

## Whether Credit Can be Taken When Exemptions Are Availed?

If a service provider of certain specified services, say outdoor caterer, transporters of goods by road, tour operators, rent-a-cab, mandap-keeper providing catering services, erection, commissioning and installation etc., opts for claiming exemption, then in such cases exemption is available only when Cenvat Credit of duty on inputs and capital goods, and abatements of cost of goods/material used, or supplied, during the course of provision of service has not been taken.

(ii) Such a service provider has availed the benefit under the notification of the Government of India, in the Ministry of Finance (Department of Revenue), No. 12/2003-Service Tax, dated 20th June, 2003 [G.S.R. 503 (E), dated 20th June, 2003].”

And w.e.f 16.6.2005, apart from the above two clauses a new clause as stated here under has been added to Notification No. 15/2004-Service Tax, dated 10th September 2005, which is amended vide Notification No.19/2005-Service Tax, dated 7th June 2005

(iii) “The taxable services provided are only completion and finishing services in relation to building or civil structure, referred to in sub-clause (c)

of clause (25b) of section 65 of the Finance Act, 1994.”

And also Notification No. 18/2005-Service Tax, dated June 7, 2005, apart from the above two clauses consists of the following clause:

(iv) The taxable services provided are only completion and finishing services in relation to residential

complex, referred to in sub-clause (b) of clause (30a) of section 65 of the Finance Act.

To understand and work out the credit one should know what is meant by abatement/exemptions and credit available. The government, in order to remove the brunt of Service Tax on the assessee, has announced certain abatements/exemptions and, in order to make the situation assessee-friendly the credit of duty on inputs and capital goods and Service Tax on input service has been allowed.

Abatement has not been defined anywhere but as per general meaning it means reducing or diminishing. As regard to abatements under Service Tax, the government after taking into consideration various factors involved to arrive at the taxable service, the abatement and exemptions from the value of taxable services has been granted subject to certain prescribed conditions.

The abatements and exemption reduces the value of taxable service and Cenvat Credit reduces the tax burden of an assessee.

### When and how much credit is allowed?

Gone are the golden days,

as it is no longer easy for a service provider to claim exemptions. One has to decide well in advance whether to claim exemption or go for abatement or shall avail Cenvat Credit, because the option once chosen has to be followed throughout a financial year.

But merely choosing an option and striding ahead, is not so easy because how to avail credit, and how much to utilise is yet another area to be pondered over.

The Cenvat Credit Rules 2004, in this regard have defined certain terms, which are relevant in understanding the prescribed conditions for availment and utilisation of credit, which are as under:

#### (1) Capital goods

As per Rule 2(a) “capital goods” means:

(A) The following goods, namely:

- (i) All goods falling under Chapter 82, Chapter 84, Chapter 85, Chapter 90, heading No. 68.02 and sub-heading No. 6801.10 of the First Schedule to the Excise Tariff Act;
- (ii) Pollution control equipment;
- (iii) Components, spares and accessories of the goods specified at (i) and (ii);
- (iv) Moulds and dies, jigs and fixtures;
- (v) Refractories and refractory materials;
- (vi) Tubes and pipes and fittings thereof; and
- (vii) Storage tank, used-

• In the factory of the manufacturer of the final products, but does not include any equipment or appliance

used in an office; or

• For providing output service;

(B) Motor vehicle registered in the name of provider of output service for providing taxable service as specified in sub-clauses (f), (n), (o), (zr), (zzp), (zzt) and (zzw) of clause (105) of section 65 of the Finance Act;

#### (2) Exempted service

As per Rule 2(e) “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;

#### (3) Input

As per Rule 2(k) “input” means-

(i) All goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to the manufacture of final products whether directly or indirectly and, whether contained in the final product or not and it includes lubricating oils, greases, cutting oils, coolants, accessories of the final products cleared along with the final product, goods used as paint, or as packing material, or as fuel, or for generation of electricity, or steam used in or in relation to manufacture of final products or for any other purpose, within the factory of production;

(ii) All goods, except light diesel oil, high-speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service;

*Explanation 1* - The light diesel oil, high speed diesel oil or motor spirit, commonly known as petrol, shall not be treated as an input for any purpose whatsoever.

*Explanation 2* - Input includes goods used in the manufacture of capital goods, which are further used in the factory of the manufacturer;

#### (4) Input service

As per Rule (l) “input service,” means any service:

- (i) Used by a provider of taxable service for providing an output service; or
- (ii) Used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products from the place of removal, and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage up to the place of removal, procurement of inputs, activities relating to business, such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, and security, inward transportation of inputs or capital goods and outward transportation up to the place of removal;

#### (5) Output service

As per Rule 2 (p) “output service” means any taxable service provided by the pro-

**The abatements and exemption reduces the value of taxable service and Cenvat Credit reduces the tax burden of an assessee**

**CBEC till 9.9.2004 had kept free the taxable service providers to enjoy the exemptions, abatement and credit simultaneously. But with effect from 10.9.2004 it has put restrictions on availment of credits and abatement of goods sold/consumed where any type of exemption is availed.**



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Since 10.9.2004, the following conditions have been added to every exemption notification:

“Provided that the said exemption shall not apply in such cases where –

(i) The credit of duty paid on inputs or capital goods has been taken under the provisions of the Cenvat Credit Rules, 2004; or

vider of taxable service, to a customer, client, subscriber, policy holder or any other person, as the case may be, and the expressions 'provider' and 'provided' shall be construed accordingly;

*Explanation* - For the removal of doubts, it is hereby clarified that if a person liable for paying Service Tax does not provide any taxable service or does not manufacture final products, the service for which he is liable to pay Service Tax shall be deemed to be the output service.

#### When is the credit in respect of input service allowed?

As per Clause (7) of Rule 4, an output service provider can claim the credit of Service Tax on input service only when he has made the payment of value of input service and Service Tax thereon. Let's understand this condition with the help of an illustration:

A is a Private Limited Company rendering the service of cable operator.

It avails the input service of B who is a multi-system operator.

B raises the bill on A for the month of April on 13/4/2005 and A makes the payment against it on 1/5/2005.

Now A cannot avail the credit of the Service Tax paid on input service, while discharging his liability of Service Tax for the month of April because A has made the payment of value of input service and Service Tax thereon after the completion of the month of April. However, while discharging the liability for the month of May, A can avail

the credit on amount of Service Tax paid in the month of May against the services received during the month of April.

#### How much credit is available?

In this regard the Cenvat Credit Rules, 2004 and Notifications issued from time to time have prescribed certain conditions for availment and utilisation of credit; the same are being enumerated here in below:

- When an output service provider is rendering only taxable service and not claiming any type of exemption or abatement:  
In such circumstances an output service provider can claim the credit of entire Service Tax and duty paid against input services and input and capital goods, respectively, which are used in rendering the ultimate output service.
- When an output service provider is rendering only taxable service and claiming exemptions or abatements:  
In such circumstances an output service provider is not entitled to claim Cenvat Credit of duty paid on inputs and capital goods, neither is he entitled to claim abatement of any expenses. However, he is entitled to avail credit of the entire Service Tax paid against the input services.
- When an output service provider is rendering taxable as well as exempted



**As per Clause (7) of Rule 4, an output service provider can claim the credit of Service Tax on input service only when he has made the payment of value of input service and Service Tax thereon**

service and is maintaining separate records of input services consumed for taxable as well as exempted services and is not claiming any exemption or abatement:

In such circumstances an output service provider can avail the entire credit of duty and Service Tax available against the inputs, capital goods and input services respectively consumed for rendering the output service as per clause (2) of Rule 6 of The Cenvat Credit Rules 2004.

- When an output service provider is rendering taxable as well as exempted service and is maintaining separate records of input services consumed for taxable as well as exempted services and is claiming exemption or abatement:  
In such circumstances an output service provider cannot avail the credit of duty available against the

inputs and capital goods. However, he is entitled to avail the credit of entire Service Tax paid against the input services consumed for rendering the output service.

- When an output service provider is rendering taxable as well as exempted service and is not maintaining separate records of input services consumed for taxable as well as exempted services and is not claiming any exemption or abatement:

In such circumstances an output service provider cannot avail the entire credit of duty or Service Tax available against the inputs, capital goods and Service Tax respectively. As per Clause 3(c) of Rule 6, the provider of output service shall utilise credit only to the extent of an amount not exceeding 20 per cent of the amount of Service Tax payable on taxable output service.

However, sub-rule (5) of Rule 6 of Cenvat Credit Rules, 2004 clarifies that in respect of services rendered by the specified service providers, notwithstanding anything contained in sub-rules (1), (2) & (3) of Rule 6 of Cenvat Credit Rules, 2004, full Credit can be taken as long as the services of the following service providers are not exclusively used for providing exempted services:

- Architect-Section 65 (105)(p)
- Auxiliary service concerning life insurance-Section 65 (105)(zy)
- Banking and other financial services-Section 65

(105)(zm)

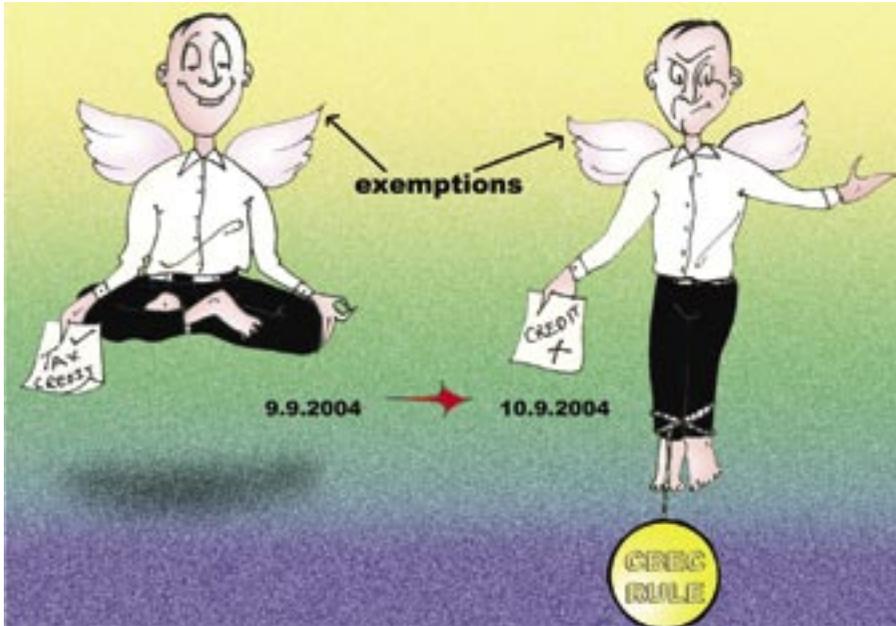
- Commercial & Industrial Construction service-Section 65 (105)(zzq)
- Consulting Engineer-Section 65 (105)(g)
- Foreign Exchange broker-Section 65 (105)(zzk)
- Erection, commissioning and installation agency-Section 65 (105)(zzd)
- Intellectual property service-Section 65 (105)(zzr)
- Interior Decorator-Section 65 (105)(q)
- Maintenance or repair-Section 65 (105)(zzg)
- Management Consultant -Section 65 (105)(r)
- Real Estate Agency-Section 65 (105)(v)
- Scientific or Technical Consultancy-Section 65 (105)(za)
- Security Agency-Section 65 (105)(w)
- Technical Testing & Analysis-Section 65 (105)(zzh)&(zzi)
- When an output service-provider is rendering taxable as well as exempted service and is not maintaining separate records of input services consumed for taxable as well as exempted services and is claiming exemption or abatement:  
In such circumstances an output service provider cannot avail the credit of duty available against the inputs and capital goods. However, he is entitled to utilise credit of Service Tax only to the extent of an amount not exceeding 20 per cent of the amount of



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- Scientific or Technical Consultancy-Section 65 (105)(za)
- Security Agency-Section 65 (105)(w)
- Technical Testing & Analysis-Section 65 (105)(zzh)&(zzi)
- When an output service provider is rendering only a taxable service and is enjoying the exemption where only a percentage of value of service becomes taxable and the service as such does not become exempted.

For an instance in case of a Commercial & Industrial Construction Service

an optional exemption of an amount of 67 per cent of the gross amount charged for construction service has been provided by the Notification No. 14/2004 - Service Tax dated 10.9.2004. In such a case the service rendered is taxable, though an optional exemption is available for the output service provider.

In such a situation the output service provider is entitled to claim entire available credit of Service Tax paid against input services. And the restriction as per clause 3(c) of Rule 6 of Cenvat Credit Rules does not apply.

Whereas, the situation would be different in the case of output service provider who is rendering only one taxable service, a part of which is exempted from whole of Service Tax by virtue of notifications. An example of which is Business Auxiliary Service.

To understand this situation let's take into consideration the service "Transportation of Goods by Road", and

notifications issued related to this service.

As per Notification No.32/2004 dated 3/12/2004 a service provider can enjoy optional exemption of 75 per cent subject to certain conditions. Further Notification No. 33 /2004 & 34/2004 dated 3/12/2004 exempts the taxable service provided by the service provider from the whole of Service Tax thereon.

Now in such a situation if the service provider avails the benefits of all the Notifications then the service provided by him as per Notification No.32/2004 dated 3/12/2004 is taxable service, whereas, service provided as per Notification No. 33 /2004 & 34/2004 dated 3/12/2004 is exempted service because as per Rule 2(e) "exempted services" means taxable services which are exempt from the whole of the Service Tax leviable thereon.

In such circumstances the output service provider can avail and utilise the credit of Service Tax paid against input services only to the extent of an amount not exceeding 20 per cent of the amount of Service Tax payable on taxable output service.

### Conclusion

The Exemption Notifications restrict the availment of credit of duty on inputs and capital goods and not of Service Tax paid against the consumption of input services. Therefore, credit of Service Tax on input services cannot be denied when exemptions are claimed, taking into consideration the language of Notifications and the provisions of Cenvat Credit Rules, 2004. □