Kudos to those behind Notification 3/2011 CE (NT) Dated 01.03.2011

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Of all the budget amendments who were behind amending the Cenvat Credit Rules, 2004 deserve kudos for their meticulous planning, though many of the amendments may be to the detriment of the trade. Let us see the important amendments made in the Cenvat Credit Rules, 2004, vide Notification 3/2011 CE (NT).

Definition of "capital goods"

Capital goods used outside the factory for generation of electricity for captive use within the factory are also covered in the definition of capital goods. Off course, only 50 % credit can be taken in the first year as usual. In many cases, part of the power generated is sold to the Power Grid and the remaining power is used captively. In such case, in so far as the capital goods used partly for manufacture of dutiable goods and partly for manufacture of exempted goods are also allowed with full credit, the requirement of captive use within the factory may pose interpretational problems. Further, if the power is not generated in a captive power plant, but in a power plant situated elsewhere then in the factory and the power thus generated is supplied to the State grid and equivalent amount of power is drawn at the manufacturing premises, credit in respect of such capital goods, may be denied by strictly interpreting the above definition, which would not have been the intention. (This amendment is effective from 01.04.2011)

Definition of "exempted services.

The definition of exempted services would also include those services for which any abatement is claimed with a condition of non availment of cenvat credit on inputs / input services (Ex. Notification 1/2006 ST Dated 01.03.2006).

Effective of this amendment would be :

(i) If the option of payment of 5 % (now reduced from 6 %) on exempted services is opted under Rule 6 of the Cenvat Credit Rules, the 5 % amount shall also be calculated on 67 % of the value of such services. So far such services were treated as taxable services.

(ii) If the option of reversal of proportionate credit is opted, the value of such service (please note entire value of such service and not 67 % of value) shall be treated as value of exempted services, for the purposes of the formula.

Trading is also made an exempted services. But the value of trading will only be the margin, i.e. difference between the cost price and selling price. The effect of this amendment would be similar to the above.

(These amendments are effective from 01.04.2011)

Definition of "inputs".

Definition of the term "inputs" has been thoroughly revamped.

- The requirement of used in or in relation to manufacture has been done away with and simplified as all goods used in the factory by the manufacturer of the final product.
- Goods procured for being used in free warranty period are declared as inputs. It has also been provided that when such inputs are cleared for being used in warranty service, it will not be treated as a clearance of inputs "as such" and hence there is no requirement of reversal of credit.
- All goods used for generation of electricity or steam for captive use. Again, if inputs are used in a far away electricity generation plant – credit may be denied by a strict interpretation of the provision.
- All goods used for providing any output service.
- Any goods used for construction of a building or a civil structure or part thereof of for laying foundation or making structure for capital goods are not inputs, except for service providers under the categories of Port services (major and other ports), airport services, commercial or industrial construction service, construction of residential complex service, and works contract service.
- Items which are covered under the definition of capital goods, cannot be claimed to be inputs, except when they are used as parts or components of the final products manufactured.
- Motor vehicles are also not inputs.
- Goods meant primarily for personal use of employees, such as food items, goods used in residential colony, club or recreation facility, guesthouse, etc.
- Any goods which have no nexus whatsoever with the manufacture o final products.

The above changes would go a long way in mitigating the litigation arising on the ground of interpretation of the term "inputs".

(These amendments are effective from 01.04.2011)

Definition of "input service.

Similarly, the definition of input service has also been thoroughly revamped.

- Services relating to setting up of factory of premises of output services are not input services.

- Activities relating to business are not input services.

- The following services are not input services, if they are used for construction of a building or civil structure or part thereof, or for laying of foundation or making of structures of capital goods, except when they are used for providing output services of same category (sub contracting). The services are, architect, Port services (major and other ports), airport services, commercial or industrial construction service, construction of residential complex service and works contract service. To elaborate, if a manufacturer is constructing a factory building and avail these services, he cannot take cenvat credit for these services. But, when a construction service provider avails the services of an architect, he can take credit of service tax paid by the architect.

- Since motor vehicles are not capital goods (except for those few categories of service providers for whom motor vehicles are declared as capital goods), the following services availed in respect of such motor vehicles are also not input services. The services are, insurance, rent a cab operator, authorised service station, supply of tangible goods. Motor vehicles are eligible capital goods for courier agency, tour operator, rent a cab operator, cargo handling agency, goods transport agency, outdoor caterer and pandal / shamiana contractor.

- The following services are specifically declared as not eligible for cenvat credit. Outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health club and fitness center, life insurance, health insurance and travel benefits extended to employees on vacation such as eave or home travel concession, when such services are used primarily used for the personal use of employees. Bulk of the disputes on cenvat credit enticement on various input services is thus put to rest. It may be noted

(These amendments are effective from 01.04.2011)

For those goods, for which 1 % duty has been prescribed now, no cenvat credit shall be taken. Similarly, the cenvat credit otherwise entitled shall not be utilised for payment of this 1 % duty. These amendments are effective from 01.03.2011.

Earlier, cenvat credit has to be reversed / repaid, only when the value of any inputs are capital goods are written off “fully”. Now even for any partial write off, the credit (full credit) has to be reversed. This amendment is effective from 01.04.2011.

If the service provider of any input service reduces his value of taxable service and if any part amount is refunded by him, the cenvat credit availed on such input service shall also be proportionately reversed. Will the government automatically grant refund of excess service tax paid, to the service provider? This amendment is effective from 01.04.2011.

Amendments in Rule 6.

Rule 6 is already a complex and the present amendments would add further to it.

- As against the option of paying 6 % on value of exempted services, the quantum is reduced to 5 %.

- If maintenance of separate records is feasible for inputs and not for input services, a manufacturer or service provider can maintain such separate records for inputs and go for formula based reversal only for input services.

- Banking companies have been given an easy option of reversing 50 % credit availed every month, instead of going through the rigmarole of formulae. Similarly insurance service providers relating to life insuance have been given an option of paying 20 % of such credit every month.

- Another important and thought provoking amendment in Rule 6 is relating toe definition of value for cases of service providers who opted for composition schemes of payment of service tax, which is available for Air travel agents, forex broking, lottery promotion and works contract. We will take the case of works contract service, to explain this amendment. For example a servie provider, apart from providing other taxable and exempted services, has also provided works contract service and opted for composition scheme (value Rs.10,00,000). Earlier, this amount of Rs.10,00,000 will be treated as the value of taxable service and this service will be treated as taxable service for the purpose of application of the formula under Rule 6. Now. The value of such service will be considered as Rs.4,00,000 (i.e. the amount of Rs.40,000 paid by him as service tax, would be corresponding to a value of Rs.4,00,000 by adoption of the general service tax rate of 10 %). This amendment has been made on the ground that since a lesser composition rate has been prescribed without the benefit of cenvat credit (either completely or partly), considering the entire value as value of taxable service, would vitiate the requirement under Rule 6.

The following comprehensive example will further explain the position.

		Application of Rule 6 Formula Before Amendment	Application of Rule 6 formula After Amendment
Value of taxable service on which service tax has bee paid @ 10.3 % without any exemption	Rs.10,00,000 (A)	CEnvat Credit Taken X Value of exempted services / Value of taxable and exempted services. Cenvat Credit taken X Rs.10,00,000 (D) / Rs.40,00,000 (A) + (B) +(C) + (D)	Cenvat Credit Taken X Value of exempted services / Value of taxable and exempted services. Cenvat Credit taken X Rs.10,00,000 (A) + Rs.10,00,000 (B) / Rs.34,00,000 (A) + (B) +(C – Rs.4,00,000) + (D)
Value of taxable service on which 67 % abatment has been claimed and service tax @ 10% paid on 33 %	Rs.10,00,000 (B)		
Value of taxable service of works contract, on which service tax @ 4 % has been paid under composition scheme.	Rs.10,00,000 (C)		
Value of service on which no service tax is payable	Rs.10,00,000 (D)		

This is where the best brains of the North Block has worked. When the benefit of abatment of given for a service with non availment of cenvat credit as a pre condition, there is no reason as to why such service has to be treated as a taxable service for the purposes of Rule 6. If any common input services credit have been taken, a proportion of such credit attributable to the value of such service for which abatement is claimed shall also be reversed. Similarly, when a lower rate of tax has been prescribed under a composition scheme, it is appropriate to consider only a corresponding value as the value of taxable service and not the entire value.

(These amendments are effective from 01.04.2011)

Once again, kudos to the brains behind this Notification.