**DISCLOSURE OF RULE 6 OF CENVAT CREDIT IN ST-3 RETURN- PRACTICAL ASPECTS: PART 3**

**- By CA Ashish Chaudhary**

Having discussed on the disclosure of availment and utilization of credit in previous two articles, we shall move on to examining applicability of Rule 6 of Cenvat Credit Rules to a service provider and its disclosure in the Return.

In any value added tax system, credit of tax paid at input stage is eligible for adjustment against output liability. Cenvat credit rules have also been formulated based on the same principles *(though have been made very complicated).* One can follow a broad principle by looking at Profit & Loss Account that if credit side of P&L has some income on which service tax/excise duty has not been charged, they may not be entitled to take full credit of taxes paid on expenditure incurred by them in their business and may be falling within clutches of Rule 6 of Cenvat Credit Rules. *(Though there are many cases where may not be applicable).* This is based on simple theory that expenditure incurred have contributed to generation of revenue on which no tax has been charged and accordingly right to take credit is also curtailed.

**A. Applicability of Rule 6**

Rule 6 of Cenvat Credit Rules is applicable where a person has been providing both taxable as well as exempted services. It requires that credit should be reversed on input/input service to the extent it has been used for provision of exempted services. Important features of Rule 6 are as follows:

(a) Rule 6 is applicable on tax paid on input/input service as defined under Rule 2. If material/service on which tax has been paid does not fall within the definition of input/input services, credit not admissible at first instance itself and *hence no applicability of Rule 6. (All expenditure incurred may not necessary fall within definition of input/input service. Need to pass the test of definition under CCR before taking credit)*

(b) If definition of input/input service satisfied but restriction imposed under any other notification, credit not to be taken and *Rule 6 not applicable.(e.g. restriction imposed under abatement notification or valuation rule)*

(c) If services/material have been exclusively used for providing exempted service, no credit shall be admissible and *hence no applicability of Rule 6. (Expenditure incurred in generating revenue on which no tax charged)*

(d) If services/materials have been exclusively used in providing taxable service, take full credit and *no need to apply Rule 6. (Expenditure incurred in generating revenue on which tax charged, hence eligible for credit. Though there is recent decision in case of* ***Thyssenkrupp Industries (P) Ltd Vs.CCE 2014-TIOL-1825-CESTAT-MUM*** *that reversal needs to be made on total input service, yet the decision is only stay matter. We are of the view that the decision is infirmed to the extent it has failed to consider the objective of Rule 6 and has merely gone by wording of said Rule)*

(e) Credit taken on input/input service used commonly for providing taxable and exempted service is *required to be reversed under Rule 6* to the extent used in providing exempted/non-taxable service.*(Follow*

*any of the option given under rule depending on the business profile. Discussed below)*

(f) *Rule 6 is not applicable* in respect of services exported outside India and services provided to SEZ unit. *(export cannot be taxed and corresponding benefit cannot be denied)*

(e) Rule 6 is not applicable for capital goods also. If capital goods have been partly used for taxable service and partly for exempted service, full credit can be taken and *no need to make reversal under Rule 6*.

**B. Different options under Rule 6 and practical relevance**

Different options have been provided under Rule 6 of Cenvat Credit Rules for reversal of credit pertaining to exempted services. Each of the option along with its practical relevance has been discussed below:

**1) Maintenance of separate records for input/input services used for providing taxable and exempted service:** This may not be feasible option for service provider especially in respect of input services as many services which are common are used in providing both taxable as well as exempted services i.e. rent, audit fee, bank charges etc.

**2) 6%/7% reversal option:** Reversal can be made @ 6% on value of exempted goods and 7% (6% till 31st May, 15) on value of exempted service. Take full credit. The reversal cannot be charged to customer. May be advisable in cases where exempted turnover is negligible in total turnover. Generally may not be feasible for service providers.

**3) Reversal based on proportionate turnover:** Ratio of exempted turnover to total turnover is calculated and reversal is made based on such ratio. Firstly reversal on provisional basis and at the end of year, on actual basis. Most preferred method by service provider.

**4) Separate records for inputs and 7%/proportionate reversal for input service:** This is hybrid of (1&2) OR (1&3) where credit on inputs can be taken based on actual records while credit on input service can be taken based on option 2 or 3 above.

There are many intricacies in following these rules which have not been discussed at the relevant place.

**C. Disclosure in the Return:** All adjustments related to Rule 6 are made in section I of the Return. Column wise discussion is made explaining the same:

**Section I1 of the Return:** This section has certain questionnaire which needs to be answered in yes/no depending upon the option to be followed for reversal of credit under Rule 6. The nature of questions being asked is self explanatory and not discussed separately.

**Section I2 of the Return:** This section of the Return requires disclosure of amount payable under Rule

6 (3) of Cenvat Credit Rules. Following is discussion made for each of the columns:

**Column I 2.1:** This column requires disclosure of value of exempted goods cleared which needs to be shown separately for each of the month/quarter, as the case may be. This part of the return is applicable mainly for manufacturer engaged in manufacturing of exempted goods.

**Column I 2.2:** This is the most important part of Return pertaining to cenvat credit wherein value of exempted services provided by service provider is required to be disclosed. Following important aspects need to be considered while arriving at the value of services to be disclosed:

*Aspects to be considered while arriving at the value of exempted services:*

**a)** Reversal is required to be made @7% of exempted turnover OR based on proportionate formula on the turnover shown in this column, hence this value needs to be calculated carefully.

**b)** ***First examine whether service is exempted services?***: Whether a service is exempted or not needs to be ascertained based on the definition of exempted service provided in Rule 2 (e) of Cenvat Credit Rules, 2004. As per the Rule, following are exempted services:

- Services which are not covered by charging section i.e. 66B. This includes negative list services and services which are rendered in the non taxable territory.

- Services which are exempted from whole of service tax by way of some exemption notification are exempted services. For e.g. services covered by exemption notification no. 25/2012-ST.

- Services where abatement is granted subject to condition that credit of input **AND** input service is not admissible. Important to note that the restriction should be imposed in the notification for taking credit on both input and input service. If restriction is imposed on one but not on other, it will not be exempted service. One has to look at abatement notification 26/2012-ST as amended for individual service.

- Export of services are not exempted service. However, if services are rendered outside non taxable territory (including in J&K) but payment not received in foreign currency, it will be considered as exempted service on which Rule 6 will be applicable.

- Activity which is outside definition of service may not fall within the definition of exempted service as it is necessary that the activity should first satisfy the definition of service for being covered under exempted service. Thus transfer of title in goods, immovable property etc. may not be considered exempted service.

- Trading of goods could be said to be excluded from the definition of service and hence not an exempted service. If considered so, no need to apply Rule 6. On the other hand, trading is covered by negative list also,

which is exempted service for Cenvat Credit Purpose. Based on this view, reversal is required. Department likely to insist for reversal as specific provision has been given for computation of exempted portion of trading activity.

**C)** ***What is value of exempted services?:*** Having determined exempted service, it is necessary to determine the value of exempted service for the purpose of disclosure under this column. Following should be taken care while arriving at value:

- Value of exempted service needs to be taken as per section 67 read with Rules. Generally, this may be taken as per invoice amount.

- In case of abatement services, the value shall equivalent to the amount for which abatement has been given. *(e.g. person providing services of transportation of goods by rail of say 1,00,000/- abatement is 70%. On 30% portion i.e. 30,000/- service tax has already been charged. On balance 70,000/- he may pay amount @ 7% and take full credit on input/input service)*

- In case of money changing, air travel agent etc. where special rate option is exercised under Rule 6 of Service Tax Rules, value shall be taken by taking amount on which if tax charged at normal rate i.e. 12%/14%, same amount of tax arrives as paid under Rule 6.

- In case of trading of goods, entire trading turnover not to be taken as exempted turnover but exempted portion to be computed. This is gross profit or 10% of COGS, whichever is higher. (e.g. *Sale value of goods Rs. 1,00,000/-. COGS Rs. 90,000/-. Value of exempted service is Rs. 10,000/- (1,00,000-90,000) or Rs. 9,000 (10% of 90,000) whichever is higher i.e. 10,000/- not entire 1,00,000/-)*

- Trading of securities is also considered as exempted service. Value to be taken same as above for trading of goods except that instead of 10%, value to be taken @ 1% of purchase price.

- Services of extending deposit, loans or advances where consideration is received in the form of interest/discount shall not be considered exempted service and no need to reverse the credit.

Above computation of value of exempted service needs to be made at the end of each month/quarter, as the case may be and accordingly value needs to be shown in this column. Irrespective of whichever option is chosen.

**Column I 2.3:** Amount paid under Rule 6 (3) by utilizing cenvat credit needs to be disclosed here. Calculation will depend upon the method being employed for reversal of credit. Separate discussion has been made for different methods:

i) **Reversal @ 7%:** Under this method, reversal is required to be made by applying 7% on value of *exempted services provided.* This reversal is required to be shown here. Having reversed here, full credit

can be taken on input/input service.

ii) **Proportionate reversal method:** Under this method, following methodology is adopted for reversal of credit:

- Calculate percentage of exempted turnover to total turnover in the *previous financial year.*

- Apply the percentage on the *input/input credit availed* during the month. This reversal is made on provisional basis.

- If there is no exempted service during previous financial year, no need to make reversal provisionally at the end of each month. Reversal can be made at the end of year on or before 30th June of succeeding financial year.

- Once the financial year is over, ratio is required to be calculated based on actual turnover of exempted service and taxable service. This ratio needs to be applied on total credit taken on input/input service during the year to arrive at actual reversal. If provisional reversal is more than actual, differential credit can be availed and *vice versa.* Such adjustment should be made before 30th June of succeeding financial year.

- If there is additional reversal required, it should be disclosed under *column I3.1.3.7*. If provisional reversal was more which needs to be taken back as credit, it should be disclosed under *column I3.1.2.6.*

- Reversal disclosed under column I2.3 should match with column I3.1.3.7.

- Where 7% option is chosen, amount reversed and disclosed in column I2.3 is final and no adjustment required at year end. On the other hand, if proportionate reversal method is followed, this disclosure is provisional. Actual reversal shall be adjusted at the end of year based on actual turnover.

All other column of section I of the return have already been discussed under earlier articles. There could be multiple permutation/combination of different possibilities which may not be possible to discuss in detail.