

CENVAT credit can be utilised for payment of service tax under the reverse charge mechanism – Karnataka HC

17 January 2022



Summary

The Karnataka High Court (HC) has held that the assessee is eligible to utilise Central Value Added Tax (CENVAT) credit available with it for discharging service tax liability under the reverse charge mechanism (RCM) for the period prior to 1 July 2012. The HC referred to rulings pronounced by its coordinate bench earlier in similar issues, wherein it was observed that when the service provider was located outside the country, the service recipient is treated as a service provider. Further, the liability to pay tax was vested on such assessee who has received the service. Therefore, the HC had held that the assessee was entitled to utilise CENVAT credit for discharge of service tax liability under the RCM. The HC further clarified that the explanation clarifying that CENVAT credit cannot be used for payment of tax when the person liable to pay tax is the recipient was inserted from 1 July 2012. However, as the period of dispute in present case is April to August 2006, the said explanation cannot be applied.

Facts of the case

- The assessee¹ is a manufacturer of Multiutility Vehicles (MUV) for passenger cars and parts, thereof falling under Chapter 87 under the Central Excise Tariff.
- It had received intellectual property services, commissioning and installation services and repair and maintenance services from its parent company situated abroad. It had also availed Goods Transport Agency (GTA) services from a local service provider.
- The assessee had utilised the CENVAT credit availed on inputs, input services and capital goods for discharging service tax on such services under the reverse charge mechanism (RCM) being a recipient of services.
- A Show Cause Notice (SCN) was issued asking the assessee to explain as to why the CENVAT credit utilised for payment of service tax under the RCM is not irregular

and recovery, along with interest and penalty, should not be ordered².

- The Commissioner of Central Excise and Service, Bengaluru, rejected the contentions of the assessee and passed order confirming the demand as per SCN.
- The assessee preferred an appeal against the said order before the CESTAT which was allowed. Being aggrieved by the CESTAT's ruling, the Revenue filed present appeal before the Karnataka HC³.

Karnataka HC observations and ruling⁴:

- **Explanation not applicable:** An explanation was added to the relevant rules,⁵ effective 1 July 2012, wherein it was clarified that CENVAT credit cannot be used for payment of tax when person liable to pay tax is the recipient. However, as the period of dispute in the present case is April to August 2006, the said explanation cannot be applied.
- **HC judgements on similar issues earlier:** The Coordinate Bench of the HC⁶ had held that when the service provider was located

¹ Toyota Kirloskar Motors

² Section 73 of Finance Act, 1994

³ C.E.A No. 59/2019

⁴ Order dated 16 December 2021

⁵ Rule 3(4)(e) of CENVAT Credit Rules, 2004

⁶ Aravind Fashions Ltd. supra

outside the country, the service recipient is treated as a service provider and liability to pay tax was foisted on such assessee who has received the service. Therefore, the HC had held that the assessee was entitled to utilise credit for payment of tax liability in such case. In another case⁷, the HC had observed that in view of specific reference to service tax and the benefit allowed to a service provider no fault can be found with the assessee in utilising the CENVAT credit available with him.

- **Assessee entitled to use credit available with it:** The HC had agreed with the decision taken by it in the earlier cases which has been applied by the CESTAT in the present case. Accordingly, the HC held that the assessee is eligible to utilise CENVAT credit available with it for discharging service tax liability under the RCM.

Our comments

On a similar issue, earlier, the Apex Court⁸ had affirmed the judgement by the Rajasthan HC, wherein it had held that the assessee shall be treated as an output service provider.

In addition, it is pertinent to note that recently, the Apex Court⁹ had held that the provisions of a taxing statute must be construed as they stand, adopting the plain and grammatical meaning of the words used.

In the present case there was no express provision under the erstwhile indirect laws restricting the usage of CENVAT credit for payment of service tax liability under the reverse charge mechanism until 1 July 2012. Therefore, the HC has held that the assessee was entitled to utilise the CENVAT credit for payment of service tax liability under the reverse charge mechanism.

⁷ Godavari Sugar Mills Ltd.

⁸ Kansara Modlers Ltd.

⁹ VVF (India) Limited

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