

Restrictions under Cenvat Credit Rules- An analysis

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Cenvat Credit scheme is designed to avoid cascading effects but it has been seen over a period that the government has been diluting the basic philosophy of the rule by introducing many arbitrary restrictions. This has been done to augment revenue without increasing the tax rates. Paper writer has made an attempt to analyse the restrictions and raise some possibilities as under:

1. **Partially using motor vehicle for renting:** Motor vehicles falling under chapter heading 8704 including their chassis are excluded from definition of capital goods. A manufacturer who purchases the motor vehicle for transportation of goods could think of partially providing service of renting of such motor vehicle charging service tax without taking abatement. This could make the motor vehicle as capital goods eligible for taking credit.
2. **Non availment of exemption notification to avoid reversal of credit on input/input service:** The definition of exempted service covers those services which are exempted from whole of duty of service tax leviable thereon. It may be possible that a service provider has been providing multiple services few of which could be taxable while other may be covered by mega exemption notification. Unlike Central Excise, where it is compulsory to avail unconditional exemption notification, there is no such compulsion under service tax. Service provider may opt to charge service tax and may take full credit. This decision to charge or not to charge may be taken based on eligibility of credit to customers.
3. **Procurement of goods from excise dealer/endorsed invoice:** A manufacturer or service provider should try to purchase the goods directly from manufacturer or excise dealer so that availment of credit is ensured. If it is not possible, the vendor must be insisted to pass on the credit through manufacturer/excise dealer invoice. Possible mechanism could be "bill to -consigned to" basis. Alternatively, credit may also be passed on through endorsement of manufacturer's bill. (Gujarat HC in case of Darshan Industries). Similar option may be examined on imported goods to be purchased from importer also by way of endorsement.
4. **Splitting of works contract to avail credit on labour portion:** A contract may also be in 2 parts (contracts). An independent contract of sale with penalties for delayed supply, testing terms. A separate contract of service with conditions for (no artificial

splitting). Credit of service tax charged on service bill may be taken fully as the restriction is only for works contract and construction service in exclusion clause of definition of input service.

5. **Credit on goods/services used for benefit of employees in the course of performance of their duties:** Goods and services consumed/used by employees excluded from definition of input and input service. Credit may be taken with reversal of certain percentage say 5-10% treating it for consumption of employees. Balance could be said to be used in the business. e.g. mobile bills are taken in the name of company but these would invariably be used for personal calls by employees. Assessee may take credit of say 90% of ST treating balance 10% as attributable to personal usage of employees.
6. **Shifting of place of removal to buyer premise:** Outward transportation credit is allowed upto the place of removal. Goods may be delivered FOR basis making the buyer premise as place of removal. Credit of service tax on expenditure incurred till that point may be taken.
7. **Receipt of input/capital goods by service provider at a place other than registered premise:** It is not mandatory to receive inputs/capital goods in the premise of service provider. Could be directly sent to premise from where services to be provided. Maintain proper documentary evidence of location. Take credit on arrival of inputs/capital goods at that location based on the documentary evidence of location.
8. **Restriction of one year on availment of credit on input/input service:** Restriction of one year from the date of invoice has been imposed on availment of credit on input/input service. (Not on capital goods) However, this may not cover the following situations:
 - Rejected/ returned goods on which credit availed under Rule 16 of Central Excise Rules.
 - Past Credits availed and reversed under protest due to oral/ written instructions from revenue officers.
 - Re-credit of credit reversed for non receipt of inputs sent on job work.
 - Re-credit of written off/ provision made inputs when put to use.
 - Service Tax payable under Reverse Charge Mechanism

Possible aspects to be examined further- 1 yr restriction

- A. Reverse Charge Credit- Where payments are normally beyond one year, assessee may make payment of ST under RCM and may take the credit based on such payment. Payment to vendor not a pre-requisite for taking credit.
- B. Delay in payment is at times due to unhappiness of the customer/ client. Rule 6(3) of ST Rules: On input services, even where the period of one year has elapsed, the credit can be availed where it can be proved that the invoice was issued against a service which was not provided in whole or part or where amount is renegotiated due to deficient provision of service or any terms in contract. In these situations, vendor may be asked to issue credit note for old invoice and to reissue new invoice as per new agreed terms based on which credit may be taken.

9. **Payment of service tax under RCM without awaiting payment to vendor:** In case of RCM, liability to pay service tax arises at the time of making payment to vendor. In cases where there is some dispute with vendor due to which payment is withheld, ST may be paid under RCM even before making payment to vendor so that interest cost on ST under RCM can be avoided. (If tax not paid within 3 months of invoice, PoT would be immediately after three months and delay would entail payment of interest). But if ultimately payment made to vendor is less than original invoice amount, there could be possibility of department questioning the excess paid service tax.
10. **Option under Rule 6:** Rule 6 cast obligation on manufacturer/service provider to reverse the credit attributable to manufacture of exempted goods/provision of exempted service. Many times, dilemma arises as to choosing a particular option. Following could be guiding factors:
- 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.
 - 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.
 - 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.

11. **Availment of credit of duty paid during dispute:**Service receiver cannot take credit on the basis of supplementary invoice issued by service provider where service provider has paid service tax during legal proceedings initiated by department. (fraud, collusion, wilful misstatement etc.). However, there is no such restriction on service tax paid under RCM/JCM. Here, service receiver may take the credit based on TR-6 challan through which duty is paid even in cases of suppression etc.

The paper writer has discussed certain aspects which may be considered by manufacturers/ service providers to be further examined to neutralise the restrictions imposed in the law to some extent. Whatever stand is taken; it is suggested to intimate the department so that no allegation of suppression etc. can be made in future.

It is expected that in upcoming GST system, many of these artificial restrictions could be done away to meet the underlying objective of permitting seamless credit to manufacturers/service providers.