An insight:
Cenvat Credit Rules, 2004

Contents

Genesis of Cenvat Credit

Setting-off of input taxes against output tax liability

Cenvat Credit Mechanism introduced with following objectives:

- Reducing/ eliminating cascading effect of indirect taxes
- Ensuring levy of tax only on value addition
- Minimizing tax incidence on ultimate consumer of goods/ services

Brief Legislative History

- Modvat Scheme introduced in 1986 for manufacturers, wherein, Credit was allowed on inputs
- In the year 1994, manufacturers were allowed Credit of capital goods
- In the year 2002, Cenvat Credit Rules, 2002 and Service Tax Credit Rules, 2002 introduced
  - Manufacturer – allowed Credit on inputs and capital goods
  - Service provider – allowed Credit on input services
- In the year 2004, Cenvat Credit Rules, 2004 (‘the Credit Rules’) were introduced to replace erstwhile Cenvat Credit Rules, 2002 and Service Tax Credit Rules, 2002
- Credit Rules provided for integration of manufacturing sector and service sector
- Credit Rules allowed Credit of service tax to the manufacturer and Credit of inputs and capital goods to the service provider

Sub-division of Credit Rules

Sub-division of Credit Rules

Broadly, the Credit Rules have been divided into the following sub-headings:

- Duties eligible for Credit
- Conditions for availment of Cenvat Credit
- Set-off of various taxes
- Requirement for payment of duty when inputs, capital goods removed from the factory of manufacturer/ premises of service provider
- Refund of Credit
- Input Service Distributor
- Documents for availing Credit
- Transfer of Credit
- Recovery and Penalties

Duties eligible for Credit

Duties eligible for Credit

Manufacturer/ Service Provider is allowed to take Credit of the following duties:

- Basic Excise Duty (however, no Credit on inputs used in the manufacture of goods liable to duty @ 2 percent)
- Additional Excise Duty (exemption available to all goods)
- Duty leviable under Textile and Textile Articles Act and Goods of Special Importance Act (however, exemption available to all goods from payment of duty)
- National Calamity Contingent Duty (‘NCCD’)
- Education Cess and Secondary and Higher Education Cess
- Additional duty of customs in lieu of excise duty (‘CVD’)
  - Import of ships, boat and other floating structure for breaking up – Credit allowed to the extent of 85 percent of CVD
- Additional duty of customs in lieu of sales tax (‘ADC’). However, a provider of output service is not allowed to take Credit of ADC
- Service tax, Education Cess and Secondary and Higher Education Cess on such service tax

Cenvat Credit may be utilized for payment of any of the following -

- Duty of excise on final product
- Duty on inputs removed as such or after being partially processed

Duties eligible for Credit

Cenvat Credit may be utilized for payment of any of the following -

- An amount equal to the Cenvat Credit taken on capital goods where such capital goods are removed as such
- An amount paid under sub-rule (2) of Rule 16 of Central Excise Rules, 2002
- Service tax on output service
- However, Credit shall be utilized only to the extent such Credit is available on the last day of the month or the quarter
- Credit cannot be utilized for payment of duty on goods which are liable to duty @ 2 percent
- Credit of ADC cannot be utilized for payment of service tax on any output service
- Credit cannot be used for payment of service tax in respect of services where the person liable to pay tax is the service recipient

Conditions for availment of Cenvat Credit

Conditions for availment of Cenvat Credit

Inputs

- Time for availment of Cenvat Credit
  - 100 percent Credit immediately on the receipt of the goods in the factory of the manufacturer/ premises of service provider (should not mean immediately at the time of receipt, however, there should not be an inordinate delay)
- Ownership of inputs is not relevant for taking the Credit
- Service Provider can take Credit when the inputs are delivered to such provider, subject to maintenance of documentary evidence of delivery and location of the inputs

Capital Goods

- Time for availment of Cenvat Credit (Rule 4)
  - 50 percent in the FY in which capital goods are received
  - 50 percent in any subsequent year, subject to the possession of such goods
- 100 percent Cenvat Credit is allowed in first year, if the capital goods are cleared as such in the same financial year
- In case of imported goods Credit of duty paid under Section 3(5) of Customs Tariff Act is allowed in the year of receipt
- No Credit of amount of duty claimed as depreciation under the Income Tax Act, 1961

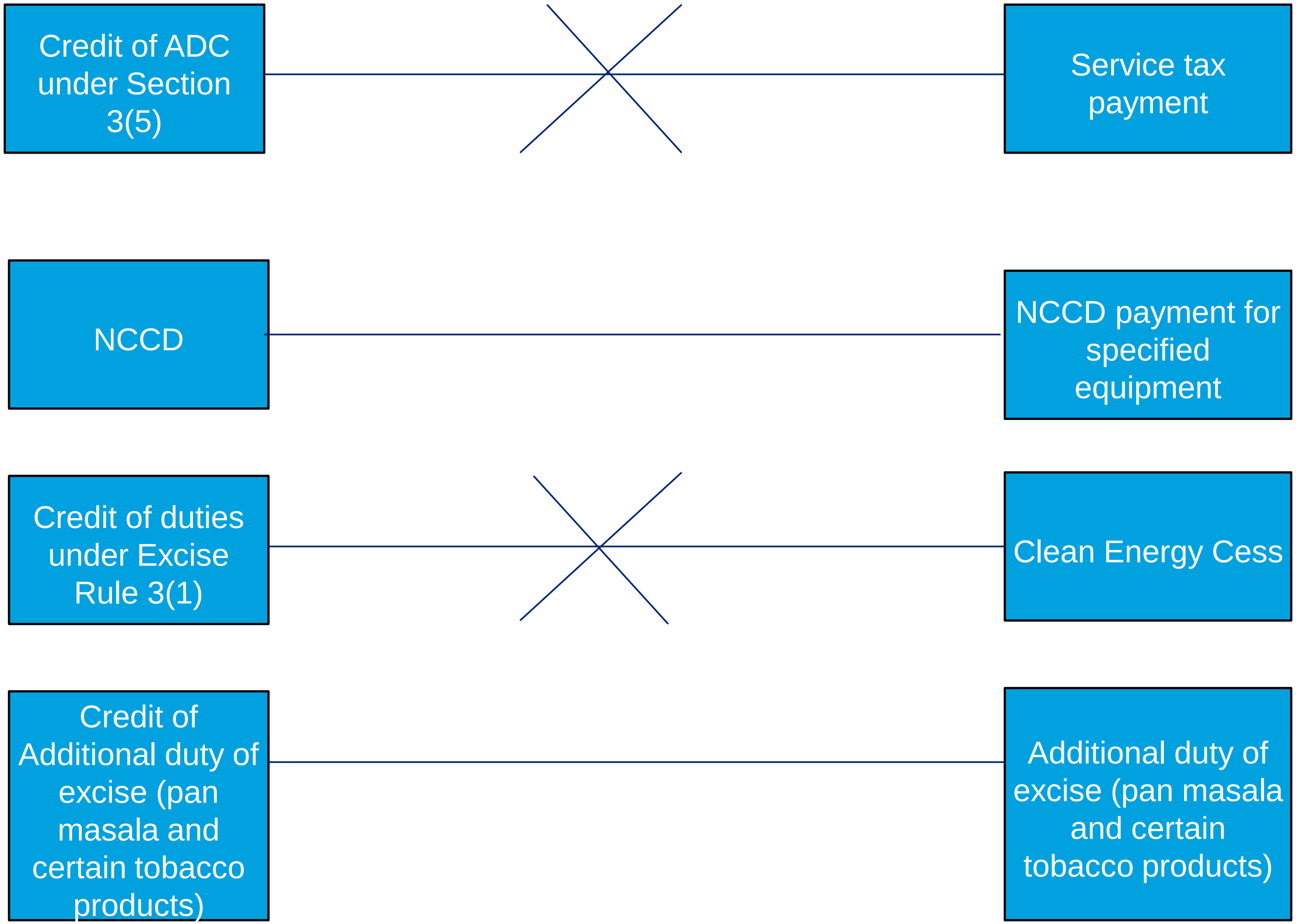
Conditions for availment of Cenvat Credit

Input Services

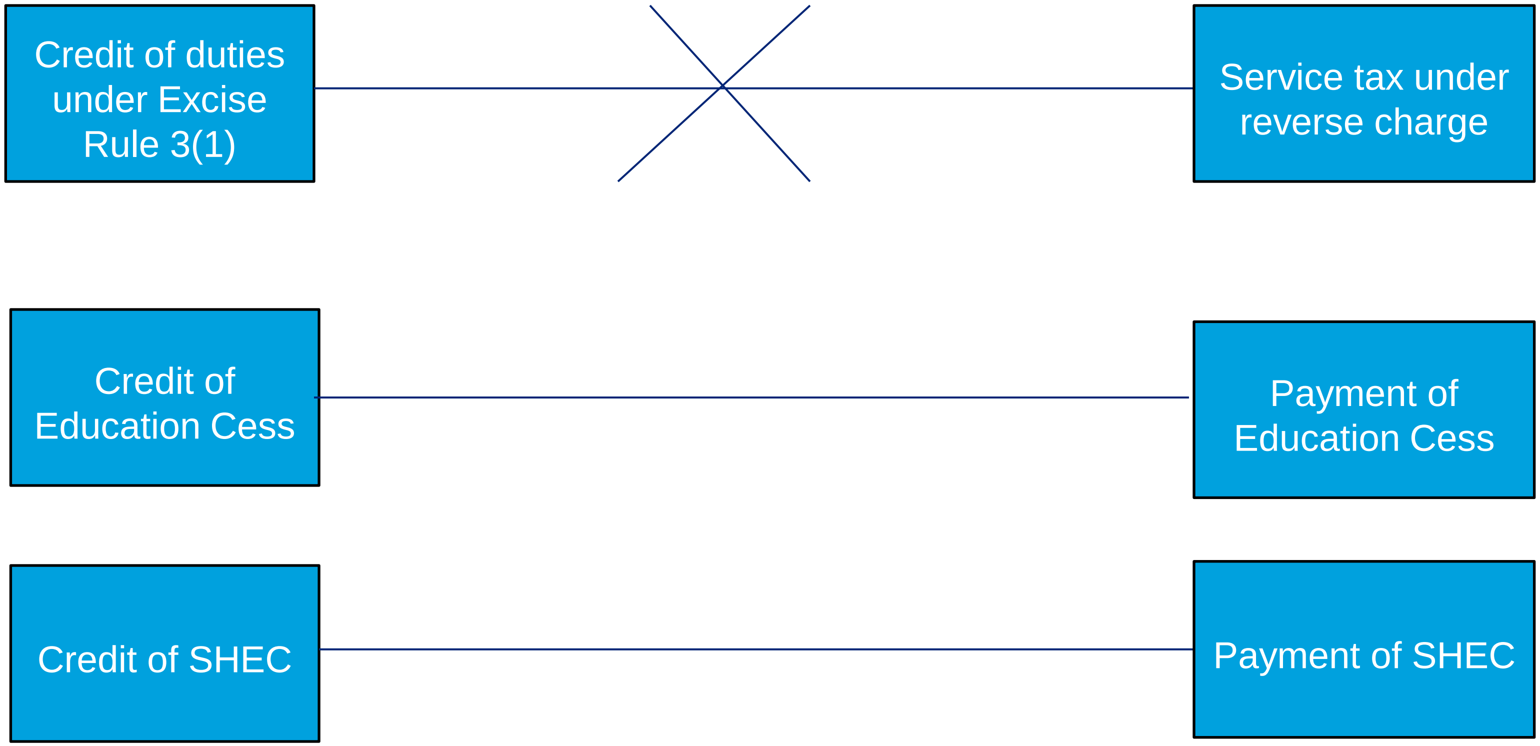
- Credit allowed on or after the date of receipt of invoice, provided payment for such services is made within 3 months from the date of invoice
- If payment not made within 3 months, assessee is required to pay an amount equal to the Credit availed. However, Credit would be available after payment
- In the case of payment of service tax under reverse charge, Credit is available on or after the payment of value of service and service tax

Set-off of various taxes

Set-off of various taxes



Set-off of various taxes



Requirement for payment of duty when inputs, capital goods removed from the factory of manufacturer/ premises of service provider

Requirement for payment of duty when inputs, capital goods removed from the factory of manufacturer/ premises of service provider

Removal of Capital goods

- As such - Pay duty equal to Credit
- After Use - Pay duty equal to higher of the following**:**
  - Credit reduced by 2.5% per quarter [however, for c*omputers and computer peripherals Credit has to be reduced by - 1st year - 10% pq, 2nd year - 8% pq, 3rd year - 5% pq, 4th and 5th year @ 1% pq]* or
  - duty payable on transaction value
- Write-off before putting to use - Reversal required
- Write-off otherwise - Credit allowed

Removal of Inputs

- For free warranty - No payment requirement
- Removal as such - Payment of duty equal to Credit taken; however, no payment required where inputs are removed outside the premises of the provider of output service for providing the output service
- Write-off before putting to use - Reversal required
- Write-off otherwise - Credit allowed

Refund of Credit

Refund of Credit

Rule 5

- Manufacturer who clears a product for export without payment of duty or a service provider who provides an output service which is exported without payment of service tax, is allowed refund of Credit
- Formula specified for refund of Credit to exporters
- Conditions and procedure prescribed separately

Refund of Credit to service providers providing services taxed on reverse charge basis

- Provider of service providing services on which service tax is payable under reverse charge and being unable to utilise the Credit availed on inputs and input services for payment of service tax on such output services, shall be allowed refund of such unutilised Credit subject to specified conditions

Input Service Distributor

Input Service Distributor

Input service distributor may distribute the Credit, subject to the following conditions:

- Credit distributed should not exceed the amount of service tax paid
- Credit of service tax attributable to service used in a unit exclusively engaged in manufacture of exempted goods or providing of exempted services shall not be distributed
- Credit of service tax attributable to service used wholly in a unit shall be distributed only to that unit
- Credit of service tax attributable to service used in more than one unit shall be distributed *pro rata* on the basis of the turnover during the relevant period of the concerned unit to the sum total of the turnover of all the units to which the service relates during the same period

Documents for availing Credit

Documents for availing Credit

Credit shall be taken by the manufacturer/ provider of output service/ input service distributor on the basis of any of the following documents:

- Invoice issued by a manufacturer, an importer, first stage dealer, second stage dealer
- Supplementary invoice issued by the manufacturer or importer of inputs/ provider of output service
- Bill of entry
- Invoice, bill or challan issued by a provider of input service
- Invoice, bill or challan issued by an input service distributor

No Credit can be taken unless all the particulars as prescribed under the Central Excise Rules, 2002 or Service Tax Rules, 1994 are present in the document

However, Credit allowed if the following particulars are present:

- Description of goods or services
- Assessable value, details of duty or service tax payable
- Excise/ Service Tax registration number of the person issuing the invoice
- Name and address of the factory, warehouse or premises of the first stage dealer or second stage dealer or service provider

AC/ DC is satisfied that goods or services are received and accounted for in the books

Transfer of Credit

Transfer of Credit

Manufacturer or service provider

- Shifts the factory/ business to another site
- Transfers the factory/ business on account of change in ownership, sale, merger, amalgamation, leases or transfers of factory to a JV with the specific provision of transfer of liability of such factory, then, the manufacturer can transfer the unutilised Cenvat Credit to such transferred, sold, merged, leased or amalgamated factory/ business
- Transfer of Credit is allowed only if the stock of inputs as such or in process, or the capital goods are also transferred along with the factory or business premises to the new site or ownership and the inputs or capital goods, on which Credit has been availed of are duly accounted for to the satisfaction of the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise.

A manufacturer having more than one registered premises may transfer unutilised Credit of additional duty leviable under sub-section (5) of Section 3 of the Customs Tariff Act subject to certain conditions

Recovery and Penalties

Recovery and Penalties

- Where the Cenvat Credit has been taken and utilised wrongly or has been erroneously refunded, the same along with interest shall be recovered from the manufacturer or the provider of the output service
- The recovery provision under excise and service tax shall apply *mutatis mutandis* for effecting such recoveries
- Wrong availment or availment of Cenvat Credit in contradiction of any provisions:
  - Such inputs and capital goods are liable to be confiscated
  - Penalty – equal to Credit amount or INR 2000, whichever is higher
- Wrong availment of Cenvat Credit on account of fraud, willful misstatement, collusion or suppression of facts or contravention of any of the provisions with an intention to evade payment of duty:
  - Liable to penalties under Section 11AC of Central Excise Act – manufacturer
  - Liable to penalties under Section 78 of the Finance Act – service provider