Rule 6 Roller coaster

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1.0 Substantial amendments have been made in Rule 6 of the Cenvat Credit Rules, 2004 vide Notification 3/2011 CE NT Dated 01.03.2011. In this article an attempt has been made to explain the effect of such amendments.

2.0 The heading of the rule has been simplified as "Obligation of a manufacturer or producer of final products and a provider of taxable service" as against "Obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services".

3.0 As per sub rule (1) of Rule 6, no Cenvat credit shall not be allowed in respect of any inputs or input services which are used in the manufacture of exempted goods or for providing exempted services, except as provided for in the said rule. The existing provision of the said rule and the amended provision are tabulated below.

Existing Rule 6 (1)	Amended Rule 6 (1)
The CENVAT credit shall not be allowed on such quantity of input or input service which is used in the manufacture of exempted goods or for provision of exempted services, except in the circumstances mentioned in sub-rule (2).	The CENVAT credit shall not be allowed on such quantity of input used in or in relation to the manufacture of exempted goods or for provision of exempted services, or input service used in or in relation to the manufacture of exempted goods and their clearance upto the place of removal or for provision of exempted services, except in the circumstances mentioned in sub-rule (2).

3.1 **Effect of this amendment:** As a result of this amendment, it cannot be argued that input services used in the manufacture of exempted goods alone are prohibited and not input services relating to clearance of such exempted goods upto their place of removal.

4.0 Sub rule (2) of Rule 6 provides that a manufacturer or provider of service can maintain separate records with regard to inputs and input services and their consumption in dutiable activities and exempted activities and take credit only to the extent they are used in relation to dutiable activity. While maintenance of such separate records may be possible for inputs, it is hardly possible for input services, making this provision otiose. Hence, the existing sub rule (2) has been substituted with a new sub rule (2). The existing provision of the said rule and the amended provision are tabulated below.

Existing Rule 6 (2)	Amended Rule 6 (2)
Where a manufacturer or provider of output service avails of CENVAT credit in respect of any inputs or input services, and manufactures such final products or provides such output service which are chargeable to duty or tax as well as	Where a manufacturer or provider of output service avails of CENVAT credit in respect of any inputs or input services and manufactures such final products or provides such output service which are chargeable to duty or tax as well as

exempted goods or services, then, the manufacturer or provider of output service shall maintain separate accounts for receipt, consumption and inventory of input and input service meant for use in the manufacture of dutiable final products or in providing output service and the quantity of input meant for use in the manufacture of exempted goods or services and take CENVAT credit only on that quantity of input or input service which is intended for use in the manufacture of dutiable goods or in providing output service on which service tax is payable.	exempted goods or services, then, the manufacturer or provider of output service shall maintain separate accounts for- (a) the receipt, consumption and inventory of inputs used- (i) in or in relation to the manufacture of exempted goods; (ii) in or in relation to the manufacture of dutiable final products excluding exempted goods; (iii) for the provision of exempted services; (iv) for the provision of output services excluding exempted services; and (b) the receipt and use of input services- (i) in or in relation to the manufacture of exempted goods and their clearance upto the place of removal; (ii) in or in relation to the manufacture of dutiable final products, excluding exempted goods, and their clearance upto the place of removal; (iii) for the provision of exempted services; and (iv) for the provision of output services excluding exempted services, and shall take CENVAT credit only on inputs under sub-clauses (ii) and (iv) of clause (a) and input services under sub-clauses (ii) and (iv) of clause (b).”

4.1 **Effect of this amendment :** This amendment, read with corresponding amendments elsewhere, enables a manufacturer or service provider to maintain such separate records either only for inputs or for both inputs and input services. In other words, a manufacturer or service provider can maintain such separate records only for the inputs and in respect of input services, they can opt for proportionate reversal, which was not hitherto possible. Once such separate records are maintained with regard to inputs, credit pertaining to the manufacture of dutiable final products and rendering of taxable services can be taken. Similarly if such separate records are maintained with regard to input services, credit pertaining to manufacture of dutiable final products and their clearance upto the place of removal and rendering of taxable services can be taken.

5.0 As per sub rule (3) of Rule 6, two options are provided to the manufacturers and service providers who have opted not to maintain separate records as envisaged in sub rule (2), which can be chosen by them. The first option is paying 5 % of the value of the exempted goods. With regard to services, the amount payable was 6 % on the value of exempted services, which is now being reduced to 5 %. The

second option is proportionate reversal of Cenvat credit attributable to the exempted activities, as per the formula prescribed in sub rule (3A). Now a third option is also provided, whereby one can opt to maintain separate records only for inputs and reverse proportionate credit for input services.

6.0 At this stage, it is necessary to refer to the amendments made in the definition of the terms "exempted goods" and "exempted services".

6.1 The pre existing and amended definitions are tabulated below.

Term	Before Amendment	After amendment
Exempted goods.	"exempted goods" means excisable goods which are exempt from the whole of the duty of excise leviable thereon, and includes goods which are chargeable to "Nil" rate of duty.	"exempted goods" means excisable goods which are exempt from the whole of the duty of excise leviable thereon, and includes goods which are chargeable to "Nil" rate of duty and goods in respect of which the benefit of an exemption under notification No. 1/2011-CE, dated the 1st March, 2011 is availed" shall be inserted with effect from the 1st day of March, 2011.
Exempted services	"exempted services" means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act;	"exempted services" means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act and taxable services 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. *Explanation.-* For the removal of doubts, it is hereby clarified that "exempted services" includes trading".

6.2 **Effect of these amendments:** In the budget, exemption from excise duty on around 130 goods has been withdrawn and an optional duty of 1 % has been prescribed with a condition of non availment of Cenvat credit. Such goods are also declared as exempted goods, so that the intention of denying proportionate credit attributable to such goods can be achieved. Since this levy is effective from 1st March 2011, this amendment is also effective from 1st March 2011.

6.3 In the definition of exempted services, services on which benefit of abatement are claimed have also been included. It may be noted that those services whose part of the value is exempted from payment of service tax on the condition of non availment of credit on inputs and input services are declared as exempted services. Notification 1/2006 ST provides for such exemption for various services and if the benefit of the abatements prescribed under the said notification are claimed such services shall be treated as exempted services, for the purpose of computation of proportionate credit to be reversed as per the formula under sub rule (3A). It may be noted that the entire value of such service shall be treated as value of such exempted service and not only the portion of value so exempted.

6.4 For example, if a service provider has provided erection, commissioning and installation service for a total value of Rs.10,00,000 and claimed 67 % abatement under Notification 1/2006 and paid service tax on Rs.3,30,000, the value of Rs.10,00,000 shall be the value of exempted services, for the purposes of formula under sub rule (3A). This is justified on the ground that a person has been permitted to pay service tax only on a lesser value, with a total prohibition of availment of Cenvat credit and hence the proportion of Cenvat credit pertaining to the entire value shall be disentitled. On the other hand, when the option of payment of 5 % on exempted services was opted by a person, such 5 % shall be paid only on the value so exempted (i.e. Rs.6,70,000 in the given example), as service tax at appropriate rate has been paid on the remaining value. So thoughtful amendment indeed!

6.5 It may also be noted services where a portion of value is exempted with condition of non availment of Cenvat credit on inputs and input services alone are treated as exempted services. Notification 12/2003 ST also provides for exemption for portion a value representing sale of goods. But under this notification, availment of Cenvat credit on input services is not barred and only inputs are barred. Hence, taxable services for which the benefit of Notification 12/2003 has been claimed could not be treated as exempted services for the purposes of this rule.

6.6 Trading is also made an exempted service for the purpose of this rule.

6.7 If a person has opted for maintenance of separate records for inputs, the proportionate reversal of credit shall be applicable only in respect of input services.

7.0 Explanation II under sub rule (3) has been substituted and the pre amended version and amended version are tabulated below:

Existing Explanation II	**Amended Explanation II**
For removal of doubt, it is hereby clarified that the credit shall not be allowed on inputs and input services used exclusively for the manufacture of exempted goods or provision of exempted service.	For removal of doubt, it is hereby clarified that the credit shall not be allowed on inputs used exclusively in or in relation to the manufacture of exempted goods or for provision of exempted services and on input services used exclusively in or in relation to the manufacture of exempted goods and their clearance upto the place of removal or for provision of exempted

	services.

7.1 **Effect of this amendment :** The intention of the provision has been abundantly clear to cover services pertaining to clearance of exempted goods upto their place of removal also.

8.0 A new Explanation III has been added, which reads as below:

Explanation III. - No CENVAT credit shall be taken on the duty or tax paid on any goods and services that are not inputs or input services.

8.1 **Effect of this amendment :** It has been made clear that the fact proportionate credit would be reversed to the extent the same is not entitled, would not make any person eligible to take any credit of duties and taxes paid on those goods and services which would not satisfy the definition of inputs and input services. Though as per Rule 3 credit can be taken only if the goods and services satisfy the definition of inputs and input services respectively, this Explanation seems to be an abundant precautionary measure against any interpretational warfare.

9.0 Amendments in Sub Rule (3A) dealing with formulae for reversal of credit.

9.1 While calculating the quantum of input services credit to be reversed for exempted goods, such credit relating not only to the manufacture of such exempted goods, but also the credit attributable to clearance of such exempted goods to their place of removal shall be calculated and reversed.

9.2 Explanations I, II and III under the said rule are deleted and this is of no consequence, as they are introduced elsewhere, with amendments.

9.3 Instead of going through the rigmaroles of the formula, a simple option of reversing 50 % credit availed every month has been prescribed for service providers under the category of banking and other financial services vide sub rule (3B). Similarly, a simple option of reversing 20 % credit availed every month has been prescribed for service providers under the category of life insurance services, under sub rule (3C).

9.4 A new sub rule (3D) has been introduced according to which payments of amounts under any of the options under sub rule (3) would amount to non availment of Cenvat credit, so that the exemptions availed subject to condition of non availment of Cenvat credit could not be denied. In other words, the ratio of the celebrated decision of the Hon'ble Apex Court in Chandrapur Magnet case has been explicitly recognized.

9.5 The Explanations omitted under sub rule (3A) have been placed under sub rule (3D), with certain amendments. The pre amended and amended Explanations are tabulated below:

	Prior to amendment	After Amendment
Explanation I	"Value" for the purpose of sub-rules (3) and (3A) shall have the same meaning assigned to it under section	"Value" for the purpose of sub-rules (3) and (3A),- **(a)** shall have the same meaning as assigned to it

	67 of the Finance Act, 1994 read with rules made thereunder or, as the case may be, the value determined under section 4 or 4A of the Central Excise Act, 1944 read with rules made thereunder.	under section 67 of the Finance Act, read with rules made there under or, as the case may be, the value determined under section 3, 4 or 4A of the Excise Act, read with rules made thereunder. **(b)** in the case of a taxable service, when the option available under sub-rules (7), (7B) or (7C) of rule 6 of the Service Tax Rules, 1994, or the Works Contract (Composition Scheme for payment of Service Tax) Rules, 2007 has been availed, shall be the value on which the rate of service tax under section 66 of the Finance Act, read with an exemption notification, if any, relating to such rate, when applied for calculation of service tax results in the same amount of tax as calculated under the option availed; or **(c)** in case of trading, shall be the difference between the sale price and the purchase price of the goods traded.
Explanation II	The amount mentioned in sub-rules (3) and (3A), unless specified otherwise, shall be paid by the manufacturer of goods or the provider of output service by debiting the CENVAT credit or otherwise on or before the 5th day of the following month except for the month of March, when such payment shall be made on or before the 31st day of the month of March	The amount mentioned in sub-rules (3), (3A), (3B) and (3C), unless specified otherwise, shall be paid by the manufacturer of goods or the provider of output service by debiting the CENVAT credit or otherwise on or before the 5th day of the following month except for the month of March, when such payment shall be made on or before the 31st day of the month of March.
Explanation III	If the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rule (3) or as the case may be sub-rule (3A), it shall be recovered, in the manner as provided in rule 14, for recovery of CENVAT	If the manufacturer of goods or the provider of output service fails to pay the amount payable under sub-rule (3), (3A), (3B) and (3C), it shall be recovered, in the manner as provided in rule 14, for recovery of CENVAT credit wrongly

	credit wrongly taken.	taken.

9.6 **Effect of the amendment in Explanation I** : In many cases of taxable services a lesser rate of service tax has been prescribed on composition basis. For example, on works contracts, service tax can be paid @ 4 % on the gross amount as per the relevant rules {Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007} The said rules prohibit availment of Cenvat credit on inputs if composition scheme is opted. Similar compositions schemes are also available under sub Rules (7), (7B) ad (7C) of Rule 6 of the Service Tax Rules, 1994 for air travel agent, forex broking and lottery promotion services. These services are not considered as exempted services for the purposes of Rule 6 of the CCR, 2004. But service tax is paid only at a lower rate on these services on the total amount. Hence if the entire value of such services is treated as value of taxable services, it will lead to allowing more credit. As per the formulae under sub rule (3A), the credit to be reversed would be in proportion to value of exempted goods and services to the value of both dutiable goods and exempted goods and taxable and exempted services.

9.7 Let us taken an example for better understanding.

Credit taken in a month : Rs,10,00,000

Value of exempted goods : Rs.25,00,000

Value of dutiable goods : Rs.75,00,000

Value of taxable services : Rs.50,00,000

(which also includes value of Rs.10,00,000 on Works Contract service, for which service tax was paid under composition scheme).

Value of exempted services : Rs.25,00,000

Prior to this amendment, the credit to be reversed would be

$$\text{Rs.10,00,000} \times \frac{\text{Rs.25,00,000} + \text{Rs.25,00,000}}{\text{Rs.25,00,000} + \text{Rs.75,00,000} + \text{Rs.50,00,000} + \text{Rs.25,00,000}} = \text{Rs. 2,85,714.}$$

9.8 The present amendment requires that in case of the service for which the composition scheme is opted, the value shall the actual service tax paid under composition, converted into corresponding value, by applying the standard rate of service tax. In the given example, on a value of Rs.10,00,000 service tax of Rs.40000 has been paid @ 4 % (Education CESS, etc. ignored for ease of understanding). At the standard rate of 10 %, this service tax of Rs.40,000 will correspond to a value of

Rs.4,00,000. So, only Rs.4,00,000 will be considered as the value of this taxable service, for the purpose of the formula. Hence, the credit to be reversed would be

$$\text{Rs.10,00,000} \times \frac{\text{Rs.25,00,000} + \text{Rs.25,00,000}}{\text{Rs.25,00,000} + \text{Rs.75,00,000} + \text{Rs.44,00,000} + \text{Rs.25,00,000}} = \text{Rs. 2,95,858.}$$

Another thoughtful amendment indeed!!

9.9 Trading is specifically made as an exempted service. But only the difference between the purchase price and selling price alone would be the value of such exempted service, for the purpose of application of payment of 5 % or calculation of proportionate credit.

9.8 **Effect of the amendments in Explanation II & III:** No substantial effect, except accommodating sub rules (3B) and (3C).

9.9 A new Explanation IV has been introduced to allow quarterly payment by those manufacturers availing small scale exemption and individual and proprietary service providers.

10.0 Sub Rule (5) of Rule 6 has given special treatment to 16 input services and full credit on these services were allowed, though they were commonly used in both dutiable and exempted activities. This sub rule has been omitted and no more protection for these services.

11.0 A new sub rule (6) has been introduced whereby the provisions of sub rules (1), (2) (3) and (4) would not at all be applicable if the services are provided to SEZ developers and SEZ units and exempted. While protection of credit for supply of goods without payment of duty to SEZ developers and units was already available, similar protection was not hitherto available to service providers, which is now being remedied.

Lo and behold and that is what the amendments in Rule 6 are all about.