In-depth Analysis of latest Changes effected in CENVAT Rules in Finance Bill 2010

CENVAT is one of the most crucial but sensitive issues both in Service Tax and Central Excise. Money saved is money earned. In case an assessee calculates its output tax liability on a higher side or claims less CENVAT credit, the result is that the net tax liability of the assessee goes up. It is of paramount importance to understand the CENVAT Rules properly as lesser claim will increase the net tax liability and excess claim of CENVAT will result into heavy penalties and interest. *It, therefore, becomes imperative to understand in the right perspective the minutest implications of CENVAT changes in the latest Financial Bill 2010.*

To begin with, CENVAT Credit is available to a manufacturer of excisable goods and provider of output service in respect of the following:-

(A) Excise duty paid in respect of Inputs.
(B) Excise duty paid in respect of capital goods.
(C) Service tax paid in respect of input services.
(D) Primary Education Cess & Secondary & Higher Education Cess in respect of Inputs, Capital Goods & Input Services.

Keeping in view the ease & convenience of understanding of readers all changes effected in Finance Bill 2010 in respect of CENVAT Credit have been dealt hereunder:-

1. Higher Percentage Reduction In Case Of Disposal Of Computer & Computer Peripherals After Use- ***Notification No. 06/2010-Central Excise (NT) dated 27-02-2010***

First of all it is necessary to know the position prevailing until 26-02-2010 in the present context. **Rule 3(5)** provides that when Inputs or **Capital Goods** on which CENVAT Credit has been taken, are **removed as such** from the factory or premises of the provider of output service, the manufacturer of the final product or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods, and such removal shall be made under the cover of an invoice referred to in Rule 9. The sub-rule (5) of Rule 3 deals with a situation in which Capital Goods are removed **without being used at all.** However, in many practical situations Capital Goods are removed after being used for a certain period of time. To take care of this practical situation **second proviso to Rule 3(5)** of CENVAT Credit

Rules 2004 has been inserted w.e.f 13.11.2007. According to aforementioned second proviso if the Capital Goods on which CENVAT Credit has been taken, **are removed after being used,** the manufacturer or provider of output service shall **pay an amount equal to the CENVAT Credit taken on the said capital goods reduced by 2.5 per cent for each quarter of a year or part thereof** from the date of taking the CENVAT Credit.

However, with an aim to provide greater benefit to a manufacturer or service provider, as the case may be, in case of disposal of Computer & Computer peripherals **Notification No. 06/2010-Central Excise (NT) dated 27-02-2010** has been issued whereby a proviso has been substituted in place of the above mentioned second proviso to Rule 3(5). As per substituted second proviso if the capital goods, on which CENVAT Credit has been taken, are removed after being used, the manufacturer or provider of output service shall pay an amount equal to the CENVAT Credit taken on the said capital goods **reduced by the percentage points** calculated by **straight line method** specified below for each quarter of a year or part thereof from the date of taking the CENVAT Credit namely:-

(a) For computers and computer peripherals

Particulars	**Percentage Reduction**
For each quarter in the first year	10%
For each quarter in the second year	08%
For each quarter in the third year	05%
For each quarter in the fourth & fifth year	01%

(b) For capital goods, other than computers and computer peripherals @ 2.5% for each quarter.

In order to fully understand the practical implications of above change, following simple illustration is given:-

ABC Ltd. acquired the following assets on 1-4-2007:-

Kinds of Capital Assets	**Total Amount (including Excise Duty) (Rs.)**	**Amount of Excise Duty (Rs.)**
Computers and Computer Peripherals	5,00,000	80,000
Capital Assets other Computers & Computer Peripherals	20,00,000	3,20,000

It is assumed that ABC Ltd **removed of above capital Assets after use on 6th March 2010.**

Thus, in accordance with substituted second proviso to Rule 3(5) of CENVAT Credit Rules 2004, ABC Ltd will pay the following amounts:-

Date of Acquisition of Assets	01-04-2007
Date of Disposal of Assets	06-03-2010
Time Gap in terms of number of quarters/part thereof between above two dates	12 quarters

(A) Case of Computer & Computer Peripherals:-

Total CENVAT availed in case of Computers & Computer Peripherals:	Rs. 80,000
Amount reduced for each quarter in the first year @ 10% i.e.4 x 10%=40%	Rs. 32,000
Amount reduced for each quarter in the second year @ 8% i.e. 4x 8%=32%	Rs. 25,600
Amount reduced for each quarter in the third year @ 5% i.e. 4 x 5%=20%	Rs. 16,000
Thus Total amount to be reduced	Rs. 73,600
Amount to be paid in cash by ABC Ltd.(Rs. 80,000 – Rs. 73,600)	Rs. 6,400/-

(B) Case of disposal of other Capital Assets:-

Total Amount of CENVAT availed	Rs. 3,20,000
Amount reduced for 12 quarters @ 2.5% i.e. 2.5 x 12= 30%	Rs. 96,000/-
Thus amount to be paid by ABC Ltd	Rs. 2,24,000/-

2. Full CENVAT to be allowed in the year in which Capital Goods are received where the assessee is entitled to avail exemption under a notification based on the value of clearances in financial year w.e.f. 01-04-2010 - *Notification No. 06/2010-CE (NT) dated 27-02-2010*

According to Rule 4(2)(a) of CENVAT Credit Rules 2004 the CENVAT Credit in respect of capital goods received in a factory or in the premises of the provider of output service at any point of time in a financial year shall be **only for an amount not exceeding fifty per cent of the duty** paid on such capital goods in the same financial year. However, **two provisos** were already there as under-

"PROVIDED that the CENVAT credit in respect of capital goods shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year if such capital goods are cleared as such in the same financial year.

PROVIDED FURTHER that the CENVAT credit of the additional duty leviable under sub-section (5) of section 3 of the Customs Tariff Act, in respect of capital goods shall be allowed immediately on receipt of the capital goods in the factory of a manufacturer."

Now, a **third proviso** has been added **w.e.f. 01-04-2010** where an assessee is eligible to avail of the exemption under a notification based on the value of clearances in a financial year, the CENVAT Credit in respect of capital goods received by such assessee shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year. Further, as per **Explanation** to aforementioned third proviso an assessee shall be "eligible" if his aggregate value of clearances of all excisable goods for home consumption in the preceding financial year in the manner specified in the said notification **did not exceed rupees four hundred lakhs.**

3. Expansion in the scope of the situation when CENVAT Credit is allowed in respect of jigs, fixtures, moulds and dies- *Notification No. 06/2010-Central Excise (NT) dated 27-02-2010*

According to **erstwhile Rule 4(5)(b)** the CENVAT Credit was also allowed in respect of jigs, fixtures, moulds and dies sent by an manufacturer of final products to a job worker for the production of goods on his behalf and according to his specifications. There was a **lacuna** in the said Rule 4(5)(b). The lacuna in the said rule was that it did not cover the situation when jigs, fixtures, moulds and dies were sent by a manufacturer of final products **to another manufacturer** for the production of goods. In order to overcome the above lacuna, a erstwhile sub-clause (b) has been substituted by a new sub-clause. Consequently, according to substituted Rule4(5)(b) the CENVAT Credit shall also be allowed in respect of jigs, fixtures, moulds and dies sent by a manufacturer of final products to :-

(i) **Another manufacturer for production of goods**; or
(ii) A job worker for the production of goods on his behalf, according to his specifications.

4. Expansion in scope of Rule 6(6)(vii) - ***Notification No. 06/2010-Central Excise (NT) dated 27-02-2010***

Rule 6 of CCR 2004 deals with obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services. Further, Rule 6(6) contains seven sub-clauses which provide that the provisions of sub-rule (1)(2)(3) & (4) of Rule 6 shall not be applicable in case the **excisable goods removed without payment of duty are cleared or supplied in the ways specified in the seven sub-clauses. The erstwhile sub-clause (vii) used to read as under:-**

> *"all goods which are exempt from the duties of customs leviable under the First Schedule to the Customs Tariff Act 1975 and the additional duty leviable under section 3 of the said Customs Tariff Act when imported into India and **supplied against International Competitive Bidding** in terms of Notification No. 6/2002-Central Excise dated 01-03-2002 or Notification No. 6/2006-CE dated 01-03-2006, as the case may be".*

The scope of above sub-clause (vii) has been increased substantially and as a result, a new sub-clause (vii) has been substituted in place of above mentioned sub- clause (vii).

"all goods which are exempt from the duties of customs leviable under the Fist Schedule to the Customs Tariff Act 1975 and the additional duty leviable under section 3 of the said Customs Tariff Act when imported into India and **supplied:-**

(a) Against International Competitive Bidding; **or**

(b) **To a power project** from which power supply has been tied up through tariff based competitive bidding; **or**

(c) **To a power project** awarded to a developer through tariff based competitive bidding**,** in terms of notification No. 6/2006-Central Excise dated 1st March 2006.

5. Increase in penalty if CENVAT Credit in respect of Input Services is taken or utilized wrongly:-

Rule 15 of CCR 2004 deals with confiscation and penalty for wrongly taking CENVAT Credit in respect of inputs or capital goods or input services. *Notification No. 06/2010 C.E (N.T.) dated 27.02.2010* substituted Rule 15 of CENVAT Credit Rules, 2004. Prior to such substitution, a penalty of upto Rs.2000/- could be imposed if CENVAT credit in respect of input services was taken wrongly or in contravention of any of the provisions of these rules in respect of any input service. Further, if CENVAT credit in respect of inputs or capital goods was taken wrongly or in contravention of any of the provisions of

these rules in respect of inputs or capital goods then a penalty not exceeding the duty on excisable goods in respect of which contravention has taken place or Rs.2,000 whichever is greater was leveiable. However, now, after the substitution, penal provisions for incorrect availment of CENVAT Credit of duty paid on inputs or capital goods or input services have been harmonized. In other words, if CENVAT credit in case of input services has been taken or utilized wrongly or in contravention of any of the provisions of these rules, then penalty shall be imposed as under:

> A penalty not exceeding Service Tax payable on such services
> Or
> Rs.2000/-, whichever is higher.

Further the word "takes" has been replaced by the words "takes or utilizes".

6. Amendment in Central Excise & CENVAT Credit Rules for the period 01.09.1996 to 31.03.2008 in respect of reversal of CENVAT Credit on exempted goods.

To resolve the disputes pending (on the date of enactment of Finance Bill, 2010) in respect of reversal of CENVAT Credit in case of a manufacturer of both dutiable and exempted goods, an amnesty scheme is proposed to be introduced from the said date i.e. date of enactment of Finance Bill, 2010. Accordingly, it is proposed to amend retrospectively w.e.f 01.09.1996 to 31.03.2008, the following rules-

(i) The Central Excise Rules, 1944;
(ii) The CENVAT Credit Rules, 2001;
(iii) The CENVAT Credit Rules, 2002; and
(iv) The CENVAT Credit Rules, 2004

The purpose is to provide an **option** to a manufacturer of both dutiable and exempted goods availing MODVAT/CENVAT Credit in respect of any inputs, other than fuel, to manufacture both dutiable and exempted goods, **to reverse credit or pay an amount equivalent to credit attributable to inputs used for manufacture of exempted goods.**

However, the option is subject to the condition that such manufacturer pays interest @ 24% p.a. from the date of clearance till date of reversal of the said credit or payment of equivalent amount. It is reiterated that such option shall be available only in those cases where disputes in this regard are pending on the date of enactment of the Finance Bill, 2010.

Further, amendment is also being made to Rule 57AD of Central Excise Rules, 1944; to Rule 6 of CENVAT Credit Rules, 2001; to Rule 6 of CENVAT Credit Rules, 2002 and to Rule 6 of CENVAT Credit Rules, 2004.

According to the said amendments, where the manufacturer opts for the above scheme, he shall –

(i) Pay the amount along with interest; **and**

(ii) Make an application to the Commissioner of Central Excise along with documentary evidence, **and a Certificate from a Chartered Accountant or a Cost Accountant** certifying the amount of input credit attributable to the inputs used in or in relation to the manufacture exempted goods.

Note:- Such application is to be made **within a period of 6 months** from the date on which the Finance Bill, 2010 receives the assent of the President.

The Commissioner of Central Excise, on receipt of such application, shall verify the correctness of the amount paid **within a period of 2 months.** In case of any shortfall, he shall call upon the applicant to pay the differential amount along with interest, which shall be paid **within a period of 10 days** from the date of receipt of communication from the Commissioner in this regard.

7. Amendments in Notification No. 5/2006-CE (NT) dt. 14-03-2006 Refund of accumulated CENVAT Credit to Exporters:-

According to **Rule 5** of C.C.R. 2004 where **any input or input service** is used in the manufacture of final product which is cleared for export under bond or letter of undertaking, as the case may be, or **used in** the intermediate product cleared for export, or **used in** providing output service which is exported the CENVAT Credit in respect of the input or input service so used shall be allowed to be utilized by the manufacturer or provider of output services towards payment of duty of excise on any final product cleared for home consumption or for export on payment of duty; or service tax on output service, and where for any reason such adjustment is not possible, the manufacturer or the provider of output service shall be allowed refund of such amount subject to such safeguards, conditions and limitations, as may be specified, by the Central Government, **by Notification**. Resultantly, Notification No. **5/2006-CE(NT)dated 14-03-2006** was issued which prescribed six conditions as well as a procedure for claiming the aforementioned refund under Rule 5 of CCR 2004.However, there was a constant complaint of the Exporters' community that they seldom received

the refund in time in pursuance of previously mentioned Notification of 14-03-2006. In order to provide **immediate solution** to the exporters (mainly BPOs/Call Centres) in getting timely refund of Excise Duty and Service Tax C.B.E.C. issued a **Circular No. 120/01/2010-ST dated 19-01-2010**. This Circular examined in detail the **various causes** for delay in grant of refunds to exporters. In particular, it was pointed out that **use of different phrases in *Notification* No. 5/2006-CE (N.T) dated 14-03-2006 & CENVAT Credit Rules 2004 was** causing delay in grant of refund. It was specified that there is a tendency on the part of field formations to take the view that for eligibility of refund the nexus between inputs/input services and the final goods/services has to *be closer and more direct* than that is required for taking credit. It has been specified that the reason for such restrictive view is the use of different phrases in **Notification *No. 5/2006-CE (N.T)*** *and CENVAT Credit Rules 2004.The following table gives* the difference between the two:-

Notification No. 5/2006-CE (N.T)	**CENVAT Credit Rules 2004**
Refund is permitted of duties/taxes paid only on such inputs/input services which are either used in the manufacture of export goods or used in providing the output services exported.	These Rules permit the credit of services used "whether directly or indirectly in or in relation to the manufacture of final product" or "for providing output service."

Now, in order to give legal backing to above mentioned Circular No. **120/01/2010** with a view to quickly process refund claims certain changes have been effected in Notification No. 5/2006-CE. These changes in aforementioned notification can be broadly divided as under:-

(I) Retrospective Changes w.e.f. 14-3-2006:-

(i) The words "in relation to" has been added in main condition (a) of Notification.

(ii) The word "in" contained in main condition (b) of the said notification has been replaced with "for".

As a result of such change it is ensured that refund is granted **on all goods and services on which CENVAT can be claimed** by the exporter of goods or services.

(II) Prospective Changes:-

Certification of certain details: - Keeping in mind the twin aims of reducing the checking of voluminous records by the officers processing the refund claims and ensuring faster processing of refund claims **certain details** needed to be submitted by the claimant are required to be **certified** as per following two tables:

(A) If the amount of refund claimed is less than Rs 5 lakh in a quarter:-

In case of a limited company	**In case of sole proprietary firms/partnerships**
By a person authorised by the Board of Directors	By a proprietor or an authorised partner

(B) If the amount of refund claimed is in excess of Rs 5 lakh in a quarter:-

In case of a limited company	**In case of sole proprietary firms/partnerships**
By a person authorised by the Board of Directors AND by a Chartered Accountant who audits the annual accounts for the purposes of Companies Act 1956.	By a proprietor or an authorized partner **AND** by a Chartered Accountant who audits the annual accounts for the purposes of Income Tax Act 1961 u/s 44AB.

With the above changes in **Notification No. 5/2006-CE (NT) dt. 14-03-2006** it is earnestly hoped that the departmental officers processing the refund will make all-out efforts and exhibit genuine interest & sincerity in promptly processing the refund claims of exporters filed in pursuance of this Notification.

Conclusion:-

Since under the proposed Goods and Service Tax (GST) CENVAT Credit will be available in respect of large number of taxes, it is highly desirable on the part of professionals to thoroughly understand the significance and implications of CENVAT. Many professionals jokingly say that a true & deep understanding of CENVAT tantamount to winning more than half a battle in Service Tax. The joke may not hold true in all situations. However, it does emphasize the significance of CENVAT Credit.

****