



BDO Indirect Tax Update

India

May 28, 2010

Rule 6(2) and Rule 6(3) of the CENVAT Credit Rules, 2004 are not attracted when an assessee is engaged in providing 'taxable output services' and 'trading activity'

The CESTAT (Ahmedabad Bench) in case of **Orion Appliances Ltd. v. CST, Ahmedabad** [Arising out of Appeal No. ST/120/09 and order dated 07-05-2010] has observed that Rule 6(2) and Rule 6(3) of the CENVAT Credit Rules, 2004 are not attracted in case where an assessee is providing 'taxable output services' and also undertaking 'trading activity'.

Brief facts

- M/s. Orion Appliances Limited ('Appellant') was engaged in providing taxable output services as well as undertaking trading activity.
- The Appellant availed full CENVAT credit of Service Tax paid on 'input service' used for both the activities considering that no specific disallowance (attributable to trading activity) exists for common input services used for both the activities under the present CENVAT Credit Rules, 2004.
- The lower authorities construed that 'trading activity' should be considered as 'exempted services' as defined under Rule 2(1)(I) of CENVAT Credit Rules, 2004 and accordingly restriction as per Rule 6(2) and/or Rule 6(3) will apply.

- The authorities also observed that the Appellant should have maintained separate accounts in respect of input services used for 'trading activities' and 'taxable output services' liable to Service Tax.
- The Appellant preferred an appeal with the CESTAT against the order of the Commissioner of Central Excise (Appeals) and the CESTAT examined the following issues:
 - Whether trading activity can be called a 'service'?
 - Whether Rule 6 of CENVAT Credit Rules, 2002 and Service Tax Credit Rules, 2002 would be applicable when input services are used in respect of trading activity as well as provision of taxable output services?
 - Under circumstances where CENVAT Credit Rules, 2002 and Service Tax Credit Rules, 2002 are not applicable, the procedure to be followed by the assessee for availing input credit of Service Tax.

CESTAT Decision

- Trading activity is nothing but purchase and sales and is covered under Sales tax law, so it is not appropriate to call it a 'service'. Accordingly, the question of 'trading activity' as a 'service' and consequently as an 'exempted service' does not arise.
- As trading activity cannot be said to be exempted services, the provisions of Rule 6(2) and Rule 6(3) of CENVAT Credit Rules, 2002 (erstwhile) and Rule 3 of Service Tax Credit Rules, 2002 (erstwhile) does not apply for the purpose of restriction on availment and utilization of CENVAT Credit.
- Where an assessee is undertaking activities which cannot be called a 'service' or which also cannot be called 'manufacture', that activity goes out of purview of both Central Excise Act as well as Finance Act, 1994.
- Accordingly, there exists a situation where an assessee would be eligible to avail CENVAT Credit of Service Tax paid on 'input services' where an assessee is providing a taxable service and undertaking another activity which is neither manufacture or service.
- The only available proposition in this scenario is to either segregate the quantum of 'input services' attributable to trading activity and exclude the same or reduce the said credit once in a quarter or in six months, by applying standard accounting principles.



BDO Comments

- The decision clarifies that trading activity is not a service at all and therefore it cannot be treated as an 'exempted service'. Accordingly, the formulae prescribed under Rule 6(3) of the CENVAT Credit Rules, 2004 cannot be made applicable for reversal of credit towards trading activity.
- However, on the other hand, the decision also calls for segregation and consequent reversal of CENVAT Credit availed on common input services attributable towards trading activity according to standard accounting principles. This view is based on the principle of equity; however no such specific treatment is stipulated in the CENVAT Credit Rules, 2004.
- The anomaly continues on reversal of CENVAT Credit on trading activities and the practical difficulties involved in segregating such credit.
- However, given the complex nature of the issue and considering the consequences involved and matter of interpretation of law, we believe that the issue may be agitated before the Higher Forums.

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