

Distribution of Service tax credits – Few issues

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Manufacturers or service providers operating from multiple locations may often find it difficult to avail the Cenvat credit on inputs, input services and capital goods which are commonly or otherwise used in multiple locations. In case of input services received, the invoices would mostly be addressed to the head office and bifurcation of the credits for distribution to each location would be tricky. In order to address this issue, the concept of Input service distributor (ISD) had been introduced in the Cenvat Credit Rules 2004. The credit distribution mechanism has undergone few changes in recent years, possibly with an intention to simplify the process. However, still few issues which are discussed in this article needs to be addressed by the Revenue.

ISD has been defined in Rule 2(m) of Cenvat Credit Rules 2004 as an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under Rule 4A of the Service Tax Rules 1994 towards purchase of input services and issues invoice / bill / challan for the purposes of distributing the credit of service tax paid on said services to such manufacturer or producer or provider. The main objective of ISD is to receive the input service invoices and distribute the credits to eligible branches / units as the services would have been commonly or exclusively utilised by such branches.

The service provider has the option of even distributing the credit of excise duty availed on inputs to other units in addition to option of distributing the input service credits.

Methodology to distribute the credits

As per Rule 7, the distribution of credit is subject to following conditions:

1. Credit distributed should not exceed the amount of service tax paid.
2. Credit of service tax attributable to service used by "*one or more units exclusively engaged in the manufacture of exempted goods or providing exempted services*" shall not be distributed.
3. Credit of service tax attributable to service used "*wholly by a unit*" shall be distributed only to that unit
4. Credit of service tax attributable to service used "*by more than one unit*" shall be distributed *pro rata* on the basis of the turnover of such units during the relevant period to the total turnover of all its units, which are operational in the current year, during the said relevant period.

Considering the methodology of distributing the credits, now we would discuss few issues which need to be addressed in the ISD concept.

Time limit for availing the credit

The provider of output service or manufacturer is allowed to avail the Cenvat credit in respect of inputs and input services within 1 year from the date of documents as specified in Rule 9(1) of Cenvat credit Rules 2004. The bill / challan issued by the ISD is also specified in Rule 9(1). Now the issue is whether the time limit of one year is applicable for ISD as well. If yes, whether the unit / branch to which credit is transferred needs to avail it within one year from ISD bill or from original bill based on which credit is transferred? From literal reading of the provisions, it appears that the time limit is applicable only from ISD bill / challans. However, the board needs to issue clarification in this regard.

Credit distribution issues

Circular no. 178/4/2014-ST dated 11.07.2014 has been issued by the board confirming that input service pertaining to more than one unit shall be distributed pro-rata irrespective of whether such common input services were used in all the units or in some of the units. Even though the method of ascertaining the eligible credit seems to be simple, there is every possibility that the assessee would end up losing eligible credit. This could be understood by following example:

Particulars during relevant period	Branch A	Branch B	Branch C
Turnover of taxable services	4,00,000/-	6,00,000/-	Nil
Turnover of exempted services	Nil	Nil	3,00,000/-
Total turnover	4,00,000/-	6,00,000/-	3,00,000/-
Credit commonly used in Branch A and B – Rs.25,000/-			
Credit to be distributed pro-rata	7,692	11,538	5,770

In the above example, credit of Rs.25,000/- needs to be distributed to all the branches based on their respective turnover even though the input service is used only at Branch A and B. The denominator for pro-rata distribution would be total turnover of Rs.13,00,000/- including turnover of exempted services. As a result of this method, the assessee would be required to distribute credit of Rs.5,770/- to Branch C even though no part of the service is utilised towards exempted services. However, credit cannot be utilised as there is only exempted services provided from Branch C.

As a result of the amendment and the clarification issued through the circular, the assessee end up losing eligible credits which otherwise would have been fully eligible. It is interesting to note that even the department could be at the losing end due to this amendment in the manner of distribution sometimes. Let us consider the following example:

Particulars during relevant period	Branch A	Branch B	Branch C
Turnover of taxable services	4,00,000/-	6,00,000/-	Nil
Turnover of exempted services	Nil	Nil	20,00,000/-
Total turnover	4,00,000/-	6,00,000/-	20,00,000/-
Credit commonly used in Branch B and C – Rs.25,000/-			
Credit to be distributed pro-rata	3,333/-	5,000/-	16,666/-

In this example, the eligible credit for the assessee would be Rs.8,333/- as the credit distribution needs to be to all the branches. The ineligible credit would be Rs.16,666/-. If turnover of only B and C is considered for distribution, then the ineligible credit would be $[20,00,000 / 26,00,000] * 25,000 = 19,231/-$.

Filing half yearly return by ISD

ISD is required to submit half yearly return as per Rule 9 (10) of Cenvat Credit Rules 2004 [CCR] in Form ST-3 giving details of credit received and distributed within 30 days from end of relevant half year. For example, for the half year October 2015 to March 2016, the due date is April 30, 2016. Rule 9 (11) of CCR provides for revision of such return within 60 days from date of filing return. However, as per the Service Tax Rules 1994 [STR], the service provider who could also be a ISD needs to file the ST-3 return within 25 days from end of half year and has option of revising the return in 90 days from filing the return.

The provisions of STR and CCR with respect to filing of ST-3 return are conflicting which needs to be addressed.

Conclusion: The better way for the board is to restore the earlier Rule wherein the credit was distributed considering turnover of only respective units or branches (for nominator as well as denominator) where the input services are used instead of considering all units. This would ensure that both revenue and assessee do not lose any tax or eligible credit which is rightly eligible for them.

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