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FCA, FCS, LLB, B. Com (Hons)

Dear Professional Colleague,

Scope of exempted services for reversal of Cenvat Credit under Rule 6 of the Credit Rules – Alarming Bell

The Union Budget 2016 has witnessed revamp changes in the Cenvat Credit Rules, 2004 (“**the Credit Rules**”) amongst many other changes brought in the arena of Indirect taxes. The Credit Rules has been streamlined with restructuring of Rule 6 of the Credit Rules to make it more cogent vide **Notification No. 13/2016 – CE (NT) dated March 1, 2016**, effective from April 1, 2016 (unless otherwise stated).

- Amendment in definition of ‘inputs’ [Rule 2(k)], to include all Capital goods having value up to Rs. 10,000 per piece, which in turn will enable an assessee to take 100% Cenvat credit immediately,
- Permitting distribution of Cenvat credit to outsourced manufacturing unit by ISD [Rule 7],
- Restricting application of reversal of Cenvat credit only on common inputs/input services [Rule 6] etc.

are some of the welcome changes brought by the Union Budget, 2016.

However, on flip side, in terms of proposed Explanation 3 to substituted Rule 6(1) of the Credit Rules, it has been provided that for the purpose of Rule 6 of the Credit Rules, ‘exempted services’ as defined in Rule 2(e) of the Credit Rules shall include an activity, which is not a ‘service’ as defined in Section 65B(44) of the Finance Act, 1994 (“**the Finance Act**”).

Further, proposed Explanation 4 to substituted Rule 6(1) of the Credit Rules, provides that value of such activity as specified above in Explanation 3, shall be the invoice/ agreement/ contract value and where such value is not available, such value shall be determined by using reasonable means consistent with the principles of valuation contained in the Finance Act and the Rules made thereunder.

The stated change has considerably extended the scope of exempted services for the purpose of Rule 6 of the Credit Rules, which is likely to have wide ramifications, if not dealt properly. It may not be out of place here to mention that the concept involving ‘exempted services’ assumes a great significance, from the point of view of Cenvat credit, as, Rule 6 of the Credit Rules mandates reversal of Cenvat credit in respect of common inputs and input services used in manufacturing of exempted goods and rendering of exempted services.

Meaning of ‘exempted services’ for Rule 6 of the Credit Rules – Present Vs. Proposed

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At the outset, it is imperative to understand the types of services presently covered under the scope of 'exempted services' under Rule 2(e) of the Credit Rules, viz-a viz proposed scope of 'exempted services', effective from April 1, 2016:

Exempted services for the purpose of Rule 6 of the Credit Rules	
Categories of services presently covered under Exempted services – Same as defined under Rule 2(e) of the Credit Rules	Categories of services proposed to be covered under Exempted services w.e.f. April 1, 2016 unless otherwise specified
Taxable service which is exempt from the whole of the Service tax leviable thereon	Taxable service which is exempt from the whole of the Service tax leviable thereon
Service, on which no Service tax is leviable under Section 66B of the Finance Act;	Service, on which no Service tax is leviable under Section 66B of the Finance Act;
Taxable service whose part of value is exempted on the condition that no credit of inputs and input services, used for providing such taxable service, shall be taken	Taxable service whose part of value is exempted on the condition that no credit of inputs and input services, used for providing such taxable service, shall be taken
--	An activity, which is not a 'service' as defined in Section 65B(44) of the Finance Act
But shall not include:	
Service which is exported in terms of Rule 6A of the Service Tax Rules, 1994	Service which is exported in terms of Rule 6A of the Service Tax Rules, 1994
	Service by way of transportation of goods by a vessel from customs station of clearance in India to a place outside India (w.e.f March 1, 2016)

Definition of 'service' under Section 65B(44) of the Finance Act

In terms of Section 65B(44) of the Finance Act, *inter alia*, any activity carried out by a person for another for consideration is a service and includes a Declared services defined under Section 66E of Finance Act. Further, the definition of 'service' as provided in Section 65B(44) of the Finance Act specifically excludes following activities, which would not be considered as service:

- (a) An activity which constitutes merely,—
- (i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or
 - (ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution; or
 - (iii) a transaction in money or actionable claim;

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- (b) A provision of service by an employee to the employer in the course of or in relation to his employment;
- (c) Fees taken in any Court or tribunal established under any law for the time being in force.

Considering an activity as 'exempted service' which is not even a 'service' - Looks illogical

Foremost, it is to be noted here is that the proposed Explanation 3 is applicable only for the purpose of Rule 6 of the Credit Rules and there is no corresponding amendment in the definition of 'exempted service' under Rule 2(e) thereof. Therefore, Rule 6 of the Credit Rules will now be applicable for the service providers undertaking activities not falling under the ambit of term 'service' also.

As per normal understanding in common parlance, an activity has to be a service first and thereafter parameters can be set to decide whether a service is exempted service or not. Ironically, if an activity is not 'service' within the four corners of the Finance Act, considering the same as 'exempted service' for the purpose of Rule 6 of the Credit Rules, appears way far from logical senses of the law makers.

Any activity which is not 'service' can be anything – Wide interpretation likely to create divergent views

Bare perusal of proposed Explanation 3 to the substituted Rule 6(1) of the Credit Rules, reveals that for the purpose of Rule 6 of the Rules, 'exempted services' as defined in Rule 2(e) of the Credit Rules shall include an activity, which is not a 'service' in terms of Section 65B(44) of the Finance Act.

There can be 'n' number of activities which are not service in terms of Section 65B(44) of the Finance Act, but does not mean that the same can be termed as 'exempted service' for invoking provisions of reversal of Cenvat credit under Rule 6 of the Credit Rules.

Moreover, extending the scope of exempted services for the purpose of Rule 6 of the Credit Rules to all the activities not falling under the purview of 'service' is likely to open a Pandora box, if intent of the proposed Explanation is not clarified properly with certain restrictions to its applicability. Some of the issues are enumerated as under:

- **Activities not for consideration**– In terms of Section 65B(44) of the Finance Act, if an activity is not carried out for consideration, the same would fall outside the scope of 'service' and hence no Service tax would be exigible. Now, with the proposed Explanation 3 to substituted Rule 6(1) of the Credit Rules, awaiting its advent from April 1, 2016, whether reversal would also be required for such activities? Logically, the answer may be no, but clarity on this aspect is required;

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- **Activities specifically excluded from the scope of 'service'** – Further, there are certain activities enumerated in Section 65B(44) of the Finance Act, which have been kept outside the scope of 'service' and hence not leviable to Service tax (supra). For example – a person engaged in real estate sector selling two types of units – Units which are sold after completion certificate and Units which are sold before completion certificate. Sale of units after completion certificate tantamount as sale and thus not covered within the purview of 'service'. Presently, such sale is not covered under the ambit of exempted service and thus implications of Rule 6 of the Credit Rules do not arise. However, w.e.f April 1, 2016, reversal as prescribed under Rule 6 of the Credit Rules would become applicable.

In the nutshell:

Albeit, the Union Budget 2016 has attempted to reduce the complexities of Rule 6 of the Credit Rules to make the provisions simpler, but other side of the coin, which proposes to invoke provisions of reversal of common Cenvat credit for any activity not falling under the term 'service', by treating the same as exempted service for the purposes of Rule 6 of the Credit Rules, are likely to raise serious concerns if the matter is not clarified prior to April 1, 2016.

Hope the information will assist you in your Professional endeavours. In case of any query/ information, please do not hesitate to write back to us.

Thanks & Best Regards

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