

Rule 6 Credit Restriction- Analysed.

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Exceptions to Restriction Under [Rule 6](#)

The cenvat credit on capital goods, inputs and input services for a manufacturer could be as high as 9% of the basic value of goods sold/ removed. This is about 75% of the normal rate of 12%. Some goods fall under the 6% rate where the credit would probably be more than the applicable rate. In case of high investment, high level of stocking, direct or indirect export, there could also be an accumulation of credits. This accumulated situation may not be apply to most service providers unless he pays tax on abated value and is eligible for input service/ capital goods credit or one who exports.

Options under [Rule 6](#)

1. Keep separate records for inputs as well as input services used in dutiable, taxable and exempt goods/ services. Avail credit on the portion related to dutiable/ taxable.
2. Pay 6% of the value of exempt goods or services.
3. Calculate the proportion as per [rule 6\(3A\)](#).

The manufacturers therefore could examine whether the reversal of 6% is economically beneficial [credit is 8%] or not. Service providers normally would not find the 6% option beneficial.

We examine the restriction item wise:

1. Capital Goods: Credit on Capital goods used exclusively for manufacture or exempted goods or provision of exempted services would not be available. Therefore if used partially for dutiable goods/ taxable activity, the entire credit would be available.
2. Inputs: Eligible inputs available only to extent used for manufacture of dutiable goods or taxable services. If used commonly then separate usage if possible then no credit on usage for exempted goods/ service.
3. Input Services: Many issues crop up here as how to ascertain / bifurcate usage. However cost accounting principles can be applied even in tally environment based on square feet [rent, housekeeping ...] or number of employees [manpower recruitment/ supply...] or value of equipment [AMC, repairs to

machinery..] This would in my opinion satisfy the “separate account” criterion. Where this is not possible then the specific input services used for exempted activity – no credit, that which is used for only taxable- 100%. The credit which is common can be calculated as per [Rule 6\(3\)](#) as to portion which is not available. For banking and NBFCs 50% has been fixed as eligible and for others based on proportion of value which is exempted.

The values which are included in exempt portion are as under:

1. Value of Exempted or Nil rated goods manufactured.
2. Value of Service on which service tax is not charged or chargeable.
3. Value of abated portion of partially taxed services where both inputs and input service restriction applies. [Ex. GTA, Chit related]
4. Value of services in the negative list as they are deemed to be services.
5. Value of traded goods considered as exempted service would be the difference between the sale price and cost of goods sold or 10% of cost of goods sold, whichever is higher. COGS can be calculated as per costing principles.
6. For trading in securities exempted value would be the difference between the sale and purchase or 1% which ever is higher.

The values which are not included in exempt portion are as under:

1. Goods cleared for export under bond, to 100% EOU, Unit/ developer of SEZ, EHTP, STPI, to UN, International organisation or for projects funded by them or under [Not. 108/95 \(CE\)](#), supplied for use in diplomatic mission or consulate under [Not. 12/12-CE](#).
2. Gold or silver arising in manufacture of copper or zinc.
3. Goods exempt under customs imported and used for international competitive bidding or power projects thru or tied up thru competitive bidding.
4. Supplies to setting up of solar power generation project or facilities.
5. Services provided without service tax to SEZ/ developers of SEZ.
6. Services exported in terms of Rule 6A if Convertible foreign exchange received in prescribed period. [The services provided outside India but not amounting to export would therefore be exempt services!!]
7. Value of abated portion of partially taxed services where either inputs or input service credit available. [Ex. Air Transport, Restaurant, works contract ..]*1
8. Value of activities which are specifically excluded in the definition of service.*2

*1 The definition of exempted services 2(e) of cenvat specifically states that where both the input credits and the input service credits are not available then only it is to be considered an exempted service. Therefore where input services are eligible then that

portion of abatement claimed may not be considered as exempted.

*2The revenue may argue that any activity which is not taxed under either service tax or excise would be covered. In the opinion of the paperwriter, this may not be correct interpretation as otherwise even transactions of immovable property etc. would be roped in.

Values where clarity is lacking

1. The value of as such sales where the entire excise duty credit is reversed [however the input services would not be part of the reversal] and at times as per practice in many manufacturing companies the transaction value wherein higher duty is discharged. Whether the value of such goods are to be considered is a grey area. Paper writer is of the view that when actual duty reversal is made it is akin to trading and when on value then akin to manufactured goods. Therefore in the case of the former- included as per trading in e) above or in case of latter- no reversal as duty paid on higher amount.
2. The common credit whether to include the credits which are specifically meant for dutiable/ taxable whether to be included in common inputs. Logically it should not be included. However a recent Tribunal decision is contrary.
3. The goods cleared under rebate of duty under rule 18 do not find a mention in the rules, which maybe an unintended omission.

The number of permutations and combination to arrive at the value of exclusion considering the issues which are still unclear as well as the tax payer wanting to maximise the credit and revenue officers minimizing it is leading to a large number of disputes in this aspect. Mathematically it may result for a very complex business 1000s of possibilities which could all be argued by the Tribunals and Court for next 10 years at least. One thing for sure the consultants and advocates in representational services would be kept occupied for a decade or more.

Maybe in the forthcoming budget we see a simpler method being prescribed retrospectively along with a clear mandate that all pending cases are closed considering the change. The industry as well as the judiciary would both sigh in relief.