderated this and ruled in favour of the assessee in the past.

There is an amendment for the purposes of Rule 6, to say that exempted services as defined in Clause (e) of Rule 2 shall include an activity, which is not a 'service' as defined in Section 65B(44).

Unless specifically mentioned elsewhere, above changes would be effective from 1st April 2016.

Reversal under Rule 6 [Refer Rule 6 of CCR]

Rule 6 of CENVAT Credit Rules, has had a dubious distinction of creating and fermenting high pitched and unreasonable disputes in almost all audits and department officers searches/surveys in the last decade. The Tribunals and Courts have moderated this and ruled in favour of the assessee in the past. This complicated rule was ridiculed and nobody including the revenue officer could surely come up with a correct method. The intention in this budget was to make this rule simple and reasonable but it appears to have only clarified that it applies only to common credits.

The option of maintenance of separate records has been done away with. Under this method, eligible credit on input services say based on cost accounting principles as supported by certificate of Chartered Accountant is omitted in the amended Rule 6 of CCR. Only if this option was not opted, the assessee could decide to pay an amount of 6%/ 7% of value of exempted goods/exempted services or proportionate reversal of credit on input services. The scrapping and consequent denial of this option is unfair to well organised and transparent assesses who were maintaining cost centre based accounts and records and availing credit under this method. Only credit relatable to taxable activities were being taken.

There is an amendment for the purposes of Rule 6, to say that exempted services as defined in Clause (e) of Rule 2 shall include an activity, which is not a 'service' as defined in Section 65B(44). In other words, credit to extent attributed to the activities specifically excluded from definition of service such as transfer of title in immoveable property, transfer of title in movable property would be denied. This would also be a cause of additional disputes.

The above stated amendments in Rule 6 would be effective from 1st April 2016. ■