

FAQ on ISD.

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A new Rule 7 has been substituted in the Cenvat Credit Rules, 2004 (CCR, 2004) dealing with distribution of cenvat credit of service tax paid on input services, by an Input Service Distributor (ISD). The salient features of this rule is explained below through FAQ. For ready reference the new rule 7 is reproduced below.

7. Manner of distribution of credit by input service distributor.-The input service distributor shall distribute the CENVAT credit in respect of the service tax paid on the input service to its manufacturing units or unit providing output service or an outsourced manufacturing units, as defined in Explanation 4, subject to the following conditions, namely :—

(a) the credit distributed against a document referred to in rule 9 does not exceed the amount of service tax paid thereon;

(b) the credit of service tax attributable as input service to a particular unit shall be distributed only to that unit;

(c) the credit of service tax attributable as input service to more than one unit but not to all the units shall be distributed only amongst such units to which the input service is attributable and such distribution shall be pro rata on the basis of the turnover of such units, during the relevant period, to the total turnover of all such units to which such input service is attributable and which are operational in the current year, during the said relevant period;

(d) the credit of service tax attributable as input service to all the units shall be distributed to all the units pro rata on the basis of the turnover of such units during the relevant period to the total turnover of all the units, which are operational in the current year, during the said relevant period;

(e) outsourced manufacturing unit shall maintain separate account for input service credit received from each of the input service distributors and shall use it only for payment of duty on goods manufactured for the input service distributor concerned;

(f) credit of service tax paid on input services, available with the input service distributor, as on the 31st of March, 2016, shall not be transferred to any outsourced manufacturing unit and such credit shall be distributed amongst the units excluding the outsourced manufacturing units.

Explanation.-The provision of this clause shall, mutatis-mutandis, apply to any outsourced manufacturer commencing production of goods on or after the 1st of April, 2016;

(g) provisions of rule 6 shall apply to the units manufacturing goods or provider of output service and shall not apply to the input service distributor.

Explanation 1.- For the purposes of this rule, —unit includes the premises of a provider of output service or the premises of a manufacturer including the factory, whether registered or otherwise or the premises of an outsourced manufacturing unit.

Explanation 2.-For the purposes of this rule, the total turnover shall be determined in the same manner as determined under rule 5:

Provided that the turnover of an outsourced manufacturing unit shall be the turnover of goods manufactured by such outsourced manufacturing unit for the input service distributor.

Explanation 3.- For the purposes of this rule, the relevant period' shall be, -

(a) if the assessee has turnover in the financial year' preceding to the year during which credit is to be distributed for month or quarter, as the case maybe, the said financial year; or;

(b) if the assessee does not have turn over for some or all the units in the preceding financial year, the last quarter for which details of turnover of all the units are available, previous to the month or quarter for which credit is to be distributed.

Explanation 4.- For the purposes of this rule, outsourced manufacturing unit means a job-worker who is liable to pay duty on the value determined under rule 10A of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 on the goods manufactured for the input service distributor or a manufacturer who manufactures goods, for the input service distributor under a contract, bearing the brand name of such input service distributor and is liable to pay duty on the value determined under section 4A of the Excise Act.

Definition of ISD under Rule 2 (m) of CCR, 2004.

"input service distributor" means an office of the manufacturer or producer of final products or pro-vider of output service, which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards pur-chases of input services and issues invoice, bill or, as the case may be, challan for the purposes of distributing the credit of service tax paid on the said services to such manufacturer or producer or provider, as the case may be.

Q 1. M/s XYZ Pvt Limited have got three manufacturing units (X, Y and Z) and a Registered office, which is registered as ISD. The Registered office has received an invoice for certain IT services being used by it in Plants, X and Z only. How the credit of service tax paid on such IT service should be distributed?

A 1. Such credit should be distributed only to Plants X and Z, based on the "total turnover" of these two units only. {Rule 7 (c)}.

For example if the "total turnover" of X, Y and Z during the preceding financial year is Rs.50 lakhs, Rs.40 lakhs and Rs.60 lakhs, respectively, and the service tax paid on IT service used by Plant X and Z is Rs.11,000, the distribution of credit of input service used only Plants X and Z should be distributed as below.

Plant X = Rs.11,000 x (Rs.50 L / Rs.110 L) = Rs.5,000.

Plant Z = Rs.11,000 x (Rs.60 L / Rs.110L) = Rs.6,000.

Q 2. The ISD of M/s XYZ Pvt. Ltd. has received an invoice for a service which is used only in Plant X. But plant X has lot of cenvat credit balance and they need cenvat credit for payment of excise duty in Plant Y. Can this credit be distributed to Plant Y?

A 2. No. The credit in respect of any input service, which is used only in one unit should be distributed to that unit only. {Rule 7(b)}.

Q 3. M/s PQR Limited are having three manufacturing units and a Trading Division (T) located separately. The Registered office of PQR Limited has received an invoice from their Chartered Accountants, who have audited their accounts. Should any credit be distributed to Trading Division D also (though such credit cannot be used by T)?

A 3. No. The credit should be distributed only to (i) manufacturing unit; (ii) unit providing output service; and (iii) outsourced manufacturing unit. The term "output service" is defined in Rule 2 (p) of CCR, 2004 as

"output service" means any service provided by a provider of service located in the taxable territory but shall not include a service, -

(1) specified in section 66D of the Finance Act; or

(2) where the whole of service tax is liable to be paid by the recipient of service

Trading is specified in the negative list under Section 66D of the Finance Act, 1994 and hence the Trading Division cannot be considered as any of the three units to which credit can be distributed. So, the entire credit of the service tax charged by the CA should be distributed only among the manufacturing units of PQR Limited, subject to application of Rule 6 of CCR, 2004, which is explained later.

{Rule 7 – Preamble portion}

Q 4. In the above example at Q3, can the portion of common services credit, attributable to trading, be reversed by the ISD itself and only the balance credit can be distributed among the manufacturing units?

A 4. No. The provisions of Rule 6 are not applicable for ISD {Rule 7 (g)}.

Q 5. M/s New Pvt. Ltd. have commenced their operations from 01.04.2016. They have their manufacturing units / output service providing units in 5 locations. The four units are having turnover from May 2016 onwards and the fifth unit started having its turnover from July 2016 only. Their ISD was receiving invoices from April 2016 itself and how and when the credit should be distributed?

A 5. Having commenced their operations only in April 2016, there would be no turnover for them in the preceding financial year. Only in the quarter July 2016 to September 2016, all the five units of M/s New Pvt. Ltd. are having their turnover. So, based on the turnover of all five units during the quarter July-Sep 2016, the credit availed from April 2016 onwards shall be distributed on or after Oct 2016. {Explanation 3 (b)}.

Q 6. How the "total turnover" has to be determined?

A 6. The term "total turnover" has to be understood, as defined under Rule 5 of CCR, 2004. The said definition is reproduced below.

"Total turnover" means sum total of the value of -

(a) all excisable goods cleared during the relevant period including exempted goods, dutiable goods and excisable goods exported;

(b) export turnover of services determined in terms of clause (D) of sub-rule (1) above and the value of all other services, during the relevant period; and*

(c) all inputs removed as such under sub-rule (5) of rule 3 against an invoice, during the period for which the claim is filed.

(2) This rule shall apply to exports made on or after the 1st April, 2012 :

Provided that the refund may be claimed under this rule, as existing, prior to the commencement of the CENVAT Credit (Third Amendment) Rules, 2012, within a period of one year from such commencement :

Provided further that no refund of credit shall be allowed if the manufacturer or provider of output service avails of drawback allowed under the Customs and Central Excise Duties and Service Tax Drawback Rules, 1995, or claims rebate of duty under the Central Excise Rules, 2002, in respect of such duty; or claims rebate of service tax under the Service Tax Rules, 1994 in respect of such tax.

Explanation 1. - For the purposes of this rule, -

(1) "export service" means a service which is provided as per [rule 6A of the Service Tax Rules, 1994;

(1A) "export goods" means any goods which are to be taken out of India to a place outside India.

(2) "relevant period" means the period for which the claim is filed.

Explanation 2. - For the purposes of this rule, the value of services shall be determined in the same manner as the value for the purposes of sub-rules (3) and (3A) of rule 6 is determined.

**Export turnover of services" means the value of the export service calculated in the following manner, namely :-*

Export turnover of services = payments received during the relevant period for export services + export services whose provision has been completed for which payment had been received in advance in any period prior to the relevant period - advances received for export services for which the provision of service has not been completed during the relevant period;

{Explanation 2 under Rule 7}.

Q 7. Please explain "total turnover" further.

A 7. The total turnover of a manufacturing unit should include the value of dutiable goods cleared, value of exempted goods cleared and value of exports. The term "exempted goods" is defined in Rule 6 of CCR, 2004 according to which even non excisable goods are considered as "exempted goods". So the value of non excisable goods also should be considered.

The total turnover of a unit providing output service should include the value of taxable service provided, value of exempted services provided and the value of services exported. It may be noted that as per the definition of "exempted service" under Rule 2 (e) of CCR, 2004, it includes services on which no service tax is leviable. As trading is covered in the negative list and hence no service tax is leviable thereon, trading is exempted service. So the value of trading should also be considered while determining "total turnover".

{Explanation 2 under Rule 7, read with Rule 5 of CCR}

Q 8. How should the value of trading be determined for the purpose of distribution of credit to a unit, which also undertakes trading?

A 8. As per the Explanation 2 under Rule 5 of CCR, 2004, the value of services shall be determined as they are determined for Rule 6 (3) / (3A). As per Explanation I (c) thereunder, the value of trading shall be

"Value" for the purpose of sub-rules (3) and (3A), in case of trading, shall be the difference between the sale price and the cost of goods sold (determined as per the generally accepted accounting principles without including the expenses incurred towards their purchase) or ten per cent. of the cost of goods sold, whichever is more.

Q 9. To a previous question it was informed that no credit needs to be distributed to a Trading Division. Now, considering trading turnover for distribution is being discussed. Is there a contradiction?

A 9. If trading is carried out from a separate premises, such premises is not at all relevant for distributing any common services credit (A3). But if trading is undertaken from the premises of a manufacturing unit or from an output service

providing unit, while determining the quantum of credit to be distributed to such unit, the value of trading shall also be considered. So there is no contradiction.

Q 10. How the credit should be distributed in the below example.

Details	A	B	C	D
Status	Manufacturing unit	Manufacturing unit	Service providing unit	Trading unit
Turnover of dutiable goods cleared during last year.	Rs.15 lakhs.	Rs.10 lakhs		
Turnover of exempted good cleared during last year	Rs.5 lakhs.			
Turnover of taxable services provided last year			Rs.3 lakhs.	
Turnover of export of services last year			Rs.2 lakhs.	
Trading turnover				Rs.20 lakhs
Cost of goods sold				Rs.15 lakhs
Value of trading as per Explanation I (c) under Rule 6				Rs.5 lakhs

A 10.

Total turnover of A = Rs.15 lakhs + Rs.5 lakhs = Rs.20 lakhs.

Total turnover of B = Rs.10 lakhs.

Total turnover of C = Rs.5 lakhs.

Total turnover of D = Rs.5 lakhs.

Credit should be distributed to A, B and C in the following ratios,

To A, Total turnover of A / Total turnover of A, B & C.

Rs.20 lakhs / Rs.35 lakhs.

To B, Total turnover of B / Total turnover of A, B & C.

Rs.10 lakhs / Rs.35 lakhs.

To C, Total turnover of C / Total turnover of A, B & C.

Rs.5 lakhs / Rs.35 lakhs.

Turnover of D, i.e. the Trading turnover is not at all relevant for distribution, as trading is carried out from a separate unit.

Q 11. In the same example, how the credit should be distributed, if trading is undertaken from the premises of B?

A 11.

Total turnover of A = Rs.15 lakhs + Rs.5 lakhs = Rs.20 lakhs.

Total turnover of B = Rs.10 lakhs + Rs.5 lakhs – Rs.15 lakhs.

Total turnover of C = Rs.5 lakhs.

Credit should be distributed to A, B and C in the following ratios,

To A, Total turnover of A / Total turnover of A, B & C.

Rs.20 lakhs / Rs.40 lakhs.

To B, Total turnover of B / Total turnover of A, B & C.

Rs.15 lakhs / Rs.40 lakhs.

To C, Total turnover of C / Total turnover of A, B & C.

Rs.5 lakhs / Rs.40 lakhs.

Q 12. Continuing with example at Q 10, how the units A, B and C would discharge their obligation under Rule 6 of CCR, 2004.

A 12. Under Q 10, trading is carried out from a separate premises and without taking into account the trading turnover, the credit has been distributed to A, B and C. In other words, the credit attributable to trading has also been distributed to A, B and C. Let us assume that the total credit to be distributed is

Rs.20,000. The same would be distributed, between A, B and C as explained under Q 10, i.e.

$$A = \text{Rs.}20,000 \times \text{Rs.}20\text{L} / \text{Rs.}35\text{L} = \text{Rs.}11,429.$$

$$B = \text{Rs.}20,000 \times \text{Rs.}10\text{L} / \text{Rs.}35\text{L} = \text{Rs.}5,714.$$

$$C = \text{Rs.}20,000 \times \text{Rs.}5\text{L} / \text{Rs.}35\text{L} = \text{Rs. } 2,857$$

Thus the entire credit, including the portion attributable to trading has also been distributed. Hence, all the units A, B and C should follow Rule 6, though B and C do not have any exempted goods / exempted services. If the option to pay 7 % of the exempted service is opted, either at A or at B or at C, 7 % of the value of trading can be paid. If proportionate reversal option is exercised, based on the proportion of exempted goods / exempted services to total turnover of the company,

A shall reverse,

$$\text{Rs.}11,429 \times \text{Rs.}10 \text{ lakhs} / \text{Rs.}40 \text{ lakhs} = \text{Rs.}2,857.$$

B shall reverse,

$$\text{Rs.}5,714 \times \text{Rs.}5 \text{ lakhs} / \text{Rs.}40 \text{ lakhs} = \text{Rs.}714.$$

C shall reverse

$$\text{Rs.}2,857 \times \text{Rs.}5 \text{ lakhs} / \text{Rs.}40 \text{ lakhs} = \text{Rs.}357.$$

Thus the total credit reversed would be Rs.3,928.

It may be noted that the value of trading is Rs.5 L in a total turnover of Rs.40 L. So, the ineligible credit on account of trading is Rs.20,000 x Rs.5 L / Rs.40 L = Rs.2,500. Let us now see how much amount is being reversed by each unit on account of trading by the above method. Out of Rs.2,857 reversed by A, the portion attributable to trading is Rs.11,429 x Rs.5 L / Rs.40 L = Rs.1,429. For B and C, the entire amount reversed by them, i.e Rs.714 and Rs.357 respectively, is only on account of trading as they do not have any other exempted turnover. So, the total amount reversed by the three units on account of trading is Rs.1,429 + Rs.714 + Rs.357 = Rs.2,500.

This would vouch that the above suggested method is foolproof and does not lead to any short / excess reversal.

Q 13. How the credit would be distributed and Rule 6 reversal would be done in the following example (where trading is undertaken from B), if the common services credit to be distributed is Rs.20,000.

Details	A	B	C
Status	Manufacturing unit	Manufacturing unit	Service providing unit
Turnover of dutiable goods cleared during last year.	Rs.15 lakhs.	Rs.10 lakhs	
Turnover of exempted good cleared during last year	Rs.5 lakhs.		
Turnover of taxable services provided last year			Rs.3 lakhs.
Turnover of export of services last year			Rs.2 lakhs.
Trading turnover		Rs.20 lakhs	
Cost of goods sold		Rs.15 lakhs	
Value of trading as per Explanation I (c) under Rule 6		Rs.5 lakhs	

A 13.

Amount to be distributed to A

$$\text{Rs.20,000} \times (\text{RS.20 L} / \text{Rs.40 L}) = \text{Rs.10,000.}$$

Amount to be distributed to B

$$\text{Rs.20,000} \times (\text{Rs.15 L} / \text{Rs.40 L}) = \text{Rs.7,500.}$$

Amount to be distributed to C

$$\text{Rs.20,000} \times (\text{Rs.5 L} / \text{Rs.40 L}) = \text{Rs. 2,500.}$$

Amount to be reversed by A under Rule 6

$$\text{Rs.10,000} \times (\text{Rs.5L} / \text{Rs20 L}) = \text{Rs.2,500.}$$

Amount to be reversed by B under Rule 6

$$\text{Rs.7,500} \times (\text{Rs.5L} / \text{Rs.15L}) = \text{Rs.2,500}$$

To put it simply, if trading is undertaken by a manufacturing unit or service providing unit, the value of trading should also be added in the unit's turnover and credit be distributed accordingly and then the unit having trading alone should follow Rule 6, based on trading value and the said unit's total turnover. But, if trading is undertaken from a separate premises, the credit should be distributed only to the other units, without considering the trading turnover and thereafter the units have to be follow Rule 6, by considering the trading turnover and total turnover of all units.

Q 14. What is an "outsourced manufacturing unit" to whom credit can be distributed?

A 14. It is a common practice in the industry to get the goods manufactured on job work basis, by supplying the raw materials to the job worker. The job worker, being the manufacturer is liable to pay duty, though he can claim exemption from payment of duty, under Notification 214/86 CE, subject to fulfilment of the conditions thereunder. In some cases, the job worker would be asked to pay duty without claiming any exemption. In such cases, various input services

received by the principal would be attributable either wholly or partly to the manufacturing carried out by the job worker. For example, if the raw materials are imported and for this purpose the services of CHAs / Clearing agents are availed and part of such raw materials are sent to the job worker, a portion of such credit of service tax paid by CHAs / Clearing agents pertain to the job worker and cannot be distributed to other manufacturing units of the principal. In order to obviate this difficulty, such job workers are also covered under the ISD scheme and the ISD can distribute the credit to such duty paying job workers also. Such job workers are named as "outsourced manufacturing units".

Further, even though the raw materials are not supplied by the principal a manufacturer who manufactures goods, for the input service distributor under a contract, bearing the brand name of such input service distributor and is liable to pay duty on the value determined under section 4A of the Excise Act, are also covered in the definition of "outsourced manufacturing units". This would cover the contract manufacturers, who manufacture goods for their principal on Principal to Principal basis and the goods are liable to duty under Section 4 A.

{Explanation 4 under Rule 7}

Q 15. How credit should be distributed to such outsourced manufacturing units, if they are undertaking similar manufacturing for other principals also?

A 15. For the purpose of distributing the common services credit by an ISD to its own manufacturing units and outsourced manufacturing units (Job worker), the value of goods manufactured by the Job worker, for this Principal alone should be considered. Such value should be the value on which the Job worker is paying duty, which would be either under Rule 10 A of the Central Excise (Determination of Price of Excisable goods) Rules, 2000 or under Section 4 A of the CE Act.

{Proviso under Explanation 2 under Rule 7}

Q 16. M/s Principal Limited have appointed a Job worker M/s Jobber to manufacture products A, B and C for M/s Principal Ltd. on job work basis. M/s Jobber have opted to pay duty on the products as applicable. While product A is leviable to duty under Section 4 of the CE Act, read with Rule 10 A of the Valuation Rules, product B is notified under Section 4 A of the Act and Product C is exempted. The following are the values.

S.No.	Details	Amount
1	Assessable value of goods "A", cleared by M/s Jobber during the preceding financial year, based on Rule 10 A, i.e. selling price of M/s Principal Ltd.	Rs.25 Lakhs.
2	Assessable value of goods "B" cleared by M/s Jobber during the preceding financial year, based on Section 4 A (after abatement)	Rs.15 lakhs.
3	Value of exempted goods "C" cleared by M/s Jobber during the preceding financial year	Rs.10 lakhs.
4	Value of goods manufactured by M/s Jobber for another principal M/s X for which M/s Jobber has paid duty	Rs. 7 lakhs
5	Value of goods manufactured by M/s Jobber for another principal M/s Y for which he has claimed exemption under Notification 214/86	Rs. 5 lakhs.

A 16. M/s Principal Ltd. should consider Rs.50 lakhs (S.Nos. 1, 2 and 3) as the turnover of M/s Jobber, for the purpose of distribution of credit. The value of goods manufactured by M/s Jobber for other principals, is not at all relevant for distribution of credit by M/s Principal Ltd.

Q 17. In the above example, whether M/s Jobber would be required to follow Rule 6?

A 17. It is observed that he is manufacturing exempted goods C, for M/s Principal Ltd. So he would be liable to follow Rule 6 of CCR, 2004.

Q 18. In the above example, let us assume an amount of Rs.50,000 has been distributed to M/s Jobber by M/s Principal Limited for the month of April 2016. This was distributed on 30.04.2016 and the credit was also availed by M/s Jobber on 30.04.2016. For the month of April 2016, M/s Jobber is liable to pay duty of Rs.12,000 on goods "A" and Rs.18,000 on goods "B", manufactured for M/s Principal Ltd. He is also liable to pay a further duty of Rs.30,000 for the goods manufactured for another principal, M/s X. Thus his total duty liability for the month is Rs.60,000. Can he utilise the entire credit of Rs.50,000 distributed by M/s Principal Ltd and pay only Rs.10,000 in cash?

A 18. The credit distributed by M/s Principal Ltd. should be used only for paying duty for the goods manufactured for M/s Principal Ltd. So, M/s Jobber can utilise only Rs.30,000 out of Rs.50,000 distributed by M/s Principal Ltd and carry forward the balance to the subsequent period. If M/s Jobber is doing manufacture for several principals, he has to maintain his Cenvat Account properly so as to ensure that the credit distributed by one principal is used to pay duty only for the goods manufactured for such principal and not otherwise.

{Rule 7 (e)}

Q 19. M/s TAX Ltd are having three own manufacturing units and one outsourced manufacturing unit. On 31.03.2016, the ISD of M/s TAX Ltd is having a balance of cenvat credit to be distributed of Rs.1,00,000. Can this be distributed to the three own manufacturing units as well as the outsourced manufacturing unit?

A 19. No. The balance of credit on 31.03.2016 cannot be distributed to outsourced manufacturing unit. It should be distributed only to the three own manufacturing units. The portion attributable to outsourced manufacturing unit cannot at all be distributed.

{Rule 7 (f)}

Q 20. M/s Cool Ltd. have four own manufacturing units. They have appointed a new job worker / outsourced manufacturing unit with effect from 01.10.2016. Can the cenvat credit balance available with the ISD as on 30.09.2016 can be distributed to the outsourced manufacturing unit also?

A 20. No.

{Explanation under Rule 7 (f)}.

Q 21. M/s Hot Limited is having two of their own manufacturing units and a job worker / outsourced manufacturing unit, which is claiming exemption from payment of excise duty under Notification 214/86. How the credit should be distributed in such cases.

A 21. As per Rule 3 of CCR, 2004 credit of inputs and input services used by a job worker, who is claiming exemption from payment of duty under Notification 214/86 can be availed by the principal. Hence, the entire credit with the ISD of M/s Hot Limited should be distributed only among its two own manufacturing units.