

Cenvat Credit Rules – Procedures Relating to Service Tax



Manoj Agarwal
The author is a member of the Institute.
He can be reached at amanoj@sbc-ca.com

Cenvat Credit Rules, 2004 are a step ahead towards unified Goods and Services Tax credit mechanism. Prior to these rules, credit of input tax on services was allowed to be utilised only for output tax on services, and credit of input tax on goods was allowed to be utilised only for output tax on goods. The Cenvat Credit Rules, 2004 prescribes the procedures for availing the credit, utilisation of the credit, maintenance of record, etc. In some situations, one can avail full credit of input tax and also utilise it fully. In other situations, one can avail full credit of input tax, but one can utilise it, subject to certain restrictions. For some services, full credit is available even if the same is utilised partly in providing a taxable service or manufacture of excisable goods. This article discusses various procedures relating to Service Tax under the Cenvat Credit Rules, 2004.

Service Tax Credit mechanism was introduced with effect from 16th August 2002 through Service Tax Credit Rules, 2002 to provide for the credit of service tax paid on the services received by the service provider. The credit was allowed where the input service and the output service fell under the same category. These rules were amended w.e.f. 14th May 2003, to allow the credit across the services. Under the amended mechanism, credit of service tax paid on input services was allowed only for payment of service tax on output services under Service Tax Credit Rules, 2002. The credit of excise duty paid on inputs and capital goods was allowed only for payment of excise duty on final products under Cenvat Credit Rules, 2002. Now-a-days, Value Added Tax is considered the best tax system. Cenvat Credit is the first unified step towards this direction. The Union Finance Minister, Mr. P. Chidambaram, in the budget speech announced that credit of input tax would be extended across goods and services. To give effect to this proposal, Government has come out with the Cenvat Credit Rules, 2004. This will also avoid cascading effect of tax on goods and services. The Cenvat Credit Rules 2004 are notified under Central Excise Notification no. 23/2004-CE effective from 10th September 2004. The Cenvat Credit Rules, 2004 are issued in suppression of the Service Tax Credit Rules, 2002 and the Cenvat Credit Rules,

2002, which ceased to be in force from 10.09.2004 except for the things done or omitted to be done before 10.09.2004. However, any notification, circular, instructions, standing order, trade notices or other orders issued under these Rules, which were in force as on 10.09.2004, shall be deemed to be valid and issued under Cenvat Credit Rules, 2004 to the extent these are relevant and consistent with the new Rules.

Important definitions

1. Input Service

(a) *For a service provider:* Input Service means any service used by a provider of taxable service for providing an output service.

(b) *For a manufacturer:* Input Service means any service used by a manufacturer, whether directly or indirectly, in relation to the manufacture of final products and clearance of final products from the place of removal.

Input Service includes services used in relation to

- i. Setting up, modernisation, renovation or repairs of a factory or premises of service provider or any related office.
- ii. Advertisement or sales promotion
- iii. Market research
- iv. Storage up to the place of

- v. removal
- vi. Procurements of inputs
- vi. Activities relating to business such as accounting, auditing, financing, recruitment and quality control
- vii. Coaching and training
- viii. Computer networking
- ix. Credit rating
- x. Share registry
- xi. Security
- xii. Inward transportation of inputs or capital goods
- xiii. Outward transportation up to the place of removal

2. Output Service:

Output service means any taxable service provided by the provider of taxable service, to a customer, client, subscriber, policyholder or any other person, as the case may be.

3. Exempted service and Export of service:

Exempted services means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act, 1994 (i.e. non-taxable services).

Output service, which is exported, means the output taxable services exported in accordance with the Export of Services Rules, 2005.

4. Inputs & Capital Goods for a service provider?

Inputs: Inputs means all goods except light diesel oil, high-speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output services.

Capital Goods: Capital Goods means specified goods, falling under specified chapter headings of the First Schedule to

the Excise Tariff Act, used for providing output service and includes pollution control equipment; components, spares and accessories of the goods specified above; moulds and dies, jigs and fixtures; refractories and refractory materials; tubes and pipes and fittings thereof; and storage tank.

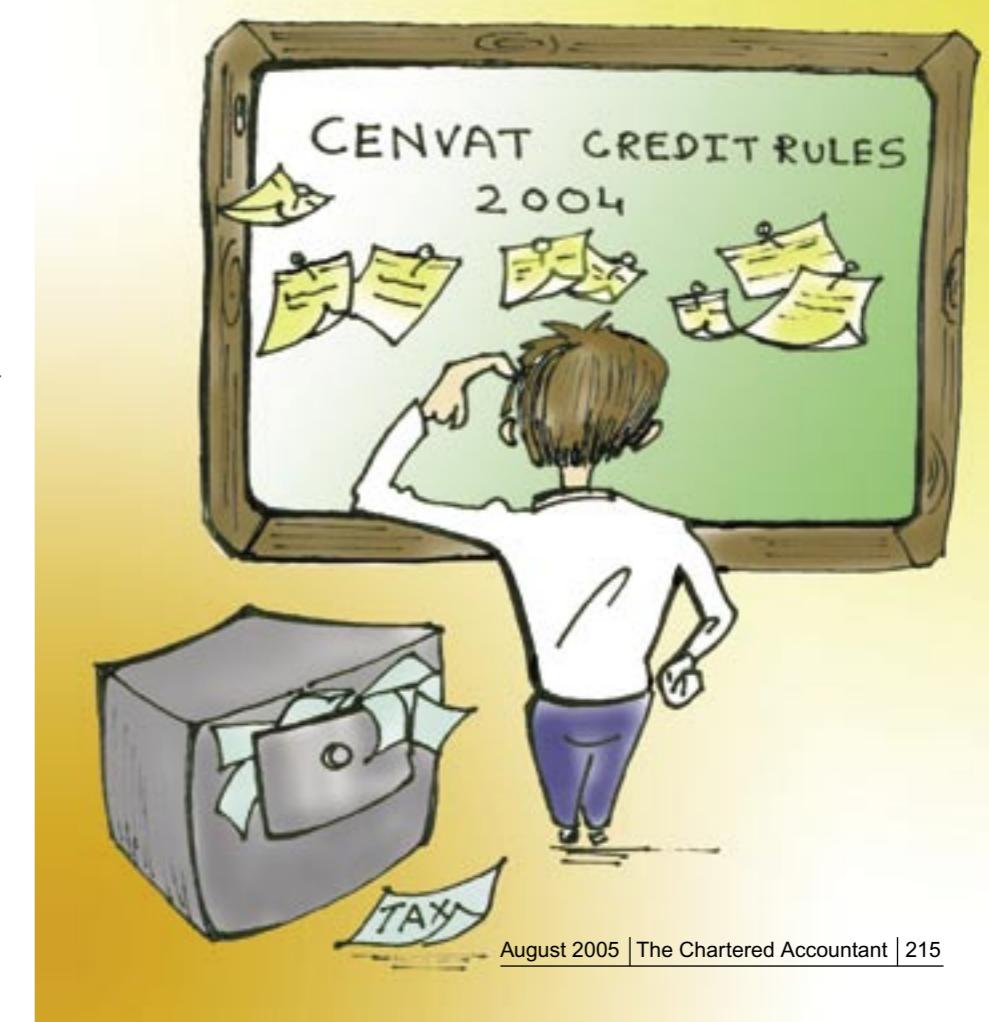
Generally the 'motor vehicle' will not be treated as Capital Goods. But, "Motor vehicle" will also be treated as capital goods if the same is registered in the name of provider of output service who is providing following type of output service

- (i) Courier agency service
- (ii) Tour operator service
- (iii) Rent a cab scheme operator service
- (iv) Cargo handling service

- (v) Goods transport agency service
- (vi) Outdoor catering service
- (vii) Pandal or shamiana contractor

Input Service distributor

Input service distributor means an office of the manufacturer of final products or output service provider, which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchases of input services and issues invoice, bill or challan for the purposes of distributing the credit of service tax paid on such input services to such manufacturer or provider of output service. A number of services are received at a place from where services are not provided or manufacturing is not carried out. Similarly



many a times invoice/ bill is raised in the name of head office or regional office whereas the services are received in the factory or premises of the service provider. Also, the services that are not specific to factory or premises such as advertising, market research, management consultancy etc., are normally billed to head office or regional office. Such offices are called as Input Service distributor (ISD).

ISD can distribute the Cenvat Credit in respect of the service tax paid on input service to its manufacturing units or units providing output service under rule 7 of Cenvat Credit Rules, 2004. The credit distributed should not exceed the amount of services tax paid. The credit cannot be distributed in respect of service tax attributable to service used in a unit exclusively engaged in manufacture of exempted goods or providing of exempted services.

As per Rule 4A (2) of Service Tax Rules, 1994, Every ISD for distributing credit shall issue an invoice/ bill or a challan signed by it for each of the recipients of the credit. Such invoice/ bill/ challan should be serially numbered and contain:

- The name, address and registration number of the person providing input service and the serial number and date of the invoice, bill or challan issued by that person.
- The name and address of the said input service distributor.
- The name and address of the recipient of the credit distributed.
- The amount of credit distributed.

Cenvat Credit available to a service provider

A service provider can avail following kind of Cenvat Credit

- Duty of excise specified in the First and Second Schedule specified in the Central Excise Tariff Act paid on inputs and capital goods.
- Additional duty of excise leviable under section 3 of the Additional Duties of Excise (Goods of Special Importance) Act, 1957 paid on inputs and capital goods.
- Service Tax leviable under section 66 of the Finance Act, 1994 paid on input services.
- Education cess on duty or service tax as mentioned above, leviable under section 91 of the Finance Act, 2004.

Cenvat Credit in respect of service tax on input service and education cess thereon shall be allowed on or after the day on which payment is made for the input service.

Cenvat Credit in respect of excise duty and education cess thereon on inputs or capital goods may be taken immediately on the receipt of



the input or capital goods in the premises of the provider of output service. The depreciation on capital goods under Income Tax Act, 1961 should be claimed on value net of credit availed on such capital goods.

The restriction of 50 per cent on availing credit on capital goods would continue for manufacturers as well as for service providers. The credit of balance amount can be availed in any subsequent financial year. However, on capital goods that are used exclusively in providing exempted services, Cenvat Credit will not be allowed.

If the inputs or capital goods on which Cenvat Credit is availed are removed as such from the premises of the provider of output service then he will have to pay an amount equal to the credit availed in respect of such input or capital goods.

The Cenvat Credit can be taken on the basis of following documents

- an excise invoice issued by a manufacturer or importer of inputs or capital goods.
- a supplementary invoice issued by a manufacturer or importer of inputs or capital goods.
- a bill of entry.
- a challan evidencing payment of service tax by the person liable to pay service tax under sub-clauses (iii) and (iv) of clause (d) of sub-rule (1) of rule 2 of the Service Tax Rules, 1994.
- an invoice or bill or challan issued by a provider of input service on or after the 10th September, 2004.
- an invoice, bill or challan

issued by an input service distributor.

The above documents should contain at least

- details of payment of duty or service tax
- description of goods or taxable service
- assessable value
- name and address of the factory, warehouse or provider of input service

The Cenvat Credit Rules, 2004 are notified under the Central Excise Notification no. 23/2004-CE effective from 10th September, 2004

cards as above are not maintained, Cenvat Credit to the extent of 20 per cent of the amount of service tax payable on taxable output services shall be allowed to be utilised. The restriction is only on utilisation of the Cenvat Credit and not on availing the credit. The balance credit can be carried forward to next period.

For example: say value of input services is Rs. 100,000 plus service tax @10 per cent Rs. 10,200 and value of taxable output service is Rs. 80,000 plus service tax Rs. 8,000 and exempted output service is Rs. 70,000. In this case if he is not maintaining separate accounts, he can avail Cenvat Credit of Rs. 10,000 but can utilise only Rs. 1,600 (i.e. 20 per cent of 8,000) and balance Rs. 8,400 (10,000-1,600) can be carried forward to be utilised in subsequent period.

Suppose in the above example if he had maintained separate accounts and it can be proved that 50 per cent of input services are used for providing taxable output service then he could have availed Cenvat Credit of Rs. 5,000 (i.e. 50 per cent of 10,000) and utilised the full Cenvat Credit of 5,000 towards his liability of 8,000 on output service. But he will not avail Cenvat Credit on balance 50 per cent of input services, which are utilised in non-taxable services.

The position can be summarised as under. The table also contains scenarios where separate accounts are maintained and input service utilisation in providing taxable output service is 80 per cent and 15 per cent.

If a service provider maintains separate accounts for some inputs/input services but does not maintain for other inputs/input services, in such situation he can utilise full Cenvat Credit on the inputs/input services for which separate accounts are maintained and for other inputs/input services, he can utilise up to 20 per cent of his balance liability on output services.

In case of following specified services credit would be disallowed only when these are used exclusively in relation to manufacture of exempted goods or providing exempted services.

- a) Consulting engineering
- b) Architect
- c) Interior decorator
- d) Management consultancy
- e) Real state
- f) Security agency
- g) Scientific or technical consultancy
- h) Banking and other financial company
- i) Insurance auxiliary services
- j) Commissioning and installation
- k) Maintenance or repair
- l) Technical testing and analysis
- m) Technical inspection and certification
- n) Construction service

Situation	Cenvat Availed	Liability on output service	Cenvat utilised	Paid in cash	Cenvat balance carried forward
Not maintaining separate account	10,000	8,000	1,600	6,400	8,400
Maintaining separate accounts (input service utilisation 50 per cent)	5,000	8,000	5,000	3,000	NIL
Maintaining separate accounts (input service utilisation 85 per cent)	8,500	8,000	8,000	NIL	500
Maintaining separate accounts (input service utilisation 15 per cent)	1,500	8,000	1,500	6,500	NIL

o) Intellectual property service

This means that even if these input services are used partly in providing taxable services/manufacturing taxable goods, full credit will be available even if no separate records are maintained. However, one will have to maintain separate record of credit availed from these input services.

An output service provider should maintain separately the Cenvat Credit of education cess on Service Tax as this can be utilised only for payment of education cess on Service Tax on output service.

Cenvat Credit of service tax available to a manufacturer

A manufacturer can avail Cenvat Credit of Service Tax leviable under section 66 of the Finance Act, 1994 and also the Education cess on Service Tax leviable under section 91 of the Finance Act, 2004.

The manufacturer can utilise the Cenvat Credit of service tax for payment of any duty of excise on any final products and inputs or capital goods if these are removed from his factory. The Cenvat Credit of education cess can be utilised only for payment of education cess on excise duty on any final products and inputs or capital goods if these are removed from his factory. However, credit of service tax can be utilised for payment of education cess on excise duty on any final products and inputs or capital goods if these are removed from his factory.

Cenvat Credit to persons liable to pay service tax as a receiver of service

Rule 2 sub-rule (1) clause (d) of Service Tax Rules, 1994 defines the persons liable to pay service tax for section 68(2) of the Finance Act, 1994 as amended. Sub-clauses (iii) and (iv) of rule 2(1)(d), defines

the receiver of service to be the person liable to pay the service tax in respect of Insurance auxiliary service and where the NRI is the provider of service respectively. By virtue of Rule 9 (1) (e) of Cenvat Credit Rules, 2004, these receivers of service can avail the Cenvat Credit on the basis of challan evidencing payment of service tax. After notifying the Cenvat Credit Rules, 2004, the Rule 2(1) (d) of Service Tax Rules 1994 has been amended to insert therein sub -clause (v) and (vi) wherein the receiver of 'Transportation Services' and receiver of 'Mutual Fund Distributing services' (under Business Auxiliary Services) respectively are made liable to pay service tax. In the line now, the Rule 9(1)(e) of the Cenvat Credit Rules, 2004 is also amended vide Central Excise Notification No. 28/2005-CE dated 07.06.2005 effective from 16.06.2005 to incorporate therein the sub-clauses (v) of Rule 2 (1) (d) of Service Tax Rules 1994 however clause (vi) is not yet included.

Therefore, now the receivers of transportation service can also claim the Cenvat Credit on the basis of the challan evidencing payment of service tax, as they will not have any other prescribed document under the Rules.

The question, however, is whether Cenvat Credit can be claimed on the basis of challan for a period up to 15.06.2005 for Transportation Services and for a period from 01.04.2005 for Mutual Fund Distribution Services.

In my view, going by the spirit of Rule 9(1)(e), in which, challan for payment of service

tax by a receiver of services listed in (iii) and (iv) of Clause (d) of Sub-rule (1) of Rule 2 of Service Tax Rules, 1994 is considered as a document for claiming a Cenvat Credit and by the recent amendment, which in my view, is clarificatory in nature, logically a challan evidencing payment of service tax by receiver of services listed in (v) and (vi) of Clause (d) of Sub-rule (1) of Rule 2 of Service Tax Rules, 1994 needs to be considered as a document on the basis of which Cenvat Credit can be claimed.

Export of services

If the output services are exported, the Cenvat Credit in respect of the inputs or input services used in providing such output services shall be allowed to be utilised by the provider of service towards payment of Service Tax on taxable output service. And where for any reason such adjustment is not possible, he shall be allowed refund of such amount subject to certain safeguards, conditions and limitations.

Export of goods

If the final products or intermediate products are exported, the Cenvat Credit in respect of the input services used in manufacturing such products shall be allowed to be utilised by the manufacturers towards payment of duty of excise on any final products cleared for home consumption or for export on payment of duty. And where for any reason such adjustment is not possible, he shall be allowed refund of such amount subject to certain safeguards, conditions and limitations.

of credit shall be allowed if the manufacturer avails of drawback allowed under the Customs and Central Excise Duties Drawback Rules, 1995, or claims a rebate of duty under the Central Excise Rules, 2002, in respect of such duty.

Records to be maintained to avail the credit

To avail the Cenvat Credit of service tax on input services proper records for the receipt and consumption of the input services are to be maintained.

To avail the Cenvat Credit of excise duty on inputs and capital goods, proper records for the receipt, disposal, consumption and inventory of the inputs and capital goods are to be maintained.

The record should contain relevant information regarding the value, duty or tax paid, Cenvat Credit taken or utilised, the person from whom the inputs or capital goods or input services have been procured.

The burden of proof regarding the admissibility of the Cenvat Credit shall lie upon the person taking such credit.

Return to be filed for Cenvat Credit availed and utilised

The provider of output service availing Cenvat Credit shall submit a Half-Yearly return in a specified form [to be notified U/R 9(9)] to the superintendent of central excise, by the end of the month following the particular half-year (i.e. for half year ending 30.09.2005, the return is to be submitted before 31.10.2005). So far no form is specified. However,

Service Tax Credit Rules, 2002 had specified a form for credit availed and utilised. That form can be used till new form is specified by notification in terms of Rule 9(9).

The input service distributor is to submit a half yearly Statement, giving the details of credit received and distributed during the said half year to the Superintendent of Central Excise, by the end of the month following the half year. No form is prescribed for the Statement.

The manufacturers are not required to file any separate return. It will be sufficient if they file ER1 (monthly return), ER2 (100 per cent EOU) or ER3 (quarterly return), as the case may be. New format of these returns have been notified vide Notification No. 25/2004 and 26/ 2004 – CE dated 27.09.2004. The same are amended vide Notification No. 26/2005-CE dated 16th May 2005.

Transition

Any amount of credit earned by a provider of output service under the Service Tax Credit Rules 2002 till 10.09.2004 and remaining unutilised on that day shall be allowed as Cenvat Credit to such provider of output service under Cenvat Credit Rules, 2004. Such credit shall be allowed to be utilised in accordance with these rules.

Consequences of Cenvat Credit taken wrongly

Where the Cenvat Credit has been wrongly taken or utilised or erroneously refunded, the same along with interest shall be recovered.

If any person takes Cenvat Credit in respect of input ser-

vices, wrongly or without taking reasonable steps to ensure that appropriate Service Tax on the said input services has been paid as indicated in the documents accompanying the input services or contravenes any of the provisions of these rules, then such person shall be liable to a penalty which may extend up to ten thousand rupees.

If any person takes Cenvat Credit in respect of inputs or capital goods, wrongly or without taking reasonable steps to ensure that appropriate duty on the said inputs or capital goods has been paid as indicated in the documents accompanying the inputs or capital goods or contravenes any of the provisions of these rules, then, all such goods shall be liable to confiscation. Also such person shall be liable to a penalty not exceeding the duty on the excisable goods in respect of which any contravention has been committed, or ten thousand rupees, whichever is greater.

In a case, where the Cenvat Credit has been taken or utilised wrongly on account of (i) fraud, (ii) willful mis-statement (iii) collusion or (iv) suppression of facts or (v) contravention of any of the provisions of the Finance Act or the rules made there under with intention to evade payment of service tax, then, the provider of output service shall also be liable to pay penalty, in addition to Service Tax and interest, if any, payable by him, a sum which shall not be less than, but which shall not exceed twice, the amount of Service Tax sought to be evaded.

The penalty may be reduced to 25 per cent of Service

Tax amount in certain circumstances.

Grey areas

1. Cenvat Credit on Transportation Service:

The definition of Input Service interalia includes "services used in or in relation to clearance of final products from place of removal" and "inward transportation of inputs or capital goods and outward transportation up to the place of removal".

In case of sales on F.O.R. Destination basis, manufacturer makes freight payment and also the service tax thereon. Whether Cenvat Credit of such service tax can be claimed arguing that the service is covered under "services used in or in relation to clearance of final products from place of removal" or Credit will be denied on the ground that "outward transportation up to the place of removal" only is eligible for input service. Contrary views on the issue are available.

There are cases where the seller, after making freight and services tax payment thereon, are claiming the freight and service tax amount from the purchaser either in the excise invoice itself or by raising a separate debit note. In such cases, can the purchaser (who happens to be a manufacturer and the items purchased are inputs or capital goods for him) claim the Cenvat Credit of the Service Tax reimbursed to the seller. Here also contrary views are available.

In my view, Cenvat Credit should be allowed in above cases if proper documentation to justify the credit is available. There may be three types of contracts between supplier and purchaser and the service tax

liability and its Cenvat Credit under each type of contract should be as under:

a) F.O.R. Destination Contract: The freight and service tax thereon is to be paid by the supplier and as it is his cost the same cannot be recovered from the supplier. In such cases, transportation service will be input service for supplier as sales completes only when the goods are delivered at purchaser's place and will be covered under "services used in or in relation to clearance of final products from place of removal". The supplier is eligible to claim Cenvat Credit on the basis of challan evidencing payment of tax and/or invoice/consignment note issued by transporter containing required information.

b) F.O.R. Dispatching Station Contract: The freight and service tax thereon is paid by supplier and claimed as reimbursement from the purchaser. In such cases, supplier pays service tax as an agent of purchaser. Thus, if supplier gives documents of payment of service tax or invoice/debit note containing his service tax registration number, freight amount and service tax amount, the purchaser can claim Cenvat Credit of the Service tax reimbursed to the supplier if the transportation service is for "inward transportation of inputs or capital goods".

c) F.O.R. Dispatching station Plus Fixed Freight Charges Contract: The freight and Service tax thereon is paid by supplier but he charges a fixed freight amount and Service tax thereon from purchaser for transportation of goods up to purchaser's place. The fixed

Particulars	Amount (Rs.)
Freight paid by supplier to transporter	1,00,000/-
Service tax paid by him on freight (tax on input service for supplier)	2,550/-
Freight charged to purchaser	1,20,000/-
Service tax charged & collected from purchaser (Tax on output service for supplier)	3,060/-
On output service, supplier will have to pay	510/-
Service tax collected	3060/-
Less: Cenvat credit of input service	2550/-

amount may be more or less than what supplier actually pays to the transporter. In such cases, the supplier becomes Goods Transport agency (GTA) as it is charging fixed freight amount for transportation. It is advised that in such cases, the supplier should issue a bill/ invoice/debit note for fixed freight amount and service tax thereon.

c) F.O.R. Dispatching Station Contract: The freight and service tax thereon is paid by supplier and claimed as reimbursement from the purchaser. In such cases, supplier pays service tax as an agent of purchaser. Thus, if supplier gives documents of payment of service tax or invoice/debit note containing his service tax registration number, freight amount and service tax amount, the purchaser can claim Cenvat Credit of the Service tax reimbursed to the supplier if the transportation service is for "inward transportation of inputs or capital goods".

The purchaser can claim Cenvat Credit of service tax amounting to Rs. 3,060/- paid to supplier.

2. Cenvat Credit on mobile phones

Service Tax Credit Rules, 2002 contained a condition that for availing credit on telephone service, the telephone should be installed in the busi-

ness premises. Based on this, the CBEC has specified in its Circular No. 59/8/2003 (Para 2.8), dated 20th June 2003 that mobile phones are not covered for the purpose of availing the credit. Service Tax Credit Rules, 2002 are suppressed but the Circular is still in force.

There are cases where the seller, after making freight and Services Tax payment thereon, are claiming the freight and Service Tax amount from the purchaser either in the excise invoice itself or by raising a separate debit note

This needs to be seen in the context that there is no such condition in the Cenvat Credit Rules, 2004 that the telephone should be installed in the business premises. As per Rule 16 of Cenvat Credit Rules, 2004 the Circular can be deemed to be valid and issued under provisions of these Rules only if it is relevant and consistent with these Rules. In my view, the Para 2.8 of the Circular is no longer valid as it is not consistent with the Cenvat Credit Rules, 2004. Therefore, credit on mobile phones will now be available provided the service is capable of being considered as an input service.

Conclusion

The Cenvat Credit across goods and services, being new, will have some teething trouble. Litigations are also expected to take place. But in the long run, it will be beneficial for the service providers, manufacturers and for the economy of our country. □