Reversal of credit on exempted services before 30th June

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Mechanism of availing Cenvat credit in case of manufacturers or service providers having both taxable and non-taxable activities has been subject to litigation. Lot of developments have happened in Rule 6 of Cenvat credit Rules 2004 in specifying the mechanism for availing the credits. The latest was in the year 2016. The scope of exempted services was enhanced with amendment of 'exempted services' meaning. Assesses would have opted for proportionate credit reversals for FY 2016-17 based on turnover ratio of FY 2015-16 as per Rule 6(3A) of Cenvat credit Rules 2004. Now they are required to re-compute the actual credit reversals based on turnover of 2016-17 before 30th June 2017 for which understanding the scope of exempted services would be key.

In Finance Act 2016, vide notification no.13/2016-CE-NT, the scope of exempted services for the purpose of Rule 6 has been expanded by stating that 'exempted services' would include an activity, which is **not a 'service'** as defined in Section 65B(44) of the Finance Act, 1994 by adding explanation 3 to Rule 6(1). It is also stated that the value to be considered in such cases is invoice/ agreement/ contract value and where such value is not available, such value needs to be determined by using reasonable means consistent with the principles of valuation contained in the Finance Act and the Rules.

This amendment has put the assessee in dilemma as computation of eligible Cenvat credit amount in case of common services would be depending on value of exempted services. In terms of Section 65B(44) of the Finance Act, any activity carried out by a person for another for consideration is a service and includes a declared services. This definition excludes following activities which would not be considered as service:

(i) Transfer of title in goods / immovable property by way of sale, gift or in any other manner;

(ii) Transaction in money or actionable claim;

(iii) Provision of service by an employee to employer;

(iv) Fees taken in any Court or tribunal established under any law.

This amendment therefore is illogical as an activity cannot be said to be an exempted service unless it is service first. Strict interpretation of this amendment would bring many assessees into Rule 6 compliance. For example, an assessee who is exclusively engaged in manufacturing of excisable goods also sells one immovable property as one time affair. He would be required to consider such sale as exempted service and the value would be invoice / contract value which could be huge and sometime could be more than turnover of manufactured goods.

After this amendment was made, immediately with effect from 13th April 2016, it was clarified by amendment to Explanation 1 that the activity which is not service would be treated as exempted service only when such activity has used inputs or input services.

However, this amendment may not help the assesses much as it can be argued that most of the input services are used even by such non-service activities. For example, sale of flats by developers before completion certificate with service tax and sale after completion certificate without service tax. It is difficult to prove that no services are used in relation to flats which are sold after completion certificate. Similarly, interest income earned on bank deposits. It could be argued that services like telephone services could are put to use in earning income from bank deposits. *[Please note that value of services by way of extending deposits, loans or advances in so far as the consideration is represented by way of interest is not to be considered as per Rule 6(3D)].*

Assesses need to be careful in ascertaining the eligible credits based on the amendment which has happened. If there are any credits which are exclusively used towards such non-service activity, entire credit to be reversed. In case of common services, proportionate credit could be reversed taking turnover ratio.

Conclusion: Professionals could play a key role in bringing this awareness among the assesses as many seem to be unaware of the impact of the amendment happened. The new GST law could get introduced from July 2017 and before this, assesses should compute all eligible credits appropriately and disclose in financial statements along with statutory returns so

that the benefit is not lost. Even credit reversals to be made, if any, can be identified for reversal under present indirect tax regime.

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