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INDIRECT TAX REVIEW
OCTOBER 2014

EXCISE

CUSTOMS

SERVICE TAX

VALUE ADDED TAX

Inside this edition

DISTRIBUTION OF CENVAT CREDIT BY AN ISD

Input Service Distributor:

Input Service Distributor is defined in Rule 2(m) of CENVAT credit Rules, 2004 (CCR). As per the above rule, it means an office of the manufacturer of final products or provider of output service, which receives invoices towards purchase of input services. It takes the credit and in turn issues invoice for the purpose of distributing the credit of service tax paid to such manufacturer or provider.

Manner of distribution of credit

Rule 7 of CCR provides the manner of distribution of credit. As per Rule 7, the distribution of credit is subject to the 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

Unit:

Explanation 1 to Rule 7 defines *"Unit"*. It includes the premises of a provider of output service and the premises of a manufacturer including the factory, whether registered or not.

Analysis of distribution of credit – Unit wise:

Unit	7(b)	7(c)	7(d)
Rule	Service used - by one or more units exclusively engaged in manufactured of exempted goods or providing of exempted services	Service used - *"wholly"* by a unit	Service used - by more than one unit
Unit 1 - Exempted goods + Exempted service	Technically, credit can be distributed as it is not exclusively engaged in the manufacture of exempted goods **or**exempted	Credit can be distributed. The word used is "or" and not "and". However, Unit cannot take the	Credit can be distributed as per formula. However, Unit cannot take the

	services. The word used is "or" and not "and". However, Unit cannot take the credit.	credit.	credit.
Unit 2 - Exempted goods + Taxable service	Credit can be distributed to this unit. However, it is not clear whether entire credit can be adjusted against the output service tax payable.	Credit can be distributed to this unit. However, it is not clear whether entire credit can be adjusted against the output service tax payable.	Credit can be distributed as per formula. However, it is not clear whether entire credit can be adjusted against the output service tax payable.
Unit 3 - Dutiable goods + Exempted service	Same as Unit 2	Same as Unit 2	Same as Unit 2
Unit 4 - Dutiable goods + Taxable Service	Credit can be distributed to this unit. But not clear whether credit has to be adjusted 50% for dutiable goods and 50% for taxable services or on pro rata based on turnover of Unit-4	Credit can be distributed to this unit. But not clear whether credit has to be adjusted 50% for dutiable goods and 50% for taxable services or on pro rata based on turnover of Unit-4	Credit can be distributed as per formula. But not clear whether credit has to be adjusted 50% for dutiable goods and 50% for taxable services or on pro rata based on turnover of Unit-4
Unit 5 - Only exempted goods	Credit cannot be distributed	Credit cannot be distributed	Credit can be distributed but Unit cannot take the credit.

Unit 6 - Only exempted service	Credit cannot be distributed	Credit cannot be distributed	Credit can be distributed but Unit cannot take the credit.
Unit 7 - Only dutiable goods	Credit can be distributed	Credit can be distributed	Credit can be distributed
Unit 8 - Only taxable service	Same as Unit-7	Same as Unit-7	Same as Unit-7

From the above table, it can be seen that if a unit is exclusively engaged in the manufacture of exempted goods and/or exempted services OR dutiable goods and/or taxable services, as far as the distribution and availment of CENVAT credit is concerned, there may not be any difficulty. However, when a particular unit itself is engaged in the manufacture dutiable& exempted goods and/or providing taxable or exempted services, then there could be a problem with regard to the availment of input service tax credit distributed by ISD. The question is, in the absence of any rule, whether the unit would be justified in availing the entire credit distributed by ISD against the duty/service tax payable by the Unit. A conservative approach would be to not take a portion of the credit "attributable" to exempted goods or services manufactured/rendered by the Unit.

SERVICES OF RECOVERY AGENTS

In the Union Budget 2014 the Government took a step to 'Facilitate' assesses covered under service tax net. As a 'Facilitation Measure' services provided by 'Recovery Agents' to banks, financial institutions and NBFC shave been brought under complete reverse charge mechanism.

Through this article I want the stakeholders to ponder as to whether this facilitation measure will actually facilitate or shall spark a new pile of litigations. There are two notifications which have been issued so as to make the reverse charge mechanism effective on the said services provided by the Recovery Agents.

First is Notification No. 09/2014-ST dated 11.07.2014, which provides for amendments in the Service Tax Rules, 1994 and shall be effective from the date of issue. As per para 2 of the Notification following sub-clause (AA) shall be added to the definition of term 'person liable for paying service tax' defined at Rule 2(1)(d)(i):-

'(AA) in relation to service provided or agreed to be provided by a recovery agent to a banking company or a financial institution or a non-banking financial company, the recipient of service'

Second Notification is Notfn. No. 10/2014-ST dated 11.07.2014 which provides for amendment in Notification No. 30/2012-ST i.e. Reverse

Charge Notification. As per para 1(i) of N. No. 10/2014-ST the following shall be added in paragraph I, clause (A) of the notification:

"(ia) provided or agreed to be provided by a recovery agent to a banking company or a financial institution or a non-banking financial company."

Further, as per para 1(ii) of Notification No. 10/2014-ST following shall be inserted in the Table given at paragraph II:-

1A	in respect of services provided or agreed to be provided by arecovery agent to a banking company or a financial institution or a non-banking financial company	Nil	100%

In effect, if any 'Recovery Agent' has been appointed by banking company or a financial institution or a non-banking financial company (in short 'the Financial Institutions'),then it shall be the liability of the Financial Institution to deposit tax in the government coffers. The purpose for this amendment appears to collect tax on services provided by non-regulated individuals who by the use of muscle power and other tactics try to make recoveries from the defaulters.

However, as this term 'recovery agent'has not been defined in the Service Tax laws, a doubt arises as to whether a 'Servicer' shall also be covered under the ambit of this clause. It is a usual practice in the finance sector that Financial Institutions sell their portfolio of loans advanced to other players in the finance sector, so as to get ready liquid funds. There are Financial Institutions who in order to fulfil the statutory requirement of minimum lending to priority sector, as per RBI and other regulatory bodies' guidelines, are always interested in buying these loan portfolios. The 'buying' Financial Institution usually appoints 'selling' Financial Institution as 'Servicer' for the loan portfolio as per the terms of the agreement. The scope of work of Servicer is as follows:

- Manage, collect and receive payment from the assets in the portfolio;
- Administer and enforce the rights of the Buyer in the sold portfolio;
- Retention of underlying documents in trust and as an agent of the Buyer;
- Maintaining of records of collection for the Buyers;
- Submitting of periodic records of collection;
- Acting as constituted attorney's;
- Assistance in Audit and Review of the assets of the portfolio;
- Reporting to the CIBIL.

Now a question arises as to whether a 'Servicer' whose scope of work in addition to other work also includes doing recovery actions against those borrowers who have defaulted in making payment. As the term 'recovery agent' has not been defined under the Service Tax laws, I tried to look into the dictionary meaning of the following terms –

'Recover'means:

'To recover means to find or regain possession of, regain control of, regain or secure by any of a legal process, to get again.'

'Recovery'means:

'Recovery means the action of regaining or securing money lost or spent by means of a legal process or subsequent profits, debts recovery. Recovery means a thing secured by a process of law, the actual possession of any thing, or its value, by judgment of a legal tribunal, the obtaining of a thing as a result of an action brought for the purpose.'

From the above definition it can be suitably summarised that the term 'recovery' refers to getting back something which has been lost and the 'recovery agent' is the person who helps us in getting back lost amount from the defaulters. A Servicer, in my view, by no stretch can be said to be only a recovery agent whose services are availed to make good the loss arising on account of non-payment of loan amount by the borrowers. A point to be noted is that under the Positive List based taxation of services even though there was a specified category to tax services provided by recovery agent, but the term 'recovery' or 'recovery agent' itself was not defined.

It makes sense to examine the facts in light of the concept of 'Bundled Service' (defined in clause 66F of the Finance Act, 1994) because the service of recovery has been bundled with the services being provided by a Servicer. As per Section 66F(3)(a) of the Finance Act, 1994, if the elements of the bundled service are naturally bundled in the ordinary course of business then it shall be treated as provision of one single service which gives such bundle its essential characteristics. In my view it is the facility of collection, manage and administration which gives the bundle its essential characteristics and not that of recovery agent because it may so happen that no borrower defaults in repayment; hence the Servicer shall not be required to perform the work of recovery agent at all.

IS RULE 14 CCR, ULTRA VIRES THE CENTRAL EXCISE ACT?

Mutatis mutandis? This writer had a fairly good understanding of this Latin legal phrase. But what does it precisely mean? Could something deeply significant be lodged in its meaning and usage? Turning to

Mittal's *Law Dictionary* the meaning became clear: "It means with necessary changes in point of detail." An enlarged meaning is evident from website uslegal.com: *Mutatis mutandis* is a Latin phrase that means 'by changing those things which need to be changed.' The phrase can also mean 'having substituted new terms.'

On having a closer look at Rule 14 of the CENVAT Credit Rules 2004:

Rule 14. Recovery of CENVAT credit wrongly taken or erroneously *refunded: -*

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 and the provisions of sections 11A and 11AA of the Excise Act or sections 73 and 75 of the Finance Act, shall apply mutatis mutandis *for effecting such recoveries.*

Something in the structure of the above CENVAT credit recovery provision intrigued me and made me ponder. Some simple questions arose that needed clarifications:

One: Who made the rules? The opening para of CENVAT Credit Rules make sit amply clear:"In exercise of the powers conferred by section 37 of the Central Excise Act, 1944, … the Central Government hereby makes the following rules, namely:"

Two: Where is Section 11A located? This alongwith other provisions mentioned in Rule 14, are provisions found inside statutes enacted by the Parliament of India: Section 11A of Central Excise Act, 1944.

Three: What is Section 11A meant for? Obviously, I remind myself, it is a statutory provision for recovery of duty of excise not paid to the Government. To be doubly sure, the recovery provision was read again: it is interesting to note that Section 11A does not contain any reference to CENVAT credit wrongly availed and utilised.

Perhaps the reader may be conscious of the direction he or she is being guided to. But hastening slowly we shall revisit Mittal's Law Dictionary : "The phrase (mutatis mutandis) is often used in legislation in applying or extending legislative provisions to same or similar circumstances of the same or similar subjects. It is nothing but a rule of adaption."Searching for an illustration we shall turn to Hon. Calcutta High Court's Himalaya Rubber Products Ltd1992(61)ELT210(Cal). Referring to this interesting form of legislation, Hon Justice Ruma Pal, as she then was, said at para11 that Rule 4(2) of the Central Sales Tax (West Bengal) Rules,**1958** in terms "incorporates the provisions of the Bengal Sales Tax Rules, **1941** … into the 1958 Rules mutatis mutandis. "

In the same context Lord Esher is quoted:

"If a subsequent Act brings into itself by reference some of the clauses of a former Act the legal effect of that as has often been held, is to write those sections into the new Act just as if they had been actually written in it with the pen or printed in it and the moment you have those clauses in the later Act, you have no occasion to refer to the former Act at all."

The pattern is now clear at least to my mind: a subordinate legislation – that is rules – can incorporate a subordinate legislative provision on mutatis mutandis *basis. Similarly a Parliamentary enactment adopts* mutatis mutandis *principle with reference to another enactment of the same body. An immediate reference of much interest would be Section 11A(15) of the Central Excise Act 1944: "The provisions of sub-sections (1) to (14) shall apply,* mutatis mutandis, *to the recovery of interest where interest payable has not been paid or part paid or erroneously refunded." (Note the words "shall apply" – they also appear in Rule 14. Thus by using those words the Parliament was applying itself to itself.)*

Therefore, for the Government to resort to mutatis mutandis technique in a Circular is understandable. Like for example in the Circular dated 12.9.2001 concerning excise instructions, at para 21 the Board instructed, "Provision for Merchant Overtime has been specified. The Customs Regulation on this has been made applicable, mutatis mutandis in excise matters."But what hath the Government wrought in CENVAT Credit Rule 14?

The Central Government, being the Executive, in exercise of its rule making powers while framing Rule 14, left its humble terrain and entered into the exalted space of the Legislature and made "necessary

changes" and "substituted new terms" in, among others, Section 11A of a Parliamentary enactment. Is this an act of administrative over-reach?

If we recollect Lord Esher we note that if a subsequent Act brings into itself by reference some clauses of a former Act the legal effect is "to write those sections into the new Act". In such a scenario there is a sort of level playing field: power and authority flows unhindered on a horizontal plane from one provision of one enactment into another provision of another Act. In other words, as noted earlier: the Parliament can "apply" itself to itself. But can the Government through subordinate legislation usurp power and authority from Parliamentary enactment and "apply" to itself statutory provision?

Thus another dimension of Rule 14 becomes evident. Through the mutatis mutandis via-media what the framers of the rule may have intended was to elevate the proceedings for recovery of wrongly availed CENVAT credit to a statutory proceeding. No, they have not done that: what was done was merely copy the text of Section 11A but not the authority of that statutory provision. In computer parlance – it is a simple copy-paste job. The executive cannot "apply" a statutory provision to its subordinate legislation unless the statute provides it. The result is that while proceedings under Section 11A for recovery of duty of excise not paid are sanctified by the law of Parliament and become a statutory proceeding, on the other hand the recovery of wrongly availed credit under Rule 14 remains an administrative dispute resolution.

As the CENVAT Credit Rules have been framed by the Government *"in exercise of the powers conferred by section 37 of the Central Excise Act, 1944" it would be useful to explore that provision. Section 37 does not give powers to the Government to change and suitably substitute the provisions of the Excise Act in furtherance of Government's objectives. Section 37(1) enjoins* "The Central Government may make rules to carry into effect the purposes of this Act." In this particular context if we again peruse Section 11A, we would find that when it stands on its own pedestal (without the support of mutatis mutandisreference in Rule 14) there is no reference in this statutory provision (or perhaps in the entire Excise Act) to recovery of CENVAT credit wrongly availed and utilised. Now, would it be correct to conclude that purpose of the Excise Act does not include recovery of CENVAT credit wrongly availed and utilised? If that be so, is Rule 14 ultra vires the enactment?

Going a step further, we can note the significance of sub-section (2) of Section 37: *"In particular, and without prejudice to the generality of the foregoing power, such rules may -*

"then one pertinent phrase comes up again and again in the sub-clauses that follow sub-section (2): **provide for …** Like in clause (ib) " **provide for … recovery of duty not paid;** "A closer look would reveal clause (ib) is **not** the source of recovery powers: the font of that power and authority is located in Section 11A. Section 37(2)(ib) merely empowers the Government to provide an administrative platform for recovery of excise duty not paid which is recoverable under Section 11A. For recovery of wrongly availed CENVAT credit unfortunately the font of such recovery powers appears to be absent in the Central Excise Act, 1944 itself.Thus, merely making rules under Section 37 cannot be of assistance to the Government for such recovery proceedings: because Section 37 cannot grant any recovery power and authority to

the Central Government in respect of wrong availment and utilisation of CENVAT credit.

It is interesting to note that whereas Section 37 provides for recovery of duty not paid, there does not appear to be any similar provision for recovery of CENVAT credit wrongly availed.

In Government's defense it can be argued that the words and phrase "duty of excise" in Section 11A in particular and Excise Act in general can take within its embrace the concept of CENVAT credit. Under Section 3(1) what is levied and collected is duty of excise. And what is physically collected could be in form of cash or through cashless credit debits – but it is duty of excise.

Thus if Section 11A is not concerned as to how the assessee obtains cash for payment of duty of excise, the provision cannot be modified through mutatis mutandis process to cover how an assessee obtains and utilises CENVAT credit. Accordingly, if Section 11A is to adequately cover wrong availment and utilisation of CENVAT credit, cosmetic application ofmutatis mutandis rule would be insufficient; much overhauling is necessary in the section itself: a task better left to Parliament rather than tinkering by the gnomes in the Ministry of Finance.

In conclusion, to one’s mind at the moment, as the complexity of the whole gamut of wrong availment and utilisation of CENVAT credit cannot be incorporated into Section 11A merely by application of mutatis mutandis rule, and as the Central Excise Act, 1944 happens to be silent on such wrongful availment and utilisation, to that extent Rule 14 of the CENVAT Credit Rules, 2004 is bereft of authority of law to recover such CENVAT credits.

VERENDRA KALRA & CO

CHARTERED ACCOUNTANTS

CONTACT DETAILS:

Head Office
75/7 Rajpur Road, Dehradun
T +91.135.2743283, 2747084, 2742026
F +91.135.2740186
E info@vkalra.com
W www.vkalra.com

Branch Office
80/28 Malviya Nagar, New Delhi
E info@vkalra.com
W www.vkalra.com

For any further assistance contact our team at kmt@vkalra.com