



CENVAT Credit Rules – Persisting Issues

R. Sridhar



Focus of the presentation

Show Stoppers

- ❑ Concept of Integration – Relook post “ Negative list based tax”
- ❑ Other regimes and whether comparison is correct –GST in India?
- ❑ Prayer of the Industry

- ❑ Key Issues of Industry– Inputs and Services
 - I. Credits attributable to Contract Packer Production
 - II. Transfer of production from one unit to another –Non 12 A
 - III. Credits for Sugar Cess – Not available to Industry – Impact
 - IV. Brand owners loss–When manufacture is done entirely by packers
 - V. Credits for Capital goods in the year of receipt –At par with inputs
 - VI. Other issues – Administrative issues

- ❑ Summary views



Concept of integration

- ❑ As long as Costs enter value stream credit to be allowed
- ❑ Relevant Extract from Press Release dated August 12, 2004

“In principle, credit of tax on those taxable services would be allowed that go to form a part of the assessable value on which excise duty is charged. This would include certain services which are received prior to commencement of manufacture but the value of which gets absorbed in the value of goods. As regards services received after the clearance of the goods from the factory, the credit would be extended on services received up to the stage of place of removal (as per section 4 of Central Excise Act). In addition to this, services like advertising, market research etc. which are not directly related to manufacture but are related to the sale of manufactured goods would also be permitted for credit”



Concept of integration Contd..

- ❑ Integration means fungibility of credits
- ❑ Interplay must be unrestricted between Goods and Services
- ❑ Concept is business oriented and not nexus focused
- ❑ Excludes standard Entertainment and Personal expenses
- ❑ Public Policy can prevent credits – Petroleum inputs



Show Stoppers – Integration

• Finance Ministers Speech (On Integration 2004 Budget 8 July 2004)

• “148. There remains the service tax. I propose to take a major step towards integrating the tax on goods and services. Accordingly, I propose to extend credit of service tax and excise duty across goods and services. In order to neutralize the revenue impact of such extension, and keeping in mind the mean Cenvat rate, I propose to enhance the rate of service tax from 8 per cent to 10 per cent.”

• Law at Present –Even after NL

I. Means portion

I. Includes portion

II. Excludes portion

III. Discretionary portion –
Explanation III in Rule 6



International Regimes - Integration- Comparable?

- ❑ Other International regime such as Australia and NZ, Singapore on GST -NZ is good regime -principal purpose test
- ❑ Federal Constitutions comparison -USA e.g. - are not on complete comparable basis
- ❑ We need solutions till GST interface as we will have steep change in credits
- ❑ Is the current regime indicative of the GST regime ?
- ❑ Will the GOI change its view for 2012-13 after law based on Negative lists taxation gets Presidential assent



Show Stoppers –What is needed – Prayer of Industry

Major Irritants

- ❑ Delete or remove Explanation III of Rule 6 and give no discretion to field force– In built already in Rule 2 , 3

Other Requests

- ❑ Complete integration as envisaged in 2004 Budget Speech
- ❑ Switch to Finance Act 2011 for Inputs but delete sub clause iv (B),
- ❑ Switch to pre -Finance Act 2011 for Services tax credits
- ❑ Provide for no Service tax credits on Entertainment , Beauty treatment only– Canteen Services , Outdoor catering cannot be denied
- ❑ Amend Section 14 AA(1)(a) of the Central Excise Act and prescribe normal limits and ratios



Industry Issues – Contract Packer production

Inputs

- ❑ Currently when inputs belonging to Brand owner is converted by a Contract Packer(CP) there is no erosion of credits on inputs – Noting on Invoice
- ❑ Credits linked to Finished Goods produced and set off allowed

Service Tax Credits

- ❑ Rule 7 embargo that distribution from HO or any other ISD only to “ its units”–Even after 2012 amendment
- ❑ Contract Packer cannot pay for Services expended for by Brand owner as the same is not his expenditure
- ❑ Service Invoice cannot be made as “ rendered for Contract packer Production”
- ❑ As most goods are taxed on MRP all costs including those relating to CP production are also included in Selling Price



Industry Issues – Transfer of production

Basic Issue

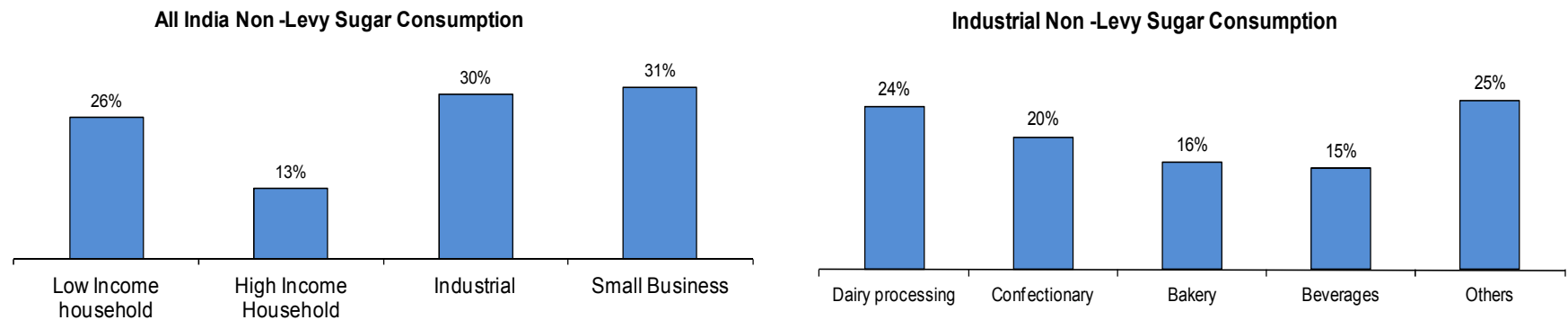
- ❑ Currently when production is transferred from one unit to another , credits are refused at transferee unit
- ❑ New Rule 10 A only part solution for SAD u/s 3(5) -Not all credits
- ❑ Duty paid at transferor unit at MRP mostly and Sec4 in few cases.

Associated issues

- ❑ Both units owned and controlled by one parent company
- ❑ Field force considers this as Trading activity
- ❑ LTU's not available in all field formations and hence 12 A not an answer
- ❑ Incremental expenses incurred at transferee units are also refused for credits as not manufactured in the transferee unit



Sugar Consumption pattern in India



Industrial consumption accounts for 30% of the sugar consumption

All India non-levy sugar consumption 2010-11– 18.2 MM MT

All India non-levy sugar consumption 2011-12E– 19.3 MM MT

Sugar production estimate Oct 2010-Sep 2011 – 24.4 MM MT

Sugar production estimate Oct 2011-Sep 2012E – 26 MM MT (Data from ISMA)

Industry Issues – Credit of Sugar Cess

Basic Issue

- ❑ Currently Sugar Cess is not Cenvatable and we are paying Rs 24 per quintal
- ❑ Credits set off not allowed and this has consequential effect .

Associated Issues

- ❑ VAT being levied in States like AP which have not put an embargo on credit on Sugar Cess
- ❑ ED Cess and SHE Cess also levied on Sugar Cess also Cenvatable
- ❑ View of Central Government as this leakage is cost to Industry
- ❑ No public policy issue involved in Sugar Cess issue and therefore denial of credit is unjustifiable.



Industry Issues – Brand Owners who produce entire goods through CP

Basic Issue

- ❑ Brand owned by one entity with no production facility
- ❑ Credits as regards its Services is exposed because transfer of Service Taxes not possible

Associated Issues

- ❑ Duty paid on MRP in food Industry and costs enter the value streams
- ❑ Net pricing not competitive and hence trade position
- ❑ View of Central Government as this leakage is cost to Industry
- ❑ Net effective credits to Industry is the principle and hence leakages in the chain need to be addressed



Industry Issues – Credits for Capital Goods in the year of receipt

Basic Issue

- ❑ Credits allowed in 2 installments– Not appropriate
- ❑ Capitalization happens in year one and net of Cenvat is the capitalized cost

Associated Issues

- ❑ Depreciation in year one on net of CENVAT amount
- ❑ Loss of time value of money on credits
- ❑ Unless GOI accepts , the States will not change as efforts are on to amend VAT provisions also
- ❑ Two year credits for CG affect capital intensive industries.



Numerical example to illustrate CG credit issue

Year I	
	Amount (Rs.)
Value of Capital Goods Purchased(say, inclusive of Excise duty of Rs. 10)	100
Total CENVAT Credit Accounted in Books at the time of acquisition (as available in two years i.e. 50% in the year of receipt plus balance 50% in subsequent year)	10 (5+5)
Amount Eligible for Depreciation under the Income Tax and Companies Act	90
CENVAT CREDIT AVAILED IN Excise Records in the first year	5
CENVAT CREDIT DEFERRED TO NEXT YEAR IN EXCISE	5
Year II	
CENVAT CREDIT Availed In Excise Records in the Second year	5



Industry Issues – Administrative

- ❑ Burden of Proof under Rule 9(5),(6) needs reconsideration
- ❑ Credits for Service Providers –Additional Duty of Customs u/s 3(5)
- ❑ Amendment of Sec11 A – Rule 9 of CCR – Prior period demands



Summary views

- ❑ Government should implement a integrated regime
- ❑ Need to enhance the scope of credit for selling assets
- ❑ Need to consult bodies on credit issues such as FICCI , ASSOCHAM,CII
- ❑ GOI must articulate what will be the GST credit profile
- ❑ GOI can mandate no litigation on credit eligibility
- ❑ Credit denial should be exceptional and not routine

