

# White Paper- Budget 2016: Changes in Cenvat Credit Rules 2004



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*This paper contains a brief on the changes made to the Cenvat  
Credit Rules 2004 in Budget 2016*

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## Budget 2016: Changes in Cenvat Credit Rules 2004

Several beneficial changes have been made in the Cenvat Credit Rules 2004 in this budget to be effective from 1 April 2016.

They are encapsulated below:

### Capital goods

- (i) Definition expanded to include more items
- (ii) Restriction on exclusive use in exempted supply will apply only for two years

The first part of the definition of 'capital goods' in Rule 2(a) has been expanded by including "wagons of sub-heading 860692" in item (A). 860692 is a sub-category of heading 8606, which covers "railway or tramway goods vans and wagons, not self-propelled". The sub-heading 8606 92 is for wagons that are not tank wagons or self-discharging wagons or closed wagons (which are covered in earlier sub-headings), and covers wagons that are "open with non-removable sides of a height exceeding 60 cm".

The exclusion of "equipment or appliance used in an office" has been deleted from Rule 2(a)(A)(1). The effect is that such office equipment or appliance, if falling under chapters 82, 84, 85 and 90, or being components, spares or accessories of these though falling under other chapters, would now become eligible for taking Cenvat credit of the duties paid on them.

Cenvat credit is allowed on the specified capital goods if used in the factory, or if used outside the factory for generation of electricity for captive use in the factory. This has now been expanded to include use outside the factory for pumping of water, by adding these words in Rule 2(a)(A)(1A), so that it now reads – (used) (1A) "outside the factory of the manufacturer of the final products for generation of electricity or for pumping of water for captive use within the factory."

Under Rule 6(4) no Cenvat credit was allowed on capital goods if they were exclusively used for manufacture of exempted goods or provision of taxable service. There was confusion and litigation on the consequences of change of use of the goods, whether credit is to be denied if they are initially used in exempted supply or whether it is to be allowed if they are later used in dutiable / taxable supply. To resolve this issue, Rule 6(4) has been substituted, to provide that no Cenvat credit will be allowed on capital goods that are exclusively used for manufacture of exempted goods or provision of exempted service for a period of two years from the date of commencement of commercial production or provision of services or installation of the capital goods (if this is a later date). Exempted supply does not include exemption for goods or services based on value or quantity of clearances made in a financial year.

## Inputs

Definition expanded to include Low-value capital goods, and material used for pumping water. The definition of “inputs” already included goods used for generation of electricity or steam for captive use; it has now been expanded to include goods used for pumping water.

So that sub-clause (iii) reads as follows: (input means) “(iii) all goods used for generation of electricity or steam or pumping of water for captive use”.

Low-value capital goods, the value of which is up to ten thousand rupees per piece, have been included in the definition of ‘input’, by sub-clause (v) inserted in Rule 2(k). The sub-clause reads as follows upon amendment: (input means) “(v) all capital goods which have a value up to ten thousand rupees per piece”.

Another amendment has been made to align with this. ‘Inputs’ being defined (inter alia) as all goods that are received in the factory of the manufacturer [clause (i) of Rule 2(k)], this would include capital goods if not specifically excluded. There is therefore a specific exclusion: (input) “excludes

(A) ...

(B) ...

(C) “Capital goods except when used as parts or components in the manufacture of a final product.”

This has now been amended so that the exclusion reads as follows:

(C) “capital goods, except when, -

- (i) used as parts or components in the manufacture of a final product; or
- (ii) the value of such capital goods is upto ten thousand rupees per piece”.

The effect of this is that items that otherwise fall into the definition of ‘capital goods’ will now be treated as inputs for the purposes of Cenvat credit. This will enable full credit to be taken upon receipt of the goods, without the restriction of fifty per cent in the year of receipt as applicable to capital goods. However, it may also expose the goods to the rigours of Rule 6(1) to (3A) if they are used for exempted supplies as well as dutiable / taxable supply. It may be noted that in the case of capital goods, full credit is available even if they are only partially used in dutiable production / taxable service [-Rule 6(4)].

## Jigs, fixtures, moulds can be directly sent to job worker

Rule 4(5)(b) allows a manufacturer to send jigs, fixtures and moulds to a job worker or to another manufacturer for production of his goods. This has been amended by allowing such items to be sent directly to the job worker / other manufacturer without having to first bring them into the factory of the principal.

## Rationalisation of method of determining proportional Cenvat credit for common inputs / services

The principle that Cenvat credit is intended to minimize the cascading effect of tax on tax means that credit is not to be allowed when no tax is payable on the output. This is embodied in Rule 6, which also provides a method of calculating proportional input tax when the input is used in common for dutiable / taxable as well as exempted supply.

The formulae for this calculation are somewhat flawed, which has resulted in litigation. The central government has now remedied the matter, by recasting the formulae in Rule 6(3A). The new formulae take the figures only of the goods / services used in common, which is more reasonable.

### Input service distribution

As per Rule 2(m) an 'input service distributor' is an office of the manufacturer or producer or provider of output services, which receives invoices for purchase of services, and distributes credit of service tax paid on the said services to such manufacturer or producer or service provider as the case may be. This has been amended now to include 'outsourced manufacturing unit' as one of the eligible recipients of distributed credit:

2(m) "input service distributor" means an office of the manufacturer or producer or provider of output services, which receives invoices issued under rule 4A of the Service Tax Rules, 1994 towards purchases 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 or an outsourced manufacturing unit, as the case may be".

"Outsourced manufacturing unit" is defined in Rule 7, 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 the 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".

Thus two types of manufacturer are eligible for distributed credit though they are different legal entities from the entity that is distributing the credit:

- (i) A job-worker who pays duty on the value determined under Rule 10A of the valuation rules. This means a job-worker from whose premises the finished goods are sold by the principal, or from whose premises the finished goods are transferred to a depot by the principal for sale from there.
- (ii) A manufacturer who manufactures goods for the person distributing the credit, under the brand name of the latter, and is liable to pay excise duty on the goods on MRP-based value under section 4A.

The difference between job worker and manufacturer is that the job-worker works on material supplied by the principal, and does not necessarily carry out the entire process of manufacture. When goods manufactured by a job worker and cleared from there by the principal to his depot or for direct sale, the job worker qualifies for Cenvat credit distributed by the principal.

On the other hand, when manufacture under the brand name of the principal is outsourced to a manufacturer 'X', and the goods are under MRP-based assessment and meant for retail sale, and the excise duty thereon is paid by the said 'X', then 'X' qualifies for Cenvat credit distributed by the principal.

Credit is to be distributed, as before, to the units in which the service was used, on the basis of their turnover. In the case of outsourced manufacturers, the value of goods manufactured for this distributor of credit will be deemed to be their turnover for the purpose of computing how much credit to distribute to them.

#### Distribution of credit on inputs

A new Rule 7A has been introduced. This allows a manufacturer with more than one unit to source inputs to a warehouse and distribute them from there like a dealer. He has to issue central excise invoices for passing on the credit.

#### Deletion of deemed FIFO clause

In the last Budget a pernicious deemed FIFO clause had been slipped into Rule 14. This provided that the opening balance of credit in a month would be deemed to be used first. Accordingly, if some amount was found to be wrongly taken as credit, it would be deemed to be used, and interest was chargeable, even though the balance of credit remained much more than the disputed amount. This clause [sub-rule (2) of Rule 14] has been deleted.

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