

Cenvat Credit on Common Inputs - Restricted in Budget 2008?

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The modern business is unlike the traditional business where the concentration was on one particular product or a service. Entrepreneurs involve themselves in multi-product or multi-service to cater the need of their customers.

It is the basic premise that cenvat credit is available in case of manufacture of dutiable product or provision of taxable service and not available in case of manufacture of exempted product or provision of exempted service. Issue arises when it comes to a person manufacturing both dutiable and non-dutiable product or providing both taxable and non-taxable service. The provisions relating to this under Rule 6 have been undergoing change for the past few years. From utilization restriction of 35 % of the tax payable to 20% of the tax payable now to proportionate credits.

Rule 6 of the Cenvat Credit Rules, 2004 gives the provision of treatment of cenvat credit in case of manufacture of dutiable and non-dutiable goods or provision of taxable and non-taxable service. This rule has been amended by virtue of Budget 2008 and notification 10/2008 dated 01.03.2008 with effect from 1st day of April 2008. In this article we discuss the earlier and latter provision.

Position upto 31st March 2008

The manufacturer providing both dutiable and non-dutiable goods or the service provider providing both taxable and non-taxable goods were having the following option:

Option I : Maintain separate records for receipt, consumption and inventory of inputs and input services for dutiable/taxable and non-dutiable/taxable respectively. Avail cenvat attributable to dutiable goods or taxable service.

Option II : Manufacturer to pay 10% of the non-dutiable goods cleared by debiting the cenvat credit.

Service provider can avail full credit, but the utilization is restricted to 20% of the tax payable. However the balance was allowed to carry forward.

There was a group of 16 common services which were eligible for 100% credit as long as they had been partially used for the provision of taxable services.

Position with effect from 01.04.2008

The manufacturer providing both dutiable and non-dutiable goods or the service provider providing both taxable and non-taxable goods was having the following option with respect to cenvat credit on inputs and input service with effect from 01.04.2008

Option I : Maintain separate records for receipt,

consumption and inventory of inputs and input services for dutiable/taxable and non-dutiable/taxable respectively. Avail cenvat attributable to dutiable goods or taxable service. (This option has been retained in the new provision also)

Option II : Manufacturer to pay 10% of the value of exempted goods cleared.

Service provider to pay 8% of the value of exempted service provided.

(The option of manufacture to pay certain sum has been extended to service provider)

Option III: The manufacture or service provider has to reverse the cenvat credit every month provisionally attributable to exempted goods/ service based on the proportion of previous financial year and adjust the same with actual after the close of the current year. (This option has been extended to manufacturers and all service providers)

Option III is subject to condition and the procedure as described in Rule 6(3A) of the said rules. We now discuss the said conditions and for the ease of understanding we shall independently examine the procedure of reversal for credit as applicable to pure service provider, pure manufacture and manufacturer and service provider.

Conditions for Option III

This option has to be exercised at the beginning of the year and such exercising of the option has to be given in writing to the Superintendent of Central Excise with the following particulars:

- Name, address and registration no. of the manufacturer of goods or provider of output service;
- Date from which the option under this clause is exercised or proposed 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

Procedure of reversal under option III as applicable to pure service provider

The provider of output service shall determine and pay provisionally every month the amount of cenvat credit attributable to inputs and input services used for provision of exempted services.

Inputs for service:

$$\text{Provisional reversal of credit on inputs} = \frac{A}{A + B} \times C$$

Input service for service:

$$\text{Provisional reversal of credit on input services} = \frac{A}{A + B} \times D$$

Where A : Total Value of exempted service during the previous financial year (say 07-08)

B : Total Value of taxable service during the previous financial year (say 07-08)

C : Cenvat credit availed on inputs (materials) during the month/quarter.

D : Cenvat credit availed on input services (services) during the month/quarter.

The provider of the output service finally at the end of the year shall compute the actual amount of reversal of credit attributable to exempted service as under

$$\text{Credit of inputs used for provision of exempted services} = \frac{P}{P + Q} \times R$$

$$\text{Credit of input service used for provision of exempted services} = \frac{P}{P + Q} \times S$$

Where P : Total value of exempted services provided during the financial year. (08-09)

Q : Total value of taxable services provided during the financial year. (08-09)

R : Total cenvat credit taken on inputs during the financial year. (08-09)

S : Total cenvat credit taken on input services during the financial year. (08-09)

The difference if any between the actual reversal calculated for the year with the total provisional reversal, has to be paid within 30th June of the next financial year (30.06.09) or the credit of the same may be avail the credit of the excess provisional reversal as the case may be.

Procedure of reversal under option III as applicable to pure manufacturer

Inputs for manufacture:

The manufacturer shall determine and pay provisionally every month the amount the amount equivalent to cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods. At the end of the year the manufacturer shall compute the amount of cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods, on the basis of total quantity of inputs used in or in relation to manufacture of said exempted goods.

The difference of total provisional and actual computation shall be paid with 30th June of the next financial year or credit of the excess provisional reversal may be availed as the case may be.

Input services for manufacture:

$$\text{Provisional reversal of credit on input services} = \frac{E}{E + F} \times H$$

Where E : Total Value of exempted good manufactured and removed during the previous financial year (say 07-08)

F : Total Value of dutiable goods manufactured and removed during the previous financial year (say 07-08)

H : cenvat credit availed on input services during the month/quarter.

The manufacturer at the end of the year shall compute the actual amount of reversal of input service credit attributable to manufacture of exempted goods as under

$$\text{Credit of input service used for manufacture of exempted goods} = \frac{T}{T + V} \times W$$

Where T : Total value of exempted goods manufactured and removed during the financial year.(08-09)

V : Total value of dutiable goods manufactured and removed during the financial year. (08-09)

W : Total cenvat credit taken on input services during the financial year. (08-09)

The difference if any between the actual reversal calculated for the year with the total provisional reversal, has to be paid within 30th June of the next financial year (30.06.09) or the credit of the same may be avail the credit of the excess provisional reversal as the case may be.

Procedure of reversal under option III as applicable to manufacturer and service provider

Inputs for manufacture:

The manufacturer and service provider shall determine and pay provisionally every month/quarter equivalent to cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods.

At the end of the year the manufacturer shall determine the amount of cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods, on the basis of total quantity of inputs used in or in relation to manufacture of said exempted goods.

The difference in the total provision and actual computation shall be paid with 30th June on the next financial year and

excess provisional reversal if any shall be availed as credit.

Inputs for service:

$$\text{Provisional reversal of credit on inputs} = \frac{I}{J+K+I} \times \{L-M\}$$

Input service for Manufacture & Service:

$$\text{Provisional reversal of credit on input services} = \frac{I+O}{K+I+J+O} \times N$$

Where I : Total Value of exempted service during the previous financial year (07-08)

J : Total Value of dutiable goods manufactured and removed during previous financial year

K : Total Value of taxable service during the previous financial year (07-08)

L : Cenvat credit availed on inputs (materials) during the month/quarter.

M: Cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods

N: Cenvat credit availed on input services (services) during the month/quarter.

O: Total Value of exempted goods manufactured and removed during previous financial year

The provider of the output service finally at the end of the year shall compute the actual amount of reversal of credit attributable to exempted service as under

$$\text{Credit of inputs used for provision of exempted services} = \frac{P}{P+Q+R} \times \{S-T\}$$

$$\text{Credit of input service used for provision of exempted services} = \frac{P+U}{P+R+Q+U} \times V$$

Where P : Total value of exempted services provided during the financial year. (08-09)

Q : Total value of dutiable good manufactured and removed during the financial year (08-09)

R : Total value of taxable services provided during the financial year. (08-09)

S : Total cenvat credit taken on inputs during the financial year. (08-09)

T : cenvat credit attributable to inputs used in or in relation to manufacture of exempted goods, on the basis of total quantity of inputs used in or in relation to manufacture of said exempted goods

U : Total Value of exempted goods manufactured and cleared during the financial year (08-09)

V : Total cenvat credit taken on input services

during the financial year. (08-09)

The difference if any between the actual reversal calculated for the year with the total provisional reversal, has to be paid within 30th June of the next financial year (30.06.09) or the credit of the same may be avail the credit of the excess provisional reversal as the case may be.

In case for any reason the shortage is not paid within 30th June then the interest of 24% p. a has to be paid. If the service provider or the manufacturer for any reason is not able to determine the turnover for the previous year, then such manufacturer or service provider is not required to pay any such amount provisionally, however the actual reversal or payment shall be made within 30th June

Analysis of option:

The paper writers feels that the first option of maintaining separate record for receipt, consumption and inventory of inputs and input service for taxable and non-taxable service may not be practically possible. For example the telephone bill the general manager of the company will be used for taxable and non-taxable service and bifurcating the same will be challenging.

The second option of payment of 10% or 8% as the case may not be economically feasible in 98 % of the cases Consider the following illustration and impact of the options.

Total Taxable Turnover: Rs.9500/-

Total Exempted Turnover: Rs.500/-

Total Credit available: Rs.1100/-

Payments under option II: Rs.40/-

Payments under option III: Rs.55/-

The third option of reversal in proposition with the exempted turnover shall be beneficial in case where the non-taxable turnover is moderate and the credit involvement is low. Consider the following illustration and impact of the options.

Total Taxable Turnover: Rs.6000/-

Total Exempted Turnover: Rs.4000/-

Total Credit available: Rs.400/-

Payments under option II: Rs.320/-

Payments under option III: Rs.160/-

The 16 common specified services would continue to be eligible for 100% credit as long as they were partially used for providing the taxable services. For many service providers, the credit on these would be the only feasible option to avoid disputes.

The new method of availment of credit would adversely affect all the service providers whose taxable services as a proportion of the total services are low such a banks and professionals like CAs. The understanding of this complicated provision would take a few years and its application is going to lead to uncalled for demands official and unofficial leading to the intermediary being blessed.