Service Tax and Cenvat Credit— Interplay of Notifications

Every new law is generally based on the edifice of the earlier provisions. Service Tax Law is no exception. In view of the expanding net of Service Tax and the need to introduce compatible provisions for its compliance, the lawmakers need to bear in mind the basic purpose behind the levy of Service Tax. The notifications issued subsequently should necessarily be in harmony with the basic constitution and intention of the Service Tax Law. This article questions the validity of the source of the issue of two provisions, which, if implemented defeat the spirit of each other.

The Central Government, through Notification No. 1/2006 dated 1st March 2006, exempts much of the value of taxable services as it thinks fit according to clause 105 of section 65, of the Finance Act, subject to the conditions mentioned in the notification.

The proviso to the notification states that this notification shall not apply in cases where:

1. The Cenvat Credit of duty on inputs or capital goods or the Cenvat Credit of Service Tax on input services, used for providing such taxable service has been taken under the provisions of Cenvat Credit Rules 2004.

Or

2. The 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.

The Notification No. 12/2003 dated 20th June 2003 reads as follows:

1. In exercise of the powers conferred by section 93 of the Finance Act, 1994 (32 of 1994), the Central Government, being satisfied that it is necessary in the public interest so to do, hereby exempts so much of the value of all the taxable services, as is equal to the value of goods and materials sold by the service provider to the recipient of service, from the service tax leviable thereon under section (66) of the said Act, subject to condition that there is documentary proof specifically indicating the value of the said goods and materials.

2. This notification shall come into force on 1st July 2003.

If one goes carefully through the proviso mentioned in Notification No. 1/2006 dated 1st March 2006 read with Notification No. 12/2003 dated 20th June 2003 the intention of law is quite clear to exempt that part of the service contract which is represented by the supply of goods and materials during its execution. Further, taxable part of the service contract can be computed either by applying Notification No. 1/2006 (i.e. Deemed percentage) or by applying Notification No. 12/2003 (exact value of taxable service – by separate billing of services and materials involved).

The motive behind providing the Cenvat Credit is to grant rebate from service tax, which is necessarily based on the value of taxable services. Here, therefore, the value of goods and materials is to be excluded and proportionate Cenvat Credit is to be given for the service tax

— CA. Amita C. Bapat

(The author is a member of the Institute. She can be reached at amitabapat@yahoo.com)

payable which is computed on the value of services (after ignoring value of goods and materials involved).

Thus it is abundantly clear that only the value taxable services under the service tax law would attract the service tax.

Now the question is whether, when the taxable value of the services is deemed by taking a fixed percentage (by virtue of Notification No. 1/2006) or specific documentary evidence of goods and materials is available for exclusion from total contract value (by virtue of Notification No. 12/2003) the Cenvat Credit which can be attributable only to the value of such taxable services can be availed.

In short, the question stands as:

Whether one should avail the Cenvat Credit in relation to those taxable services, which are exclusive of the value of goods and materials sold during the execution of the service contract?

In view of the spirit behind the question, the answer should obviously be – YES.

The 'YES', does not put the assessee at undue advantage nor the revenue at prejudice.

Consider the following example where the assessee has some value of goods and materials sold during the execution of the service contract.

Here, the assessee cannot avail the Cenvat Credit because of the interplay of the proviso to Notification No. 1/2006. Alternatively, the assessee cannot avail the benefit of the said notification if he avails the Cenvat Credit.

This is because of the proviso at the end of Notification No. 1/2006, which states that the assessee cannot avail the benefit of notification if any of the two conditions mentioned in the proviso are satisfied.

That means the assessee cannot avail the Cenvat Credit or the benefit of Notification No. 12/2003 if he wants to avail the benefit of Notification No. 1/2006.

To keep intact the intention behind the Cenvat Credit Rules of 2004, the two conditions in the provision at the end of Notification No. 1/2006 dated 1st March 2006, should be given a go after reconsideration.

Whether one should avail the Cenvat Credit in relation to those taxable services, which are exclusive of the value of goods and materials sold during the execution of the service contract? In view of the spirit behind the question, the answer should obviously be – YES.

When two or more provisions of law are to be drafted, they should be such that they do not defeat the intention of each other.

Service Contract Value	Rs. 100,000/-
Value of goods or materials sold during the execution (by virtue of Notification No. 1/2006)	Rs. 40,000/- (deemed percentage)
Therefore taxable under service tax law	Rs. 60,000/-
Service Tax on above	Rs. 7344/- (60,000 X 12.24%)
Cenvat Credit available as per books	Rs. 7000/-
Cenvat Credit which should be available for set off against above liability of Rs. 7344/-	Rs. 4200/- (ie 60% of 7000/-)
Cenvat Credit allowed under Notification No. 1/2006	NIL