RULE 6 JINX IN EXPORT OF SERVICE

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"Goods and services can be exported but not the taxes"

Someone, someday said that this quote is said by Mahatma Gandhiji. Even though not so sure, we religiously quote it in almost all of our presentation on indirect taxes. Whether he said it or not, it has always been the baseline of Indian economics. But there appears to be a threat to the above fundamental principles in respect of "Export of Services", which is the feedstock of this article.

Cenvat Credit Rules, 2004 (CCR) allows cenvat credit of duties of excise paid on inputs / capital goods, as well as, the service tax paid on input services, to a provider of output service and manufacturer of excisable goods. Rule 6 of the CCR provides that, if an output service provider provides both taxable services as well as exempted services, he shall take Cenvat credit only to the extent, where such input services have been used in rendering of taxable output services and shall also maintain adequate records in this regard. Wherever such meticulous approach is impracticable, the Rule also provides that the output service provider can avail full cenvat credit (except in respect of those input services which are exclusively used in rendering of exempted output services), but such credit can be utilized only to an extent of 20 % of the service tax liability of the service provider. In other words, 80 % his service tax liability has to be paid only through cash. In case of manufacturers, the restriction has been worded in such a way that he has to either reverse proportionate Cenvat Credit in respect of the exempted goods manufactured by him or has to pay 10 % of the price of the exempted goods, as the case may be.

In tune with the policy spelt above as to Exports, Rule 6 also inherits this legacy and the vice of the said Rule is not applicable in case of exports. As per Rule 6 (6) ibid, the vice of Rule 6 is not applicable, if the goods are cleared without payment of duty, to 100 % EOUs, SEZ units, or physically exported under bond. As such, export of goods has been given the desired protection. But, alas, what about the "Service Exporters?" Unfortunately, they are yet to be immuned from the vice of the provisions of Rule 6 of CCR. It is curious to note that the protection under Rule 6 (6) ibid has been given only to manufacturer exporters and not to exporters of services. Further, as no service tax is paid on the services exported, in terms of Rule 4 of the Export of Service Rules, 2005, the same shall be considered as an "exempted service". In the result, as on date, the exporter of service can utilize his cenvat Credit only to an extent of 20 % of his liability.

In case of export of goods, the same were not liable to any duty of excise, under Rule 19 of the Central Excise Rules, 2002. It may be observed that "exported goods" are not considered as "exempted goods", as the export goods were not exempted from payment of duty in terms of any exemption notification issued under section 5 A of the Central Excise Act, 1944. So, even in the absence of the immunity granted under Rule 6 (6) ibid, it can be safely argued that the vice of Rule 6 is not applicable for the goods exported. This view is also supported by certain judicial pronouncements, one among them being, Lloyds Metal and Engineers Limited Vs **CCE – 2002 (147) ELT 255.**

Exports of services were governed by Export of Service Rules, 2005, notified vide Notification 9/2005 ST Dated 03.03.2005. As per Rule 4 ibid, no service tax is payable if the services are exported, in terms of the said Rules. The said Export of Service Rules, 2005 was framed under Section 94 of the Finance Act, 1994, which is the general rule making power. So, it can be argued that, export of service is not an "exempted service" and hence the vice of Rule 6 of CCR, 2004 is not applicable for the services exported. Let us also refer to the definition of the term "exempted service" under Rule 2 (e) of the Cenvat Credit Rules, 2004, which reads as

> *"exempted services means taxable services which are exempt from the whole of the service tax leviable thereon, and includes services on which no service tax is leviable under section 66 of the Finance Act".*

From the above, it may be concluded that only those taxable services which have been exempted by way of an exemption notification and services on which no service tax is leviable (non taxable services) can be considered as "exempted services" and the vice of Rule 6 of the Cenvat Credit Rules, 2004 (restriction on utilisation of cenvat credit only to an extent of 20 % of the service tax liability) would not be attracted in case of "export of services".

But, by way of a silent amendment carried out in the Export of Service Rules, 2005 vide Notification 13/2006 ST Dated 19.04.2006, the Rules have been consciously amended to the effect that the Rules have been framed in exercise of powers conferred under Section 93 as well as section 94 of the Finance Act, 1994, instead of Section 94 alone. It may be observed that Section 93 ibid refer to grant of exemption and the provisions of Rule 4 ibid, providing that no service tax is payable in case of export of services, shall have the effect of making "export of services" as "exempted services".

As a consequence, an output service provider, who is also exporting his services cannot avail Cenvat Credit in respect of those inputs / input services which are consumed in rendering of the services which are exported. Otherwise, he would be restricted in utilising the Cenvat Credit, to an extent of 20 % of his liability. Certainly, this could not have been the intention of the Government and this appears only to be a slip, but a costly slip. So, it is fervently prayed that suitable amendments be carried out in Cenvat Credit Rules, 2004, protecting "export of services" from the vice of Rule 6 ibid, before more damage is done by way of avoidable issue of show cause notices, appeals, litigation, etc.

Before parting.....

In case the services are exported, the duties paid on inputs consumed thereon and the service tax paid on input services consumed thereon can be claimed either as a rebate under Rule 5 of the Export of Service Rules, 2005 and the Notification issued thereunder, or by way of Refund of Cenvat Credit, under Rule 5 of the Cenvat Credit Rules, 2004 and the Notification issued thereunder. While thus cash refund of the input duties / taxes consumed in exported services is permissible, it is highly impractical and illogical to hold that the service provider would not be entitled to utilize the credit in full, but would be granted cash refund of such credit.