

**RULE 6 OF CENVAT CREDIT RULES 2004 – RECENT CHANGES**

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**Introduction**

Rule 6 of Cenvat Credit Rules 2004 is perhaps one of the most important rules from the point of view of a manufacturer of both dutiable and exempted goods and a service provider who provides both taxable as well as exempted services for the simple reason that the said rule contains and exemplifies the core concept of cenvat credit and that is denial of cenvat credits of excise duties paid on inputs and service tax paid on input services used for exempted activity. Interestingly, since the notification of Cenvat Credit Rules 2004 with effect from 10.09.04, Rule 6 has never specifically dealt with the issue of a manufacturer of dutiable goods providing exempted services or for that matter providing taxable services and manufacturing exempted goods. Though the broad guidelines to be followed in such a case by way of separate accounts had been suggested, where, in a scenario the assessee did not maintain such records, the scheme prescribed for apportioning the credits was hardly covering the entire problem. This had led to the industry in some cases following the practice of apportioning the credits on the basis of turnover of sale of goods and provision of services and then explaining the rationale for the same to the department when all the while what was required was a change in Rule 6. This year, the change has come about in Rule 6 though some may wonder whether it leaves scope for more confusion.

Under the Cenvat Credit Rules 2004, a manufacturer or a service provider is entitled to claim the benefit of cenvat credits in respect of the excise duties paid on inputs and capital goods and the service tax paid on input services used for the manufacture of dutiable final product or for providing taxable service. Where the usage is for manufacture of exempted goods or for providing exempted service, the credits would not be admissible. Precisely for this reason the manufacturer or the service provider would be required to ensure proper usage of the inputs and input services and avail credits on those inputs and input services used for dutiable/taxable activity. The measures in this regard should include proper physical controls over the inventory of materials to ensure that the goods are used for manufacture of dutiable goods as well as provision of taxable service apart from segregating the materials at the time of accounting the receipt, consumption and inventory of such materials in the books, from those meant for use in manufacture of exempted goods or for providing exempted services. In respect of capital goods, the question of denial of credit would arise where such goods are used exclusively for

manufacture of exempted goods or for providing exempted services. In respect of input service too, the segregation as to usage would be required. This segregation would be easy where certain services are used solely for providing specific service but could be difficult where not identifiable or meant for providing any specific service.

Assessee often had problems with regard to certain inputs and input services which were common to both the dutiable/taxable activity as well as exempted activity where segregation as to usage was not possible. Between inputs and input services, the problem was more pronounced in case of input services though in case of specified input services given here, the credits can be claimed in full where such services are common services and segregation is not possible. These input services are – Consulting engineer's services, Services received from an architect, Interior decorator's services, Management consultant's services, Real estate agent's services, Security agency's services, Services provided by a scientist or a technocrat in relation to scientific or technical consultancy, Banking and financial services, Insurance auxiliary services concerning life insurance business, Erection, commissioning and installation services, Management or maintenance or repair service, Technical testing and analysis agency's services, Technical inspection and certification services, Banking or other financial services by a foreign exchange broker, Commercial or industrial construction services, Intellectual property services.

Some of the assessee had the practice of not maintaining separate accounts and instead were reversing credits on materials used for exempted activity on the basis of the Bill of Material and requisition reports after full credits had been availed initially at the time of receipt. In case of input services, credits were determined on the basis of relative turnovers where the same was not possible on the basis of consumption. Where this was found to be too tedious, then the assessee had no option but to follow the prescription laid down by Rule 6 and that was, payment of 10% of the value of exempted goods or utilising credits in respect of input service to the extent of 20% of the tax payable on output service which was not in many cases, cost effective.

With effect from 01.04.08, changes have been brought about in Rule 6 of Cenvat Credit Rules 2004 to cover a scenario where the assessee does not wish to maintain separate accounts in respect of consumption of inputs or usage of input services. The rule now gives the assessee two options –

- Service provider to pay an amount equal to 8% of the value of the exempted services or manufacturer to pay an amount equal to 10% of the value of exempted goods **or**
- Pay an amount equivalent to the Cenvat credit attributable to inputs and input services used for providing exempted services or for manufacturing exempted goods as per the formula/method indicated. The formula would be applicable where payment of 8% or 10% spoken of above is not desired.

The cenvat would be determined in two steps -

1. Initially, during each month, the cenvat credits attributable to exempted activity would be ascertained provisionally by taking the value of exempted services, goods manufactured and taxable services provided during the preceding financial year as the basis and the credits availed accordingly. Here, for the purpose of provisionally determining the credits during the month, the only variable would be the total credits during the month as the proportion of exempted activity to total activity is that pertaining to preceding financial year which would be the same for each month of the current financial year.
2. Next, the actual credits that the service provider is entitled to, would be calculated at the end of the year on the basis of actual figures for the relevant financial year with regard to the value of exempted services and taxable services provided or goods manufactured during the year.

Where the credits ascertained at the end of the year in relation to exempted activity are less than the credits ascertained provisionally, the service provider can take credit for the differential amount.

Where the credits ascertained at the end of the financial year in relation to exempted activity are more than the credits ascertained provisionally, the service provider will have to pay the differential amount on or before the 30<sup>th</sup> June of succeeding financial year. Where the payment is made after 30<sup>th</sup> of June, interest at 24% p.a. will be payable for the delayed period.

The calculations to be made every month for ascertaining provisional credits in relation to exempted activity would be as follows -

1. Let the cenvat credit attributable to inputs used for manufacturing exempted goods be A.
2. The cenvat credits are to be ascertained provisionally in respect of **inputs** used for providing exempted services applying the formula –  $(B/C) * \text{Total credits taken during the relevant month on inputs not including amount A}$  ascertained above.

Here, B = total value of exempted services provided during the preceding financial year

C = total value of dutiable goods manufactured and removed during preceding financial year + total value of exempted services and taxable services provided during preceding financial year.

3. The cenvat credits attributable to input services used for providing exempted services or for manufacturing exempted goods is to be determined applying the formula –  $(E/F) * \text{Total credits taken during the relevant month on input services}$

Here, E = total value of exempted goods manufactured and removed during the preceding financial year + total value of exempted services provided during the preceding financial year.

F = total value of dutiable goods and exempted goods manufactured and removed during preceding financial year + total value of exempted services and taxable services provided during preceding financial year.

Note: -

- *If one analyses the aforesaid three steps, cenvat credits in respect of inputs used for manufacturing exempted goods is not available as per step 1. This in other words is the credit on inputs used exclusively for manufacture of exempted goods. Readers may note that inputs used for exempted goods have to be identified separately and that the formula does not talk about common inputs used for both dutiable as well as exempted goods!!*
- *The formula addresses a problem where inputs are used for providing taxable service, exempted service as well as manufacture of dutiable goods as indicated by step 2. Here, the credits in relation to input service used for exempted service is to be identified so that the same is not claimed.*
- *The third step talks about input services used for providing exempted services as well as for manufacturing exempted goods besides using them for taxable activity. Thus it is quite clear from the three steps that the possibility of a manufacturer having dutiable final product and exempted service has also been covered by the formula.*

The following calculations will have to be made at the close of the financial year –

- 1 The cenvat credit attributable to inputs used for manufacturing exempted goods is to be determined and let the credits be H.
2. Determine the cenvat credits in respect of **inputs** used for providing exempted services during the financial year as follows –  $(J/K) * \text{Total credits taken during the relevant financial year on inputs not including amount H}$  indicated above.

Here, J = total value of exempted services provided during the relevant financial year

$K$  = total value of dutiable goods manufactured and removed during relevant financial year + total value of exempted services and taxable services provided during relevant financial year.

3. Determine the cenvat credits attributable to input services used for providing exempted services or for manufacturing exempted goods as follows –  $(E/F) \times$  Total credits taken during the relevant financial year on input services

Here,  $E$  = total value of exempted goods manufactured and removed during the relevant financial year + total value of exempted services provided during the relevant financial year.

$F$  = total value of dutiable goods and exempted goods manufactured and removed during relevant financial year + total value of exempted services and taxable services provided during relevant financial year.

*Note: -*

- *The three steps given here are similar to the three steps explained for provisional determination on a monthly basis with the significant changes being total credits for the current/relevant financial year being considered instead of the credits for the month and the proportion of exempted activity to taxable activity being based on such current/relevant year's figures rather than preceding year's figures.*
- *Value for this purpose shall have the meaning assigned in section 67 of Chapter V of Finance Act for service tax and section 4 or 4A of Central Excise Act 1944 with regard to goods.*

Example –

If the sale of exempted goods during 2007-08 had been Rs. 150,000 and clearance of dutiable goods had been Rs. 187,000 during the said year and the exempted services had been Rs. 45,000 and taxable services had been Rs. 25,000 for 2007-08, and the input credit total for the month of April 2008 is Rs. 22,000 out of which the credits on inputs used for exempted goods is Rs. 2500, the determination for April 2008 would be as follows –

Step 1: - Credits on inputs used for exempted goods =Rs. 2,500

Step 2: - Credits on inputs used for exempted services = Rs. 3414.40.

Credits for April 2008 (excluding step 1 credits)  $\times$  Exempted services for last year / (Dutiable goods value + Taxable service value + Exempted service values for last year) =  $(22,000 - 2,500) \times (45,000) / (187,000 + 45,000 + 25,000)$

Step 3: - Input service credits is nil here.

Therefore, the total credits which can be claimed in April 2008 = Rs. 22,000-2,500-3414.40 = Rs.16085.60

If we assume that input service credit of Rs. 4000 is also available, then

Step 3: - Credits on input services used for exempted goods and exempted services = Rs. 1916.46

(Credits for April 2008) $\times$ (Exempted services value+Exempted goods values for last year)/(Dutiable goods value+Exempted goods value+Exempted service value+Taxable service value for last year) =

4000 $\times$ (45,000+150,000)/(187,000+150,000+45,000+25,000)

Therefore the credits admissible on input services would be Rs. 4000-1916.46 = Rs.2083.54

*Where the assessee opts for ascertaining the credits as per the method prescribed under Rule 6 of CCR 2004 on a provisional basis the following particulars will have to be intimated to the Superintendent of Central Excise -*

- Name, address and registration number of the provider of output service/manufacturer of goods
- Date from which the option is to be exercised
- Description of dutiable goods or taxable services
- Description of exempted goods or exempted services
- Cenvat credit of inputs and input services lying in balance as on the date of exercising the option under this condition

Once opted for, the option here cannot be withdrawn during the remaining part of the financial year and shall be exercised for all exempted goods or exempted services involved.

Once the credits have been determined finally and the excess credits availed, paid back or credits short availed have been availed, the following details will have to be sent to the SCE within 15 days from date of payment or adjustment –

- Cenvat credits attributable to exempted goods and exempted services for the whole financial year, determined provisionally on monthly basis

- Credits attributable to exempted goods and exempted services for the whole financial year determined finally
- Amount short paid with the date of payment of the said amount
- Interest payable and paid on the shortfall
- Credits taken on excess payments made earlier

**Conclusion –**

While the new amendment is an improvement over the old rule, the practicality of following it would have to be seen especially in case of large enterprises where the cenvat credits in a single month could run into crores of rupees. There could also be issues with regard to input service credits as such credit can be utilized only on payment to service provider and there could be a time lag in receiving such services and the point of time at which credits are claimed. The formula deals with credits taken during the month/financial year and does not talk of the credits being related to such month/financial year. Whether this implies arrears of credit can also be claimed in any of the months or even the subsequent financial year? As of now, in the opinion of the paper writers seems possible.