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Seminar on Key Latest Developments under Direct Taxes and Service Tax

Key issues under Cenvat Credit Rules

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KEY ISSUES UNDER CENVAT CREDIT RULES

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Restrictive cenvat credit regime

- Wef July 1, 2012 service tax is leviable on all services except those specified in the negative list
- However, several limitations and exceptions for availment of credit in respect of inputs & input services
- Credit on inputs and input services used for construction of civil structures for eg
  - factory, port, airport, pipeline, shopping malls, offices, etc

  not allowed
- Substantial / majority cost of these projects is the construction cost – why is credit not allowed???
- Is it not against the fundamental principle of cenvat credit – ie to avoid duplicity of taxes on the input as well as the output side

KEY ISSUES UNDER CENVAT CREDIT RULES

Restrictive cenvat credit regime

- Credit on cabs, catering services, etc not allowed
  - at times statutory requirement ;and
  - clearly essential for provision of services / running of the factory
- Deletion of the term “activities relating to business” makes it even more restrictive
- Moving towards GST – credit regime should be in line

KEY ISSUES UNDER CENVAT CREDIT RULES

Loss of service tax credit in case of job work

- Currently when inputs belonging to Brand Owner is converted by a job Worker there is no loss of credits on inputs
- Credit on inputs can be passed on to the job worker – bill to ship to mechanism, etc
- However, input service tax credit (like advertisement, brand name payments, etc) in the hands of the Brand Owner
  - no mechanism to pass the credit to the job worker

KEY ISSUES UNDER CENVAT CREDIT RULES

Unnecessary categorization as capital goods, inputs and input services

- Interpretative disputes vis a vis qualification as ‘input’, ‘input service’ and ‘capital goods’ and the restrictive interpretations adopted in this regard
- Half the litigation on this account only
- What is the need for such involved classification and complex definitions??
- Service tax is a value added tax; it is not a tax on the business and has to be borne by the ultimate consumers
- The ultimate objective of a value added tax should be to ensure a free flow of credit between various business entities
- As long as Costs enter value stream credit should be allowed
- Focus should be ‘cost nexus’ and not ‘physical or use nexus’

KEY ISSUES UNDER CENVAT CREDIT RULES

Unnecessary categorization as capital goods, inputs and input services

- The concept of 'value added tax' is elucidated in the International VAT / GST Guidelines issued by OECD
- Clearly point out that complete deductibility of input taxes is the key feature of value added taxes:

  "The full right to deduction of input tax through the supply chain, with the exception of the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain and the technical means used for its delivery..."

KEY ISSUES UNDER CENVAT CREDIT RULES

- Excess credits should be allowed as refund like under the VAT laws – leads to significant cash flow issues at times
- Capital goods – entire credit should be allowed in the year of receipt

KEY ISSUES UNDER CENVAT CREDIT RULES

Amendment in the manner of calculation of the credit to be reversed

Old provisions		*New provisions*
Proviso to Rule 3(5) – removal of capital good after use	**Replaced by**	Amended Rule 3(5A) – removal of capital good after use, whether as capital goods or waste and scrap
Rule 3(5A) – removal of capital good as waste and scrap		

Amended Rule 3(5A)

- In case of such removal the amount of CENVAT to be reversed / paid shall be:
  - CENVAT credit taken on the said capital goods as reduced by the prescribed percentage; *or*
  - Duty payable on transaction value;

whichever is *HIGHER*

KEY ISSUES UNDER CENVAT CREDIT RULES

- Reversal of credit on capital goods cleared, after use, as scrap
  - Only partial credit (10% per year) allowed as per formula
  - Assumes life of capital goods as 10 years
  - Many capital goods (for eg batteries, generators, etc) have a useful life of only 3 to 5 years
  - Such goods effectively get credit of only 30 to 50 percent

KEY ISSUES UNDER CENVAT CREDIT RULES

Anomaly in the definition of output service

- ‘Output service’ means any service provided by a service provider located in the taxable territory excluding service:
  - Specified in negative list; or
  - **On which whole of service tax is payable by service recipient**
- Credit available only on ‘input service’
- ‘Input service’ defined to mean any service

  “Used by a provider of output service for providing an ‘output service’…”
- In case whole of service tax is paid by service recipient (say, in case of a law firm where service tax is to be discharged by the recipient of service) will the credit be disallowed as the said service would not qualify as ‘output service’

KEY ISSUES UNDER CENVAT CREDIT RULES

Restriction on the distribution of service tax credit by an ISD

Rule 7

- Conditions imposed for an ISD to transfer input service tax credit to its units:
  - Credit distributed does not exceed the amount of service tax paid
  - Credit attributable to exclusive exempt unit shall not be distributed
  - Credit attributable to service used ***wholly*** in a unit shall be distributed ***only to that unit***; and
  - Credit attributable to service used in more than one unit shall be distributed ***pro-rata*** on the basis of the turnover of the concerned unit during the **relevant period**

New conditions

- Explanations inserted:
  - Explanation 1 – Unit to include premises of manufacturer / service provider
  - Explanation 3(a) – relevant period shall be the month previous to the month **during which the Cenvat Credit is distributed**

KEY ISSUES UNDER CENVAT CREDIT RULES

Restriction on the distribution of service tax credit by an ISD

Issues

- The above amendment has created hardship to all industries by creating many practical difficulties
- Not always possible to determine turnover for each premises on a monthly basis
- Proportionate turnover between exempt unit and taxable unit may vary from month to month
  - Credit to be distributed as per last month's turnover
  - Is the credit to be distributed every month – or can it be distributed for a block of months
  - If for last month entire turnover from taxable unit and no turnover from exempt unit; can entire credit (for a block of months) be distributed
  - This is subject to abuse and litigation

SPEAKER PROFILE

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- Abhishek is a Partner at BMR
- He has experience of over 12 years in indirect taxation during which he has been extensively involved in advising multinational and domestic companies across a range of sectors such as Infrastructure, Power, IT, FMCG, Financial Services, etc
- Abhishek has a rich, practical & varied experience in advising clients in the areas of Customs, Central Excise, VAT/CST, Service tax and Foreign Trade
- He has advised leading companies like General Electric, Cisco, ITC, Network 18, Coca Cola, Tupperware, Areva, Schneider, GSPL, Petronet LNG Limited, Abhijeet Group, etc
- He is a regular speaker at various industry forums including the Power Associations, ICAI, CII, etc and has published many articles to his credit
- In the realm of EPC contracts, he has been one of the key speaker for the Seminar organized by Infraline for the years 2006, 2007, 2008 , 2009, 2010 and 2011
- A Lawyer by qualification

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