The Panorama of CENVAT Credit on Outward Transportation

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Poonam Harjani, Partner, Nitya Tax Associates

Lalitendra Gulani, Senior Associate

Anshika Agarwal, Associate

Admissibility of credit on services used for clearance of final products beyond the factory premises has always been a litigious issue. In case of Free-on-Road ('FOR') sales, the cost incurred in supply of goods beyond the factory premises forms a part of the price of final product on which excise duty is discharged. Disallowance of credit in such circumstances leads to cascading of taxes and frustrates the underlying objective of Credit Rules. Recently, the Apex Court in ***CCE v. Ultratech Cement Limited*** **[TS-19-SC-2018]** ('***Ultratech Cement***') dealt with a similar situation. Before drawing an analysis of the above judgement, it is pertinent to briefly chart the background and the development of definition of term 'input services'.

The Credit Rules entrust a manufacturer and a service provider with the right to avail cenvat credit of specified duties and taxes paid on inputs, capital goods and input services. The term 'input service' as defined under Rule 2(l) of the Credit Rules can be fragmentated into three parts, *viz*. (i) Means clause, (ii) Inclusive clause, and (iii) Exclusive clause. Noteworthy, the credit on services used for clearance of final products, outward transportation and storage is restricted by reference to place of removal. Prior to March 2008, while the Means clause allowed credit on services used for clearance of final products from the place of removal, the Inclusive clause restricted it to services used for outward transportation and storage upto the place of removal.

At this juncture, it is pertinent to note the use of expressions 'from' and 'upto'. The ***Çoncise Oxford English Dictionary*** [*Twelfth edition (2011)*, *Oxford University Press, refer at page 750 and 1590*] defines the term 'from' as 'indicating the point at which a journey, process or action starts' and the term 'upto' as 'as far as'. Simply put, while the term 'from' denotes the starting point, the term 'upto' denotes the finishing point. By reference to the above definition, the Means clause covered services used for clearance of final products, such as outward transportation, where starting point was the place of removal. In case of ex-works factory sales, the factory forms the starting point. As a natural corollary, under the earlier definition, an assessee was entitled to credit of service tax paid on outward transport even in the case of ex-works factory sales. This view was affirmed in Tribunal Larger Bench decision in the case of ***ABB Limited v. CCE***, ***2009 (15) STR 23 (Tri-LB)***, affirmed by Karnataka High Court in ***2011 (23) STR 97 (Kar.)***.

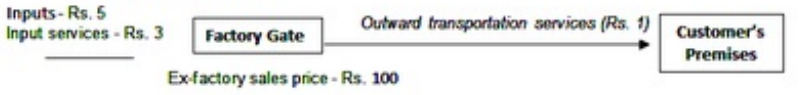
It is trite that the purpose of allowing credit is to avoid cascading of taxes. The above interpretation lead to an anomaly, as in such cases the cost of these services was not included in the price of final product for discharge of excise duty, yet the credit of transportation cost incurred beyond such point was available. It gave rise to a situation where an assessee was unjustly enriched by grant of credit of the service tax which did not suffer from cascading effect.

This aspect can be elucidated by following illustration:

Illustration:

Value of inputs: Rs. 50 (Excise duty @10% = Rs. 5)
Value of input services: Rs. 30 (Service Tax @10% = Rs. 3)
Value of outward transportation services: Rs. 10 (Service Tax @10% = Rs. 1)
Ex-factory sales price: Rs. 100

When place of removal is factory



Assessable value of final product - Rs. 100 (cost of outward transportation not includible)
Excise duty on final products - Rs. 10 (10% of Rs. 100)
Total admissible credit – Rs. 9 (Rs. 8+Rs. 1)

***Note**: Impact of abatement on transportation services rendered by goods transport agency ('GTA') not taken in the above illustration*

In the above illustration, the assessee was entitled to credit of service tax (Rs. 1) paid on outward transportation even when it did not form part of the assessable value. The assessee is unjustly enriched.

In order to remedy this defect, the Central Government brought an amendment vide ***Notification No. 10/2008-CE (NT)*** dated March 1, 2008 ('Notification 10/2008-CE'). The said amendment substituted the term 'from' with the term 'upto'. Resultantly, the benefit of credit admissible on services used for clearance of final products, such as outward transportation, was restricted up till the place of removal. Thus, an assessee could avail credit on outward transportation only when goods were sold on FOR basis. In the above illustration, in respect of the period post amendment, an assessee will not be entitled to credit on outward transportation. The said view is fortified by various high court rulings and departmental circulars.

Notable that the revenue however continued to dispute credit of service tax paid on outward transportation in respect of sales effected on FOR basis. In the case of ***Ultratech Cement***, the Appellant received GTA services for outward transportation of final products upto the customers' premises in case of clearances made on FOR basis. The Appellant availed credit of the service tax discharged on such GTA services under reverse charge mechanism. The revenue disputed the admissibility of credit basis ground that the services were received beyond the factory premises and did not have any nexus with manufacture of final products.

The Apex Court whilst ruling the issue in favour of revenue observed that the definition of 'input service' was amended to substitute the term 'from' by the term 'upto'. Resultantly, the benefit of credit admissible on outward transportation shall not be available beyond the place of removal. Further, the services received once final products are fully manufactured and cleared from the factory premises, cannot be considered to have been used in relation to the manufacture of final products.

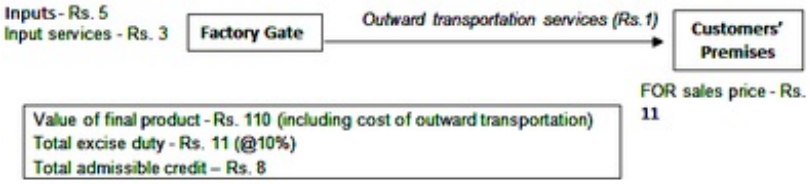
As has been discussed above, the eligibility of cenvat credit on transportation services is co-terminus with the 'place of removal'. Thus, it becomes imperative to take into consideration what would constitute place of removal for a manufacturer intending to avail cenvat credit on GTA services. Time and again the CBEC vide its various circulars issued in August 2007, October 2014 and February 2015 has clarified that place of removal refers to the point at which the ownership in goods is divested from the manufacturer in favour of the buyer. This leads to the necessary inference that an assessee is entitled to credit of the service tax paid on services used for clearance of final products upto customers place in case of FOR sales from factory.

Notable that the Apex Court in Ultratech ruling reached to the conclusion *de hors* the terms of sale, *i.e.* without delving into point at which the property in goods transfers to the buyer. Further, the judgment failed to capture the *raison détre*, viz. the reason behind substitution of the term 'from' by the term 'upto' which was indeed to align the principles for valuation under excise law with the point of credit eligibility under the Credit Rules. An analysis of the above ruling reveals that the judiciary has landed the assessee from a beneficial position to a position of undue loss. The same has been illustrated under:

Illustration:

Value of inputs: Rs. 50 (Excise duty @10% = Rs. 5)
Value of input services: Rs. 30 (Service Tax @10% = Rs. 3)
Value of outward transportation services: Rs. 10 (Service Tax @10% = Rs. 1)
FOR sales price: Rs. 100

When place of removal is buyer's premises



Value of final product - Rs. 110 (including cost of outward transportation)
Total excise duty - Rs. 11 (@10%)
Total admissible credit – Rs. 8

***Note**: Impact of abatement on transportation services rendered by GTA not taken in the above illustration*

In the above illustration, an assessee is bereft of credit on outward transportation, even when its cost is included in the price of final product for discharge of excise duty liability.

The ruling merits reconsideration in as much as it does not ponder over the relevance of place of removal in determining the eligibility of credit. Further, it goes beyond the rationale for amendment made in the definition of input service 2008. It merely moves on the presumption that in the period prior to amendment, credit was admissible on outwards transportation. Thus, as a natural corollary, no such credit will be admissible for the period post amendment. The ruling will have far-reaching implications as relying on the department's own circulars, the entire industry has ever since been availing credit on outward transportation received beyond the factory premises in case of FOR sales.

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