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Negative Blues – XV

Vicious Rule 6

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As we all know, if a manufacturer is manufacturing both dutiable goods and exempted goods or if a service provider provides both taxable and exempted services, the vice of Rule 6 of Cenvat Credit Rules, 2004 would be attracted. By virtue of this rule, either such a manufacturer / service provider shall take credit only to the extent pertaining to his dutiable / taxable activity or fulfill any of the obligations cast under him, under sub rule (3) of Rule 6 ibid.

It may also be noted that as per Rule 3 of the CCR, 20404, the cenvat credit scheme itself is applicable only for manufacturers of "final products" and providers of "output service". The term "final product" is defined in 2 (h) ibid as "final products means excisable goods manufactured or produced from input, or using input service" and the term "output service" is defined in rule 2 (p) as "output service means any service provided by a provider of service located in the taxable territory but shall not include a service, -

(1) specified in section 66D of the Finance Act; or

(2) where the whole of service tax is liable to be paid by the recipient of service.

It is also relevant to refer to the definition of the term "exempted services" as per Rule 2 (e) of the CCR, 2004, which is reproduced below:

"exempted service" means a -

(1) taxable service which is exempt from the whole of the service tax leviable thereon; or

(2) service, on which no service tax is leviable under section 66B of the Finance Act; or

(3) taxable service 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;

but shall not include a service which is exported in terms of rule 6A of the Service Tax Rules, 1994.

It may be noted that certain activities are kept outside the definition of service, under section 65 B (44) of the Act, such as "an activity, which constitutes merely a transaction in money or actionable claim". It is also relevant to refer to the following clarification contained in the CBEC's education guide.

2.8.4 Would an investment be transaction only in money?

Investment of funds by a person with another for which the return on such investment is returned or repatriated to the investors without retaining any portion of the return on such investment of funds is a transaction only in money. Thus a partner being admitted in a partnership against his share will be a transaction in money. However, if a commission is charged or a portion of the return is retained as service charges, then such commission or portion of return is out of the purview of transaction only in money and hence taxable. Also, if a service is received inlieu of an investment it would cease to be a transaction only in money to the extent the investment represents the consideration for the service received.

Further, the negative list under section 66 D of the Act, contains the following entry, inter alia.

(n) services by way of—

(i) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount;

Now to the crux…

Any manufacturer or service provider might have invested some amount in shares and securities and may get return in the form of dividends. Similarly, they might have also made fixed deposits or advanced loans, earning interest thereon. Such investment would be an activity outside the definition of service, being a mere transaction in money and deposits and loans would be an activity mentioned in the negative list.

Such a manufacturer or service provider might be availing cenvat credit on various input services, out of which some services could be relatable to the above activities of mere transaction in money (which is not at all a service) or activities of deposits and loans (a service in negative list). The examples of such common input services could be, Chartered Accountant services, security services, telephone services, financial consultants, etc. To these extent, these services would be used for an activity which is not at all a service or an activity mentioned in section 66 D (n) of the Act, on which no service tax is leviable under Section 66 B of the Act. The services mentioned in Section 66 D are not leviable to service tax under section 66 B of the Act and hence they satisfy the definition of exempted services under CCR, 2004. An activity which is not at all a service is not at all entitled for any cenvat credit as per Rule 3 of the CCR, 2004.

Hence, any manufacturer having incomes in the form of dividend / interest on deposits / interest on loans would be hit by the provisions of Rule 6 of the CCR, 2004 and forego proportionate credit attributable to such income or pay 6 % of such income! Though the definition of "exempted service" under CCR, 2004 would not cover an activity which is not at all a service, it cannot be a ground not to reverse any proportionate credit, since such an activity by itself would not be entitled for any cenvat credit as per rule 3 of the CCR, 2004, as such an activity is neither manufacture of final products nor provision of any "output service".