Exempted goods and Exempted services – Service Tax - Confusion galore

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Manufacturers or service providers engaged in providing taxable and exempted activities avail cenvat credit. One big task would be compliance under Rule 6 of CCR 2004. The provisions of credit have gone through a number of restrictive attempts and attempts to rationalise the restrictions. Even in this Finance Bill 2016, significant change were made with introduction of new explanation expanding the scope of exempted services. We have tried to analyse the impact of these changes.

Expansion in scope of exempted goods

The scope of exempted goods was expanded in Finance Act 2015 to include non-excisable goods cleared for a consideration from the factory. The value of such non-excisable goods would be the invoice value. In case invoice value is not available, the value of non-excisable goods would be determined by using reasonable means in accordance with valuation principles contained in Excise Act and the Valuation Rules.

It may be noted that the definition of 'exempted goods' does not include non-excisable goods even now in the definition of 'exempted goods' in Rule 2 of CCR 2004. The discussed amendment is only for the purpose of Rule 6. There were also many disputes in respect of reversal of credits pertaining to non-excisable goods. All these have led to expansion of scope of exempted goods.

The term 'non-excisable goods' is not defined in the Central Excise provisions. However, the definition of 'excisable goods' has been provided under Section 2(d) of the Central Excise Act to mean goods specified in first and second schedule to the Central Excise Tariff Act, 1985 (CETA) as being subject to a duty of Excise and includes salt. Therefore, goods finding entry in CETA but with no rate of excise could be considered as non-excisable goods. Electric energy is the best example for this. Following are few issues which are cropping up due to this amendment:

a) An assessee may also goods such as used oil, used packing materials, barrels which are all not manufactured along with other dutiable goods. Now the question is whether such goods should be treated as non-excisable goods.

b) The amendment is through an explanation from 1st March 2015. However, it is not clear if the amendment is prospective or retrospective.
c) The term consideration has not been discussed anywhere. Therefore, in case invoice is not issued, ascertaining of values for non-excisable goods would lead to divergent views. When the invoice is raised, then also department could question valuation especially in case of related party transactions.

Expansion in scope of Exempted services

In Finance Act 2016, (Not. no. 13/2016-CE NT) expanded the scope of exempted services for the purpose of Rule 6 by stating that 'exempted services' would include an activity, which is **not a 'service'** as defined in Section 65B(44) of the Finance Act, 1994. The value to be considered is invoice/ agreement/ contract value and where such value is not available, such value needs to be determined by using reasonable means consistent with the principles of valuation contained in the Finance Act and the Rules.

This amendment has put the assessee in dilemma as computation of eligible Cenvat credit amount in case of common services would be depending on value of exempted services. In terms of Section 65B(44) of the Finance Act, any activity carried out by a person for another for consideration is a service and includes a declared services. This definition excludes following activities which would not be considered as service:

(i) Transfer of title in goods / immovable property by way of sale, gift or in any other manner;
(ii) Transaction in money or actionable claim;
(iii) Provision of service by an employee to employer;
(iv) Fees taken in any Court or tribunal established under any law.

This amendment therefore is illogical as an activity cannot be said to be an exempted service unless it is service first. Strict interpretation of this amendment would bring many assessees into Rule 6 compliance. For example, an assessee who is exclusively engaged in manufacturing of excisable goods also sells one immovable property as one time affair. He would be required to consider such sale as exempted service and the value would be invoice / contract value which could be huge and sometime could be more than turnover of manufactured goods.

Further few other examples which are could lead to different interpretations and litigation:

(i) Sale of flats by developers before completion certificate with service tax and sale after completion certificate without service tax. In this sale of flats after completion would be treated as 'exempted' as it is outside purview of 'Service' definition.

(ii) Interest income earned on deposits.

(iii) Trading of goods is also not a service. Department could argue that the entire value should be taken as 'exempted service' even though one could argue that only margin or 10% of cost to be considered as exempted value as clarified.

Conclusion: Central Government has taken few good initiatives and seems to have spent considerable time to amend various provisions. However, there are few changes which have muddied the waters.

The assessee could make representations through associations demanding suitable changes. Alternatively, clarification could be sought from the CBEC. The Government needs to either modify or remove the amendment. Clarification on issues may or may not help the already hazy area of reversal of credit.

-This article has been uploaded in KSCAA
journal in the month of May 2016.