CENVAT: A Fresh Perspective

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In the process of manufacture or provision of service, the Manufacturer or Service Provider uses numerous inputs, both in form of goods and services. Some of these goods had been classified as Inputs and others as Capital Goods. However, till now, there was a third category of goods which did not fall under any of the two categories mentioned above, yet, output tax was paid on their manufacture or provision of service but without any corresponding credit to the buyer. The following article discusses that a combined reading of the amended definitions under Cenvat Credit Rules, 2004 with the relevant circular dated 29th April,2004 would entitle admissibility of CENVAT credit on Furniture, Stationery and many other items of similar nature which were hitherto neither covered under Capital Goods definition nor Input definition."

1. Introduction

1.1. The Government of India has amended the definitions of Input and Input Service as defined under Rules 2 (k) and 2(l) respectively of the Cenvat Credit Rules, 2004 vide Notification No. 3/2011-CE(NT) dated 1st March,2006. The following article deals with the history of the CENVAT credit, the recent amendments and their impact.

2. History

2.1. Excise Duty in India traces its history back to 1889 when the Salt, Abkari and Customs departments were together. With the passage of time, new Acts came into effect. However, one shortcoming persisted – Cascading of taxes commonly known as Double Taxation. It is a situation wherein, taxes are paid on taxes already paid. To remove this limitation, the Government of India introduced the concept of providing credit of taxes on goods used in manufacture. The Government materialised the concept by bringing Proforma Credit Scheme wherein, credit was provided for taxes paid on goods used as input in manufacture. This ensured that taxes paid on inputs were given credit and thus, no taxes were levied on such input taxes. However, this scheme suffered from a deficiency as it allowed credit of only those inputs which were used in manufacture of finished goods falling under the same tariff entry.

2.2. Since the benefit of Proforma Credit Scheme was very limited and did not completely tackle the main concern i.e. the double taxation problem, the Government of India introduced Modified Value Addition Tax Scheme (MODVAT Scheme) in 1986. The original MODVAT Scheme did not provide for credit of taxes paid on Capital Goods however, it was later amended to provide such credit of taxes on Capital Goods also. As far as tax credit on Inputs was concerned, Rule 57 of the MODVAT Scheme was much wider as compared to Proforma Credit Scheme. However, the MODVAT Scheme had its own limitations as it was theoretically sound but had difficulties in its practical application. The Scheme had burdensome compliance procedures and formalities and thus, was not Assessee friendly.

2.3. With a view to eradicate the problems encountered so far, the Government of India introduced The CENVAT Scheme 2002, which was later replaced by the CENVAT Scheme 2004. The CENVAT Scheme is Assessee friendly and allows the Assessee on his own, to avail credit of taxes paid on Inputs, Input Services and Capital Goods used in manufacture, without intimating/declaring to the Department every time it is availed, provided he could prove that such Inputs, Input Services and Capital Goods were used in manufacture. This reduced the burden of compliance on the Assessee resulting in cost and time saving.

3. Amendments

3.1. With a view to further widen the scope of Inputs under CENVAT Scheme, the Government of India in Budget 2011, amended the definition of 'Input' as defined under Rule 2 (k) of the Cenvat Credit Rules, 2004 vide Notification No. 3/2011-CE (NT) dated 1st March,2011. The following is a comparison between the definition of Input prior to its amendment and post amendment.

Input Rule 2(k) PRE-AMENDEDMENT	**Input Rule 2(k) POST-AMENDEDMENT**
"Input" means - all goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, used in or in relation to the manufacture of final product whether directly or indirectly and whether contained in the final product or not and includes lubricating oils, greases, cutting oils, coolants, accessories of final products cleared alongwith final product, goods used as paints, or as packing material, or as fuel, or for generation of electricity or steam used in or in relation to manufacture of final products or for any other purpose, within factory of	"Input" means - all goods used in the factory by the manufacturer of the final product; or any goods including accessories, cleared along with final product, the value of which is included in the value of the final product and goods used for providing free warranty for final products; or all goods used for generation of electricity or steam for captive use; or all goods used for providing output any service; but excludes- light diesel oil, high speed diesel oil, or motor spirit, commonly known as

production;	petrol;
all goods, except light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol and motor vehicles used for providing output service;	any goods used for-
Explanation 1.- The light diesel oil, high speed diesel oil and motor spirit, commonly known as petrol, shall not be treated as an input for any purpose whatsoever.	construction of a building or a civil structure or a part thereof; or
Explanation 2.- Input includes goods used in manufacture of capital goods which are further used in the factory of the manufacturer; but shall not include cement, angles, channels, Centrally Twisted Deform bar (CTD) or Thermo Mechanically Treated bar (TMT) and other items for construction of factory shed, building or laying of foundation or making structure for support of capital goods.	laying of foundation or making of structure for specified in Sub-clauses (zn), (zzl), (zzm), (zzq), (zzzh) and (zzzza) of Clause (105) of Section 65 of the Finance Act;
	capital goods except when used as parts or components in the manufacture of a final product;
	motor vehicles;
	any goods, such as food items, goods used in a guesthouse, residential colony, club or a recreation facility and clinical establishment, when such goods are used primarily for personal use or consumption of any employee; and
	any goods which have no relation whatsoever with the manufacture of a final product.
	Explanation .- For the purpose of this clause, "free warranty" means a warranty provided by the manufacturer, the value of which is included in the price of the final product and is not charged separately from the customer.

3.2. From a plain reading of the amended definition, it can be observed that the scope of Input has been widened. The new definition enables the manufacturer to avail credit of taxes paid on all goods used in the factory of production except the ones specified in the negative list. The words "used in or in relation to the manufacture of final products ,whether directly or indirectly and whether contained in the final product or not" have been removed, thus implying that credit of taxes on all inputs used in the factory shall be admissible. However, to check the misuse of this broadened scope, the amended definition states that "any goods which have no relation whatsoever with the manufacture of a final product", thus ensuring that tax credit of Input not used in manufacture is not extended.

3.3. Further, the Government of India has also amended the definition of 'Input Service' defined under Rule 2(I) of the Cenvat Credit Rules, 2004 vide Notification No. 3/2011-CE (NT) dated 1st March,2011. The following comparison between the original definition and the amended definition will help clear the picture.

Input Service Rule 2 (I) PRE – AMENDEDMENT	**Input Service Rule 2 (I) POST-AMENDEDMENT**
"Input service" means any service,- (i)used by a provider of taxable service for providing an output service; or(ii)used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal,and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, activities relating to business, such as accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal;	"Input service" means any service,- (i)used by a provider of taxable service for providing an output service; or(ii)used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal,and includes services used in relation to setting up, modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, ,accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, and security, inward transportation of inputs or capital goods and outward transportation upto the place of removal; but excludes services -(A) specified in Sub-clauses (p), (zn),

	(zzl), (zzm), (zzq), (zzzh) and (zzzza) of Clause (105) of Section 65 of the Finance Act (hereinafter referred as specified services), in so far as they are used for- (a) construction of a building or a civil structure or a part thereof; or(b) laying of foundation or making of structures for support of capital goods,except for the provision of one or more of the specified services; or(B) specified in Sub-clauses (d), (o), (zo) and (zzzzi) of Clause (105) of Section 65 of the Finance Act, in so far they may relate in a motor vehicle except when used for the provision of taxable services for which the credit on motor vehicle is available as capital goods; or(C) such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession, when such services are used primarily for personal use or consumption of any employee.

3.4. In the amended definition, the words “activities relating to business, such as” have been removed thus, narrowing the scope of Input Service. This would imply that the credit is admissible only on services used in relation of manufacture or provision of output service. It is noteworthy that both manufacture and provision of output service are a part of business; thus, both manufacture and provision of output service per se are narrower in scope than business. This would also curtail the credit available as the scope of Input Service has narrowed. Further, an exclusion clause has been added which specifically excludes services used for personal consumption of the employees. However, such changes would also minimise superfluous litigation and save a lot of time and resources of the Courts as the changes have made the definition more certain.

4. Analysis and Impact

4.1. Reduction in frivolous litigations

One of the main objectives of bringing about the above amendments is to reduce litigation. The same is also expressed in Circular No. F.No. 334/3/2011-TRU, dated 28th February,2011 issued by the Tax Research Unit (TRU), Ministry of Finance as 'Describe the scope of eligible inputs and input services more clearly so as to minimise disputes in their interpretations'. This would ensure reduction in litigations and disputes.

4.2. Paving way for GST

The Indian Economy is preparing itself for an important change in the indirect taxation system with the introduction of GST. GST shall merge various Centre and State indirect taxes into a single tax regime. GST shall also minimise exemptions and would be levied on all transactions whether involving goods or services. Thus, the tax net would increase manifold with introduction of GST. Further, the said changes have broadened the scope of Inputs and included more inputs. Thus, a wider scope of Inputs would ensure that there is no breakage in the credit chain and all Input taxes paid are allowed as credit.

4.3. Wider Scope of Input

The definition of Input has been widened to cover all inputs used in factory, whether used in manufacture or not. The amended definition of Input is similar to the definition of Capital Goods under Rule 2(a). Both the definitions stipulate the condition for availment of credit as usage of the said capital good or input in the factory. The same view is also expressed in Para 7.1 (a) wherein it is stated "The definition of "Input" contained in Rule 2(k) has been revised. The requirement that goods should be used in or in relation to the manufacture of final products, whether directly or indirectly and whether contained in the final product or not has been removed. Henceforth, all goods used in the factory by the manufacturer of the final product, except those specified in the negative list and goods having no relationship whatsoever with the manufacture of final product, would qualify for treatment of inputs." However, to prevent the misuse of this provision, an exclusion clause has also been added which states "but excludes any goods which have no relation whatsoever with the manufacture of a final product". Thus, tax on Inputs used in factory having even the slightest relation with manufacture of finished goods shall be admissible as credit.

4.4. Increased burden on Service Provider

The Service Providers may now have to face increased financial burden. The credit of taxes paid on input services used for the personal consumption of employees has been excluded. Further, the scope of Input Service has been reduced. Service industry is a human resource driven industry wherein, employees are the backbone of delivering quality service to customers. In order to retain and motivate talent, the service industry arranged various personal services for the employees and availed tax credit of Service Tax paid on such services. However, with introduction of the above amendment, credit of Service Tax paid on such services would not be available. This could lead to breakage of credit chain and increased financial burden on the Service Provider.

5. Conclusion

5.1. Excise Duty and Service Tax are taxes levied on manufacture and service respectively. In the process of such manufacture or provision of service, the Manufacturer or Service Provider uses numerous inputs both in form of goods and services. The goods used in manufacture had been classified into Inputs and Capital Goods. However, till now there were goods which didn't fall under any of the two categories i.e. Inputs or Capital Goods thus, leading to emergence of a third category of goods. This third category of goods refers to those goods which were used in manufacture but were, not covered under statutory definition of Input and Capital Goods under CENVATt and thus, no benefit of CENVAT was available on them. It must be stated here that the fact that certain goods are out of the ambit of Cenvat Scheme would have no impact on the Excise paid on their manufacture. In other words, these goods had been loaded with the burden of output duty without the facility of any corresponding credit available to the buyer or Manufacturer as these did not qualify as Inputs or Capital Goods as per the statutory definition. This led to the breaking of credit chain and thus, a cascading effect, whose ultimate sufferer was the final consumer, who was already reeling under high inflation. Thus, by widening the definition of Input, the Government has eliminated this purported third category which has been discussed above. The same is also reflected in Circular No. 943/4/2011-CX., dated 29th April,2004 issued by Tax Research Unit (TRU), Ministry of Finance wherein it states-"Goods such as furniture and stationary used in an office within the factory are goods used in the factory and are used in relation to the manufacturing business and hence the credit of same is allowed." Thus, a combined reading of the amended definition with the said circular would entitle admissibility of CENVAT credit on Furniture, Stationery and many other items of similar nature which were hitherto neither covered under Capital Goods definition nor Input definition.

5.2. The Government of India has also made parallel changes in the definition of Input Service while limiting the scope of credit. The Government has narrowed the scope by removing the words 'relating to business activities such as' and adding an exclusion clause that credit of taxes paid on services for personal use by the employees would not be admissible. This would drastically reduce the scope of credit of taxes on Input Service. Thus, only services of the kind mentioned in the definition and those which have a direct nexus with manufacture or output service would qualify as Input Service for CENVAT purposes. This may lead to an increased financial burden on the Service Provider. However, the other side of the coin is that the definition of Input Service has been made more certain. This shall go a long way in reducing the earlier ambiguity, resulting in lesser litigation & disputes, thereby saving precious time and resources for both the Government & Service Provider.

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