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Cenvat Credit – Set off or subsidy?

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The much awaited decision of the Larger Bench of the Hon'ble Tribunal in the matter of cenvat credit entitlement for service tax paid on freight for outward transportation of final products is finally out, setting at rest wide speculations on the subject and fomenting litigation. Rather, the Larger bench has also gone an extra mile and put the issue in proper perspective.

Upto 01.03.2008, the definition of the term "input service" read as below, as per Rule 2 (l) of the Cenvat Credit Rules, 2004.

> "input service" means any service, -
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> (i) used by a provider of taxable service for providing an output service, or
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> (ii) used by the manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products from the place of removal,
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> and includes services used in relation to setting up, modernization, 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;

With effect from 01.03.2008, the above definition has been amended and the phrase "from the place of removal" has been replaced as "upto the place of removal".

It is also relevant to refer to a clarification issued by the CBEC, vide its Master Circular bearing NO. 97/6/2007 Dt. 23.08.2007.

> (c) ISSUE: Up to what stage a manufacturer/consignor can take credit on the service tax paid on goods transport by road?
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> COMMENTS: This issue has been examined in great detail by the CESTAT in the case of M/s Gujarat Ambuja Cements Ltd. vs CCE, Ludhiana [2007 (006) STR 0249 Tri-D]. In this case, CESTAT has made the following observations:-
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> "the post sale transport of manufactured goods is not an input for the manufacturer/consignor. The two clauses in the definition of 'input services' take care to circumscribe input credit by

stating that service used in relation to the clearance from the place of removal and service used for outward transportation upto the place of removal are to be treated as input service. The first clause does not mention transport service in particular. The second clause restricts transport service credit upto the place of removal. When these two clauses are read together, it becomes clear that transport service credit cannot go beyond transport upto the place of removal . The two clauses, the one dealing with general provision and other dealing with a specific item, are not to be read disjunctively so as to bring about conflict to defeat the laws' scheme. The purpose of interpretation is to find harmony and reconciliation among the various provisions".

Similarly, in the case of M/s Ultratech Cements Ltd vs CCE Bhavnagar 2007-TOIL-429-CESTAT-AHM, it was held that after the final products are cleared from the place of removal, there will be no scope of subsequent use of service to be treated as input. The above observations and views explain the scope of the relevant provisions clearly, correctly and in accordance with the legal provisions. In conclusion, a manufacturer / consignor can take credit on the service tax paid on outward transport of goods up to the place of removal and not beyond that.

8.2 In this connection, the phrase 'place of removal' needs determination taking into account the facts of an individual case and the applicable provisions. The phrase 'place of removal' has not been defined in CENVAT Credit Rules. In terms of sub-rule (t) of rule 2 of the said rules, if any words or expressions are used in the CENVAT Credit Rules, 2004 and are not defined therein but are defined in the Central Excise Act, 1944 or the Finance Act, 1994, they shall have the same meaning for the CENVAT Credit Rules as assigned to them in those Acts. The phrase 'place of removal' is defined under section 4 of the Central Excise Act, 1944. It states that,-

"place of removal" means-

(i) a factory or any other place or premises of production or manufacture of the excisable goods ;

(ii) a warehouse or any other place or premises wherein the excisable goods have been permitted to be stored without payment of duty ;

- a depot, premises of a consignment agent or any other place or premises from where the excisable goods are to be sold after their clearance from the factory; from where such goods are removed."

It is, therefore, clear that for a manufacturer /consignor, the eligibility to avail credit of the service tax paid on the transportation during removal of excisable goods would depend upon the place of removal as per the definition. In case of a factory gate sale, sale from a non-duty paid warehouse, or from a duty paid depot (from where the excisable goods are sold, after their clearance from the factory), the determination of the 'place of removal' does not pose much problem. However, there may be situations where the manufacturer /consignor may claim that the sale has taken place at the destination point because in terms of the sale contract /agreement (i) the ownership of goods and the property in the goods remained with the seller of the goods till the delivery of the goods in acceptable condition to the purchaser at his door step; (ii) the seller bore the risk of loss of or damage to the goods during transit to the destination; and (iii) the freight charges were an integral part of the price of goods. In such cases, the credit of the service tax paid on the transportation up to such place of sale would be admissible if it can be established by the claimant of such credit that the sale and the transfer of property in goods (in terms of the definition as under section 2 of the Central Excise Act, 1944 as also in terms of the provisions under the Sale of Goods Act, 1930) occurred at the said place.

So, wherever the conditions specified in the Master circular are satisfied, i.e. (i) the ownership over the goods passes to the buyer only upon delivery at his place; (ii) the seller bears the risk of transit; and (iii) the freight charges are also included in the assessable value of the goods, there is no difficulty in availing cenvat credit of the service tax paid on freight incurred for transporting the goods upto the customers' place.

The significance of the decision of the Larger Bench would reveal itself only where the factory or the depot is the place of removal and one or more of the three conditions mentioned above are not satisfied. In such cases, even after the amendment of the definition of the term input service, with effect from 01.03.2008, cenvat credit of service tax paid on freight incurred for transport of goods from the factory / depot to the customers' place can be availed as cenvat credit.

This is because, the Larger Bench has held that transporting the final product from the factory / depot is an activity relating to business, which is entitled for cenvat credit, as per the definition of the term input service. The restrictive clauses restricting the credit "upto the place of removal" should give way to the later inclusive part of the definition which covers activities relating to business. Further, the Larger Bench has also held that inclusion of freight in the assessable value of the goods is not a condition for availing cenvat credit. Thus, various situations can be tabulated as below:

S.No.	Situation	Impact on Cenvat Credit.	Impact on Valuation
1	Factory is the place of removal and where customers' place cannot be considered as the place of removal. Freight incurred for transport of goods from the factory to the customers' place.	Cenvat credit of Service Tax paid on such freight is entitled for cenvat credit, as held by the LB, since it is an activity relating to business.	The freight need not be included in the Assessable Value of goods, as per Rule 5 of the Central Excise Valuation Rules, 2000.
2	Depot is the place of removal and where customers' place cannot be considered as the place of removal. Freight incurred for transport of goods from the factory to the depot.	Since it is transportation upto the place of removal, credit is entitled as per clause (i) of the definition of the term input service.	Such freight has to be included in the Assessable value of Goods, as any freight beyond the place of removal alone can be excluded as per Rule 5 ibid.
3	Depot is the place of removal and where customers' place cannot be considered as the place of removal. Freight incurred for transport of goods from the depot to the customers' place.	Same as (1) above.	Same as (1) above.
4	Customers' place is the place of removal. (conditions mentioned in the master circular are satisfied) Freight is incurred for transport of goods from the factory / depot to the customers' place.	Credit is entitled as per Master Circular. No need to rely on the LB decision.	Same as (2) above.

Before parting…

No doubt, valuation of goods for payment of duty and entitlement for cenvat credit are two different issues. But, the very objective of the cenvat credit scheme is to alleviate the cascading effect of duty on duty. Once freight is not included in the assessable value of the goods for the purposes of payment of duty of excise on the goods, why at all, cenvat credit of service tax paid on such freight shall be allowed? Now tell us, is Cenvat credit a set off or subsidy?