THE BENGAL CHAMBER

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CST – Budget Recommendations

1. Amendment in CST Act to specifically include Sec. 5(2) and Sec. 6(2) for Lease/HP Transaction

Operating lease transaction came within the tax net under various state sales tax statutes by virtue of the 46th Constitutional Amendment Act, 1982. In line, Section 2(g) of the Central Sales Tax Act, is amended by Finance Act No. 20 of 2002 which received the assent of President of India on 11.05.2002.

There are number of Judgments of High Courts and Supreme Courts where it is held that Deemed Sale is at par with normal Sale. Since the assessment under CST is done by respective State Authorities while CST Act is administered by Centre. Authorities in the states have been treating Operating lease transaction as different from Normal Sale and are rejecting claims of High Sea Sales and Sale in Transit 6(2). In the absence of clear explanation under Sec 5(2) and 6(2) for allowing exemption from CST State VAT authorities who have been denying benefit of the exemption, by treating deemed sale as different from Normal Sale and thus rejecting exemption form CST.

The present provisions under section 5(2) and 6(2) of the CST Act are read as;

"Section 5(2) - A sale or purchase of goods shall be deemed to take place in the course of the import of the goods into the territory of India only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the Customs frontiers of India."

"Section 6(2) - (2) Notwithstanding anything contained in sub-section (1) or sub-section (1A), where a sale of any goods in the course of inter-State trade or commerce has either occasioned the movement of such goods from one State to another or has been effected by a transfer of documents of title to such goods during their movement from one State to another, any subsequent sale during such movement effected by a transfer of documents of title to such goods to a registered dealer, if the goods are of the description referred to in sub-section (3) of section 8, shall be exempt from tax under this Act"

Most of the construction equipment, machinery given by NBFCs are under operating lease for Public Infrastructure. Thus, such an erroneous treatment puts unnecessary burden and cost. It is requested to kindly make appropriate amendment(s) in the legislation so as to get the explanation making exemption under 5(2) and 6(2) equally applicable for Deemed Sale also or issue a requisite clarification for correct field formation.

All these have led to the untimely and unfortunate death of Leasing in India. NBFCs have moved to simple Loans against Hypothecation. We need to appreciate the fact that Leasing is the most preferred and viable mode of lending all over the world.

Accordingly, it is suggested that –

There is an urgent need to bring clarity on the tax treatment of Lease and promote leasing in India.

2. Levy of Tax on "Transfer of Right to use"

As per the amended provisions of Article 366(29A) of The Constitution of India, "Transfer of Right to use" any goods is covered by the meaning of the word "Sale" empowering the State Governments to levy Sales Tax / VAT on the same. Accordingly almost all the States have amended the definition of the term "Sale" so as to include "Any Transfer of Right to use any goods for any purpose for cash, deferred payment or other valuable consideration" within its ambit and levy taxes thereon. Even the definition of the term "Sale" given in Sec. 2(g) of CST Act, 1956 was amended to include "Transfer of Right to use any goods" within the scope of said definition.

Further as per the existing provisions of the Finance Act, 1994, Service Tax is levied on "Supply of Tangible Goods including machinery, equipment, appliances etc. for use without transferring right of possession and effective control of such assets" since the same is treated as one of the taxable services under the Finance Act, 1994.

There lies a very thin line of difference between a transaction with "Transfer of Right to use" and a transaction without it. In case of former, State Governments have the power to levy Sales Tax /VAT since the same is covered by the definition of the term "Sale of goods". In case of latter, the Central Government ONLY has the power to levy Service Tax.

The term "Transfer of Right to use" has been a subject matter of litigation since the 46th Constitutional Amendment and there are series of contradictory pronouncements by judicial Authorities. Even the pronouncement by the Apex Court made long time back has not resolved the issue till date.

As a result of aforesaid controversy, "Double Taxes" are being levied and/or demanded by Revenue Authorities on the same transaction – VAT by the State Revenue Authority and Service Tax by the Central Revenue Authority.

The root cause of the problem seems to be the absence of definition of the term "Right to use" in the statute book.

Even the existing provisions of the CST Act, 1956 are silent as to when a sale or purchase is deemed to have taken place during the course of inter-State trade or commerce, during the course of import or export so far as the transfer of "Right to use" is concerned.

Accordingly, it is suggested that –

(i) The levy of Service Tax as well as VAT / CST on the same transaction should be annulled to avoid multiplicity of taxes;

(ii) The term "Transfer of Right to use without transferring right of possession and effective control" should clearly be defined in the Finance Act, 1994 for the purpose of levy of Service Tax;

(iii) The term "Transfer of Right to use with transferring right of possession and effective control" should be defined in the CST Act, 1956 for the purpose of levy of Sales Tax/ VAT.

(iv) *Where a dealer is paying VAT /CST, such transaction should be treated as sale of goods and accordingly beyond the jurisdiction of Service Tax Authorities to examine such transactions for the purpose of levy of Service Tax.*

(v) *The benefit of exemption available U/s 5(2) and 6(2) of the CST Act, 1956 should also be made available to a transaction involving Right to use treated as sale under the CST Act, 1956. Suitable amendment should be made in this regard to reduce existing litigations and controversies.*

3. Immediate reduction of CST rate to 1%

With the introduction of VAT, it was announced that CST rate would be brought down to 1% in successive years. However, as of now the CST rate is 2% and the last reduction was done on 1st June 2008. However, no further reduction of the CST has been effected.

Accordingly, it is suggested that –

The CST rate be reduced to 1% immediately and brought down to "Zero" upon introduction of GST.

4. Other Changes

(a) Works contract

Definition of 'works contract' as per Central Sales Tax Act may be incorporated in the Finance Act, 1994 for uniform interpretation of the scope of the expression.

(b) Charges /recoveries towards electricity supplies

Clarification may be issued that recovery of costs relating to electricity supplied by developer to tenants either by way of diesel generating sets or by way of purchase of power from the State Electricity Board would not be subject to levy of service tax. Presently only electricity supplied by an electricity transmission or distribution authority is exempt.

5. Issuance Of Form F By Job-Workers

In terms of Section 6A(1) of the Central Sales Tax Act, 1956 if an assessee sends goods on inter-State stock transfer then he has to furnish a Form F to his jurisdictional assessing authority to establish that the goods were actually sent out on stock transfer and not in the course of an inter-State sale. The Form F has to be issued by the recipient of the goods, being any other place of business of the assessee / agent of the assessee / principal. In the event of non-submission of Form F the transaction is deemed to be an inter-State sale.

Due to the provisions of Section 6A(1) in cases of despatch of goods by way of inter-State stock transfer to the assessee's job-worker, the Department does not permit issuance of Form F by the job-worker to the principal notwithstanding the fact that the principal is permitted to issue Form F to the job worker. Consequently, genuine cases of inter-State stock transfer from a principal to a job-worker situated in another State are assessed to tax as inter-State sales and taxed accordingly. This leads to avoidable disputes and litigation between the Department and the assessee.

It is recommended that the Central Sales Tax Act be amended such that job-workers receiving materials through inter-State stock transfer from their Principals are permitted to issue Form F to the Principals.

6. **Extension Of Time For Filing Statutory Forms (e.g., F Form, C Form)**

Upon introduction of online application system for statutory Forms in a number of States, a consistent delay on part of the Department is observed in issuing statutory forms due to technical faults in Department's server or for some other reason. In Some States, online returns are made quarterly and therefore, especially for F Form there is always a probability of delay, at least for the first month of the quarter. Further, there are many other States especially North Eastern States, which still operate on manual method where stationery of Statutory Forms is not available on timely basis.

This sometimes leads to a delay in submission of statutory declaration beyond the existing provision of Rule 12 (7) of the Central Sales Tax (Registration and Turnover) Rules, 1957 which requires Statutory Forms to be "furnished to the prescribed authority within three months after the end of the period to which the declaration or the certificate relates". Such delay is beyond the control of the Dealers. There is a relaxation given in the proviso to this Rule, however, that completely depends on the discretionary power of the assessing authority.

It is observed that the aforementioned delay on part of the Commercial Taxes Department in several States coupled with the existing provision under Central Sales Tax Rules, is leading to a number of litigations which could otherwise be avoided by making necessary amendments and allowing the dealers to submit the Statutory Declarations or Certificates at any time before the Assessment Order for the relevant period is passed.

It is recommended that the Central Sales Tax law be amended so as to permit the dealers to submit the Statutory Declarations or Certificates at any time before the Assessment Order for the relevant period is passed.

7. **Issuance Of C Form For All Goods Received In The Factory Of The Manufacturer**

Section 8(3) (b) of the Central Sales Tax Act 1956 provides that goods can be purchased by a dealer in the course of inter-state trade, at a concessional rate when such goods, inter alia, are for use by him in the manufacture or processing of goods for sale.

The above provisions restrict the scope of concession to only such goods which are used in the manufacture or processing of goods for sale. The central sales tax by itself adds to the cascading effect of taxes and by restricting the scope of concessional rate to goods only used in the manufacture of goods compounds to the overall cascading effect. Such restricted scope also leads to a lot of litigation.

It may be noticed that several acts have enlarged the scope of providing benefits to the manufacturer in respect of all goods which are used in the factory rather than merely restricting the scope to goods used in the manufacture. For example, CENVAT Credit Rules, 2004 allows credit of specified duties paid on all goods used in the factory by the manufacturer of final products.

Central Sales Tax Law be amended to allow purchase of all goods by a dealer in the course of inter-state trade, at a concessional rate, so long as such goods are used in the factory by the manufacturer of final products.

8. Issuance Of C Form For All Goods Brought In Connection With Marketing And Distribution Related Activities

Section 8(3)(b) of the Central Sales Tax Act, 1956 provides that goods can be purchased by a dealer in the course of inter-state trade, at a concessional rate, when such goods are
intended for re-sale by him, or;
for use by him in the manufacture or processing of goods for sale or in the telecommunications network or in mining or in the generation or distribution of electricity or any other form of power, or;
are containers or other materials specified in the certificate of registration of the registered dealer purchasing the goods, being containers or materials intended for being used for the packing of goods for sale, or;
are containers or other materials used for the packing of any goods etc.

However, currently the law does not allow sales at concessional rate of tax when the materials are used for the purpose of marketing and distribution activities. It may be appreciated that in recent times India has started witnessing an accelerated growth in organized retail sector which is still to achieve its peak. With huge opportunity of capital investment in this sector, incentives must be given to this sector by way of extending the scope of Section 8(3)(b) to cover goods used in connection with marketing and distribution activities like handling equipment, storage equipment, plant and machinery for cold storage etc. A suitable amendment in Section 8 (3) (b) and Rule 13, to this effect, will be always welcome in the interest of capital investment in one of the most potential sector of the country.

Central Sales Tax Law be amended to allow purchase of all goods by a dealer in the course of inter-state trade, at a concessional rate, so long as the same is used in connection with marketing and distribution related activities.

9. Loss Of Tax Cost In Cases Of Sales Returns

As per Section 8A of the Central Sales Tax Act, 1956, the sale price of goods returned to the dealer by the purchaser of goods shall be deducted from the aggregate of the sale prices, provided following conditions are satisfied : (a) the goods are returned within a period of six months from the date of delivery of goods (b) satisfactory evidence of such return of goods is furnished before the assessing authority and (c) refund or adjustment on account of the sale price is made and evidence to that effect is produced before the assessing authority.

Additionally, as per the same Section 8A, deduction can be made from the turnover of dealer the value of sales returns within a period of six months only from date of delivery.

Unlike the practice of four seasonal collections (Spring, Summer, Autumn and Winter) in vogue in the Western countries, in India the apparel industry operates on a “two seasons” basis – Winter and Summer. The summer season is, in fact, a long season and closure of the season within six months is not feasible. As per industry practice, about 60% of the estimated demand for a season is placed in stores at the pre-season launch phase. At the end of the season, unsold garments (typically about 30% of the total goods placed) are returned to brand-owner by way of sales returns

In most of the cases, sales returns are received after a period of six months from date of delivery, resulting in non-adjustment of CST paid on earlier sale. The problem is compounded by the fact that Assessing Authority issue Form C for the value of net purchases (which is net of returns) as disclosed in the VAT / CST return. Hence, Form C is not issued by the buyer for returns, which results in additional liability of differential tax for the dealer for returns received beyond six months.

Recommendation

It is recommended that in case of readymade garments:

i. **period for acceptance of sales return may be extended to one year from date of delivery of goods, and,**
ii. **suitable clarificationsbe provided for issuance of Form – C on gross value of goods purchased. Alternately, the deduction for sales returns be allowed only for value of sales returns within a period of six months.**

10. Restriction On Free Trade In Agri-Commodities

Certain statutory provisions in the Central / State Sales Tax legislation which restrict the applicability of exemption from sales tax for sale/purchase in the course of Export need to be amended appropriately as these provisions hinder free trade in agri-commodities.

Section-5 of the Central Sales Tax Act, 1956 covers, inter alia, some aspects of taxes/exemptions applicable to the trade conducted in the course of export. Three of the provisions therein affect the free trade in the course of exports.

Firstly, it is mandatory that the purchases must take place after procuring the Export Order to qualify the transaction for exemption from Sales Tax.

In items like agri commodities, where supplies are seasonal and the demand is spread over the year, it is important that an exporter procures the exportable commodities in advance (during the season) even if the demand does not exist in the international market at that point; even if it does, prices may not be right. Exporters either sell in distress or lose the business opportunity to remain within the scope of this provision.

Sec 5(3) of CST Act to be amended to such that any sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods out of India is also deemed to be in course of such export not withstanding whether such sale or purchase took place against an existing Export Order

Secondly, the exemption is applicable to the penultimate sale prior to the actual export sale alone.

Traditionally, in India the existing commodity trade channels and the highly fragmented structure of Indian farms has fostered a chain of traders and agents between a farmer and the exporter. The aforesaid provisions of CST severely restrict trading liquidity because it is not always possible that an exporter directly procures from farmers. Thus, the only alternative is to pay taxes at all points until the penultimate leg, making the price uncompetitive in the process.
Lastly, the procedure to avail exemption from CST necessitates a one-to-one linkage of various purchases and sales.

This would mean complication in blending of goods of various qualities to produce the exportable product of a desired specification, when multiple purchases (made at different points of time) are used to deliver multiple sales (compounded by the first provision explained above). An exporter has to issue Form H under the CST Act in support of his claim of tax exemption.

It is recommended that Form H may be permitted to be issued and the exemption be availed by the buyers at all transaction points as long as the goods are eventually exported (evidenced by the Bills of Lading as required under the current regulations) irrespective of the timing of buying (meaning that an exporter can also buy goods before entering into a sales contract) without necessarily linking purchases and sales one-to-one (only the aggregate volumes may be considered at the time of assessment).

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Customs – Budget Recommendations

1. Removal Of Goods – Customs (Import Of Goods At Concessional Rate Of Duty For Manufacture Of Excisable Goods) Rules, 1996

Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996 applies to an importer who intend to avail of the benefit of exemption notification issued under the Customs Act and where the benefit of such exemption is dependent upon the use of the imported goods for the manufacture of excisable commodity. These rules also apply to importers who intend to import goods which can be imported only when such goods are used in the manufacture of specified goods and where the notification prescribes for the observation of these rules.

Difficulty is being faced by the importers in implementing the Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996 where goods received under these Rules are required to be removed to another unit of the manufacturer or where goods received under these Rules are required to be removed to another eligible manufacturer (for manufacture of specified goods) as there are no corresponding provisions in the said Rules.

Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996 be amended to provide mechanism for transfer of goods received under the said rules in the following situations

a. Removal of goods received to another unit of the manufacturer or

b. Removal of goods received to another eligible manufacturer

so long as the conditions imposed in connection with import are compiled by the recipient unit / manufacturer.

Similar amendment should be made in Central Excise (Removal of Goods under Concessional Rate of Duty) Rules, 2001.

2. Export Obligation Discharge Certificate (EODC)

EODC is required to be submitted to the Customs Department upon fulfilment of export obligation against pre-export licences (like Advance Licence, DFIA, EPCG and so on). Without submission of the EODC to the Customs authorities the Bond / Letter of Undertaking (LUT) furnished by the exporter is not cancelled.

As per current provisions of law the EODC has to be obtained from the jurisdictional DGFT office and submitted to the Customs authorities thereafter. Only upon verification of the EODC the Customs authorities cancel the Bond / LUT executed by exporter at the time of import. The entire process is time consuming and at times the cancellation of the Bond / LUT remains pending even after a decade of issuance of the EODC by the DGFT.

In order to reduce avoidable paperwork and delays in cancellation of Bonds / LUT it is recommended that while issuing the EODC the DGFT should can declare in the Certificate that export obligation is fulfilled and all bonds/LUT executed in respect of the specific Authorisation (with Ministry of Finance / Ministry of Commerce) stand cancelled with immediate effect. This information can be updated in the on-line system to ensure updation of records maintained by Customs Department as well.

3. Fabric &Garments Under Customs Tariff Chapters 51, 52, 54 55 61 & 62

Fabric and garments covered in above stated chapters attract different specific duties of Customs at 8 digit HS code level depending on the fibre content, gram per sq. meter (GSM) of fabric, weave type etc.

The difference in the product description under various sub–classifications cannot be determined or identified by physical inspection and requires submission of samples for chemical tests by Textile Committee. This results in inordinate delays in clearance of goods.

Recommendation

The structure of specific duties applicable to goods covered under the aforesaid Chapters should be harmonised and rationalised to obviate the necessity of testing.

In the event some testing is found to be essential, test reports from any accredited testing laboratory should be accepted. If necessary, the sample fabric affixed on the test report can be matched with the import consignment.

4. Customs Duty On Paper/Paperboards

The Indian Paper/Paperboard industry has made significant capital investments to ramp-up capacities for meeting domestic requirements. The Industry has strong backward linkages with the farming community, from whom wood, which is a raw material, is sourced. A large part of this wood is grown in backward marginal / sub-marginal lands, which are potentially unfit for other use. The paper industry, being mainly located in backward areas, has transformed the socio economic conditions of the population residing there. The output of this industry which is predominantly used by the educational, printing and packaging sectors is aligned to the Government's initiatives such as "*Sarva Shiksha Abhiyan*". It is therefore strategically important and also necessary to keep Paper/Paperboard industry, outside the ambit of FTAs (ASEAN etc.) and recognize this Industry as "sensitive" deserving special treatment.

The economic slowdown in developed economies and export dependant economies has led to severe excess capacity in of Paper/Paperboard in paperboard manufacturing countries. Taking advantage of the low Customs Duty rate of 10%, these countries find India as an attractive outlet for diverting their excess inventory.

Increased imports from foreign countries is severely impacting the economic viability of paper mills in India with consequential adverse impact on the local farming community and the society around the mills since their livelihood is intrinsically dependant on the viability of the industry.

Recommendations

In order to provide a level playing field to the domestic industry it is recommended that:

i. **The Customs duty for import of Paper and Paperboards be increased to 25% and brought in line with agricultural products which are ranging up to 40% as currently industry is sourcing majority of its raw materials from Agro-forestry – supporting millions of farmers in creating value on their marginal lands.**
ii. **This category to be kept in the Negative List (i.e., no preferential treatment) in bi-lateral and multi-lateral trade treaties and agreements.**

5. Customs Duty On Import Of Pulp

In May 2012 the Government reduced the import duty on pulp from 5% to "Nil". More than 1.25 million MT of pulp, valued at approximately USD 820 million (about Rs. 4,600 crore) is imported in to the country every year. The customs duty for these imports is estimated to be about Rs. 245 crore p.a.

The break-up of the pulp imports is as under:

Type of Pulp	Quantity ('000 MT)	Value (Rs. Crore)
Hard Wood Chemical Pulp	900	3,420
Soft Wood Chemical Pulp	200	900
Bleached Chemi Thermo Mechanical Pulp (BCTM Pulp)	160	580
Total	**1,260**	**4,580**

Consequent to the customs duty exemption, pulp imports are expected to increase significantly in the near future to levels of about USD 2 billion p.a.

In view of the fact that Soft Wood cannot be grown in the country, requirement of Soft Wood Pulp will have to be met through the import route only.

However, in so far as Hard Wood Pulp is concerned, it would be pertinent to note that the domestic industry is working closely with the farming community for creating sustainable supply of wood – a key raw material for hard wood pulp – through re-development of waste-lands.

Already, about 10 lakh hectares of waste / degraded land has been developed in to eucalyptus/ subabul plantations wherein more than 5 lakh farmers are engaged. Coupled with this agro-forestry initiatives like inter-cropping – whereby both cash and commercial crops are grown on the same plot of land – has created significant employment and livelihood opportunities for local communities whilst, at the same time, further strengthening wood and food security. This is also in line with the Planning Commission's objectives of bringing 33% of land mass in India under tree cover through afforestation of nearly 43 million ha of land, including re-development of degraded forest land comprising approximately 15 million ha.

The paper/paperboards industry in the country is expected to grow by @ 8% p.a. and initiatives of the Government like the *Sarva Shiksha Abhiyan* are expected to push up the rate of growth further. Consequently, over and above the existing capacity of about 10 million tons, capacities of about 1 million tons will have to be added every year of which about 50% is likely to be through the pulp route. This offers an excellent opportunity for the farming community to increase areas under pulpwood plantations, creating livelihoods in hinterlands and attendant environmental benefits. Cheaper imports of duty free hardwood pulp would not be in the interest of Indian farmers as the benefit will flow to farmers in exporting countries like Indonesia and Brazil.

In so far as Bleached Chemi Thermo Mechanical Pulp (BCTMP) is concerned, the technology for manufacturing BCTMP has not been available in India. In line with the vision "Make in India" of Hon'ble Prime Minister, for the first time, the industry is setting up a state of art BCTMP manufacturing facility in India, which is expected to be operational by June 2016. The project involves huge capital investments and will continuously save forex outflows that would otherwise be spent for import of BCTM pulp. This will have positive multiplier effect on the farming community in India, who supply the key raw material – wood for manufacturing of pulp.

Recommendation

In an era of increasing global competition it is necessary for governments and industry to work in partnership to ensure creation of economic wealth for the nation. Accordingly, for creation of sustainable sources of fibre required by the pulp and paper industry it is recommended that:

- **i. policy measures be put in place to facilitate private sector participation in plantation development programmes, and,**
- **ii. 10% customs duty on pulp be imposed only for Hard Wood Chemical Pulp and Bleached Chemi Thermo Mechanical Pulp (BCTMP)**

6. Simplification Of Procedure For Import Of Pulp For Manufacture Of Paper And Paperboard

In terms of Notification 12/2012–Cus. dated 17.03. 2012 (as amended up to date) pulp of wood or of other fibrous cellulosic material (excluding rayon grade wood pulp) can be imported at nil rate of customs duty when used for the manufacture, inter alia, of paper and paperboard, subject to fulfilment of certain conditions.

The said condition prescribe that the importer has to follow the procedure set out in the Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996 (the Rules) read with Circular No.46/96-Cus., dated 30.8.1996.

The detailed guidelines/procedures to be followed include the following:

- i. the manufacturer intending to avail the benefit of exemption shall obtain registration from the Assistant Commissioner (AC-Excise) or Deputy Commissioner (DC-Excise) of Central Excise having jurisdiction over his factory
- ii. the manufacturer shall make an application to the AC(Excise)/DC(Excise), indicating the estimated quantity and value of such goods to be imported, particulars of notification applicable on such import and the port of import
- iii. the manufacturer shall also give undertaking that the imported goods shall be used for intended purpose
- iv. the manufacture has to executed a bond with the AC(Excise)/DC(Excise) in respect of end use of the imported goods in the manufacturers factory
- v. on the basis of the above document, the Assistant Commissioner (AC-Customs) or the Deputy Commissioner of Customs (DC-Customs) at the port of importation shall allow the benefit of exemption to the importer
- vi. the AC-Customs or the DC-Customs shall forward a copy of the bill of entry containing the particulars of import to the AC-Excise or the DC-Excise
- vii. the manufacturer shall give intimation of the receipt of imported goods in his factory within two days of such receipt to the jurisdictional Superintendent of central excise

viii. the manufacturer to maintain an account to clearly indicate the quantity and value of goods imported, the quantity of imported goods consumed for the intended purpose, the quantity of remaining stock, bill of entry wise and shall produce the said account as and when required by the AC-Excise or DC-Excise.
ix. The manufacturer to submit a quarterly return, in the prescribed format

The myriad procedures prescribed above are highly time consuming and increases considerably the transaction cost for the paper and paperboards industry - which is highly capital intensive with long gestation periods.

Further, there is no clear procedure prescribed for transfer of pulp imported by one mill of the manufacturer to another mill of the same manufacturer. Consequently, different Commissionerates have varying views on the subject, ranging from disallowing transfers to prescribing different procedures for the same. This state of affairs results in putting the manufacturers through undue hardship and procedural delays – particularly in the event of emergencies like making up the shortfall of pulp in one mill from pulp stocks available at a sister unit.

Recommendation

i. **With a view to reduce transaction cost, the Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996 (the Rules) be not made applicable for import of pulp by the paper/paperboard industry. The private records maintained by manufacturers – which are relied upon by Central Excise Audit also – should be prescribed as appropriate documentation for verification of end use of imported pulp.**

ii. **Manufacturer importer should also be given the flexibility to use the imported pulp for manufacture of paper and paperboard either within the same factory (for which pulp was originally intended for use) or in any other factory of the same manufacturer with a simple intimation to the AC-Excise or DC-Excise having jurisdiction over the factory.**

7. **In sectors such as electronics, where the inverted duty structure prevails, the customs duty on import of inputs should be lower as compared to the duty on output.**

Currently, sectors such as electronics is subjected to tax on inputs at higher rates and duty on output at lower rates, thereby resulting in blockage of input taxes. This issue is commonly referred to as 'inverted duty structure'. Rectification of inverted duty structure is also essential to deal with the problem of cheaper imports from the countries with whom India has signed Free Trade Agreements.

8. **Government should consider lowering Special Additional Duty (SAD) on imported raw material from 4 per cent to two percent.**

In sectors where manufacturing has significant imports, Special Additional Duty of Customs (SAD) of 4% is applicable over and above the Countervailing Duty of 12.5%. The accumulated amount of cenvat credit for these duties require substantial amount as value addition to offset / neutralize such credit. Since the output Excise Duty is generally at 12.5%. SAD has been stagnant at 4% though the Central Sales Tax has moved down to 2%. While SAD is available as a refund to traders, to manufacturer the assumption that such duties are available as credit is a myth, since there isn't sufficient value addition to offset such duty effect in several sectors. The Government should address such anomaly by lowering Special Additional Duty (SAD) on imported raw materials from 4 percent to 2 percent.

Central Excise – Budget Recommendations

1. ***Direction From CBEC For Utilisation Of Accumulated Credit Balance of Education Cess and Secondary & Higher Education Cess Or Refund Of The Same To Assessees***

In the Union Budget of 2015 all goods on which central excise duty is leviable were exempted from Education Cess and Secondary & Higher Cess with effect from 1st March 2015. Subsequently, vide Notification No. 12/2015-C.E. (N.T.) dated 30th April 2015 the CBEC brought about amendments in the Cenvat Credit Rules, 2004 whereby assessees were permitted to utilise the credit of such Cesses in respect of inputs and input services, paid on or after 1stMarch 2015 against liability of central excise duty leviable under the First Schedule to the Central Excise Tariff Act.

No such provision was made in respect of accumulated credit of such Cesses till 28th February 2015. Consequently, such credit balances are lying idle in the hands of the assessees. The CBEC is requested to make appropriate amendments to the Cenvat Credit Rules, 2004 to either enable assessees to utilise such accumulated balances against central excise duty leviable under the First Schedule to the Central Excise Tariff Act or, make provisions enabling refund of such credit balances to the assessees.

2. *Duty On Clearance Of Waste Generated*

Central Excise authorities insist on payment of excise duty on clearance of waste that arises during the course of manufacture in case the inputs are those on which CENVAT credit has been availed by the assessee. The rationale for the duty demand seems to be that since CENVAT credit has been availed on the inputs, clearance of waste arising out of usage of such inputs for manufacture are also liable to excise duty. As a result of the position taken by the Excise Authorities, mere generation of waste (e.g., paper scraps arising in the course of slitting paper bobbins, slag generated by usage of fuel oils, etc.) is being held to be 'manufacture' of a 'marketable product' and hence, dutiable.

The CBEC has already clarified that duty should not be demanded on waste packages / containers used for packaging CENVAT-able inputs when cleared from the factory of the assessee availing CENVAT credit. This clarification is based on the Hon'ble Supreme Court's judgment in M/s West Coast Industrial Gases Limited v. Commissioner of Central Excise.

There are instances where the Commissioner (Appeals) has set aside Orders of the Department demanding duty on clearances of waste generated during manufacture in respect of one particular Unit of an assessee, while, on an identical issue Show Cause Notices have been issued to sister Units of the same assessee. It is submitted that clearance of scrap/waste generated by the use of CENVATable inputs in the manufacturing process is, conceptually, the same as clearance of waste packages and containers and should, therefore, be outside the scope of central excise levy.

It is recommended that the provisions of the Central Excise statutes be amended to make clearance of scrap/waste arising out of the manufacture of finished / intermediate goods duty free.

3. **Amendment Of The Provisions Related To Unjust Enrichment**

Section 11B of the Central Excise Act, 1944 provides for diversion of refund of excess excise duty paid by an assessee to the Consumer Welfare Fund in order to avoid unjust enrichment. This holds true even in cases where the excess duty has been paid erroneously or has been appropriated by the Department through coercive demands.

No doubt, the Hon'ble Supreme Court of India, in the case of Mafatlal Industries, has upheld the constitutional validity of the principle of unjust enrichment. However, the law as it stands today is draconian because the assessees right to appeal has been rendered illusory since the Department invariably denies the return of pre-deposit / refund of duty on grounds of unjust enrichment – even in cases where the excess duty has been paid by mistake or under coercion. In view of the inequitable consequences of Section 11B, there is a strong case for its modification.

It is recommended that Section 11B be amended to provide relief to assessees in cases of erroneous collection of duty and further, not be made applicable to duty paid on captive consumption, return of pre-deposits made in the course of litigation and excess duty paid under provisional assessments, as determined at the time of finalisation.

4. Power To Grant Or Take Away Exemption Retrospectively

Sub-Section 2A of Section 5A of the Central Excise Act, empowers the Executive to clarify the applicability of a Notification by inserting an 'Explanation' in the Notification within one year of its issue and provides that such explanation shall have effect from the date of the original Notification.

The power to issue explanations beneficial to the assessee, with prospective effect, already exists per sub-section 1 of Sec. 5A. **However, sub-section 2A provides for retrospective effect of a Notification, merely by insertion of an 'Explanation' subsequently.** To the extent such 'Explanations' are to the detriment of assessees, such a provision is unjustified and inequitable since it causes undue hardship.

It is recommended that Section 5A be amended appropriately to prevent retrospective effect of changes in Notifications in case these are detrimental to the assessee.

5. Time Limit For Return Of Inputs Or Capital Goods Sent To Job-Workers

Under the provisions of Rule 4(5)(a) of CENVAT Credit Rules, 2004, if the inputs or the capital goods (on which CENVAT credit has been availed) are sent out of the factory premises for further processing, manufacture of intermediate goods necessary for manufacture of final products, etc., to a job-worker and are not returned within 180 days or 2 years respectively, the manufacturer has to pay an amount equal to CENVAT credit attributable on such inputs or capital goods. The re-credit of such amount is allowed as and when the inputs / capital goods are returned.

It is submitted that return of capital goods from a job worker location with consequential disruption of manufacture at such location, merely to avail CENVAT credit, is economically inefficient. Additionally, in the event of return of inputs / capital goods beyond 2 years due to reasons like strike / lockout / other disruptions at the job-workers premises also disentitles an assessee from availing the CENVAT credit for reasons beyond his control.

It is recommended that the time limit for return of inputs and capital goods removed to job-worker premises be done away with. Alternately, jurisdictional authority be delegated the necessary powers to extend the time limit of 180 days for return of inputs from job worker for reasons beyond the control of the manufacturer, like strike/lockout at the premises of the job worker. In

respect of capital goods the time limit be extended for the duration of the contract with the job-worker based on which such capital goods are sent out.

6. **Inputs Cleared 'As Such'**

Rule 3(5) of CENVAT Credit Rules, 2004 provides for payment of excise duty on inputs / capital goods equal to the credit availed on them in case they are cleared from the factory 'as such'. In order to comply with this provision, the manufacturer has to keep track of inputs, the rate of duty at the time of their entry into the factory and the value at which they were purchased – until such time that the inputs are in stock. Since maintenance of such voluminous data over long periods is prone to human error, very often there are objections by Departmental officers, particularly Audit, and consequent litigation.

It is recommended that Central Excise statutes be amended to allow removal of inputs 'as such' on payment of excise duty at the rate prevailing on the date of removal and the value for purpose of duty determination be the Weighted Average Cost of the inputs as on that date (as per the assessee books of accounts).

7. **CENVAT Credit On Capital Goods**

In terms of Rule 4(2) of the CENVAT Credit Rules, 2004 the credit of CENVAT in respect of capital goods has to be distributed over two years. In the year in which the capital goods are received in the factory credit equivalent to 50% of CENVAT can be availed. The balance 50% can be availed only during the next financial year. As a result of this a lot of time and effort is expended in tracking each capital goods in terms of year of entry, amount of credit available in each year, etc. Apart from the cost involved in such tracking, this also leads to errors and, consequently, long-drawn disputes/litigation with the Department.

It is recommended that the CENVAT Credit Rules, 2004 be amended appropriately to enable credit of full CENVAT in respect of capital goods in the year of receipt in to the factory. This would be in line with the provisions on CENVAT credit in respect of inputs.

8. **Storage Of Capital Goods Outside The Factory Of The Manufacturer**

Having regard to the nature of the goods and shortage of space in the factory premises, manufacturers are permitted under Rule 8 of the CENVAT Credit Rules 2004 to store inputs, in respect of which CENVAT credit has been taken, outside the factory premises after obtaining necessary permission from the jurisdictional excise authorities.
At times the manufacturers are also constrained to store capital goods outside their factory premises on account of shortage of space which could be caused due to reasons such as major infrastructural up-gradation, modernisation, renovation, etc. of the factory premises.

It is recommended that the CENVAT Credit Rules 2004 be amended appropriately permitting the manufacturers to store the capital goods outside the factory premises without reversal of CENVAT Credit in the same manner as is currently permitted for storage of inputs outside the factory premises.

9. <u>CENVAT Credit On Goods Removed After Subsequent Use</u>

Rule 4(2)(a) of CENVAT Credit Rules 2004 provides that CENVAT credit in respect of capital goods received in a factory at any point of time in a given financial year shall be taken only for an amount not exceeding 50% of the duty paid on such capital goods in the same financial year. As per Rule 4(2)(b), the balance of CENVAT credit may be taken in any financial year subsequent to the financial year in which the capital goods were received.

For Capital Goods cleared "as such" in the same financial year, the First proviso to Rule 4(2) (a) of the CENVAT Credit Rules 2004, provides that CENVAT credit in respect of Capital goods shall be allowed for the whole amount of duty paid on such capital goods in the same financial year if such capital goods are cleared as such in the same financial year.

For Capital Goods cleared "after use" in the subsequent financial year, the Third proviso of Rule 3(5) of the CENVAT Credit Rules 2004, provides that in case the capital goods on which CENVAT credit has been taken are cleared after being used, then <u>the amount payable shall be either the amount calculated on the basis of CENVAT credit taken at the time of receipt reduced by a prescribed percentage or the duty on transaction value, whichever is higher.</u>

However, situation may also arise where a manufacturer, after having used the capital goods during the first financial year and having taken credit up to fifty percent of the duty paid on such capital goods, removes the capital good in the same financial year. The CENVAT Credit Rules does not provide any clear mechanism for availment of the balance CENVAT credit which has not been availed in the first financial year.

It is recommended that the CENVAT Credit Rules 2004 be amended appropriately permitting the manufacturers and service providers to avail the CENVAT credit for the whole amount of duty paid on such capital goods in the same financial year in cases where such capital goods are removed after subsequent use in the same financial year.

10. <u>CENVAT Credit On Service Tax Paid On Input Services</u>

Under Rule 6 of CENVAT Credit Rules, 2004 there is no restriction on availing CENVAT credit of excise duty paid on capital goods that are used for manufacture of goods that are dutiable and goods that are exempt. For example, if any capital goods are used to manufacture any goods that are excisable and has any by-product that is exempt or if any capital goods are used to manufacture exempt as well as dutiable goods alternately, there is no restriction on availment of CENVAT credit.

However, under the same Rule 6 in case of input services that are used partly for providing taxable output services or for manufacturing excisable goods and partly for providing exempt output services or manufacturing exempt goods, in order to avail input tax credit the assessee has to satisfy any one of three stringent conditions that have been prescribed.

It is recommended that the CENVAT Credit Rules 2004 be amended appropriately permitting the manufacturers and service providers to avail entire CENVAT credit of service tax paid on all input services, if such services are partly used for exempted goods and partly for dutiable final products or partly used for providing both taxable service as well as exempted service.

11. CENVAT Credit On Service Tax Paid On Intermediate Goods

There are many instances where a manufacturer manufactures excisable goods in two or more stages across different manufacturing units. In cases like these it is quite possible that intermediate goods are manufactured in one or more stages and then the same are transferred to another manufacturing unit where the finished goods are manufactured. In cases where such intermediate goods are exempt from central excise duty, the manufacturer is denied CENVAT credit of input services used in the manufacturing process notwithstanding the fact that the intermediate goods are used thereafter for manufacture of excisable goods.

It is recommended that in such cases the manufacturer is allowed to take credit of input taxes paid on services and transfer the same, through the ISD mechanism to the unit where the dutiable finished goods are manufactured.

12. Reversal Of CENVAT Credit On Capital Goods (Including Spares And Consumables)

Under Rule 3(5A) of the CENVAT Credit Rules, 2004 in case of clearance of used capital goods – on which CENVAT credit had been taken – the assessee was required to pay an amount equal to the CENVAT credit taken on the said capital goods reduced by prescribed percentage points calculated by straight line method for each quarter of a year or part thereof from the date of taking the CENVAT credit.

The above Rule 3(5A)(a) has been amended with effect from 27.09.2013 wherein it prescribes that in case the capital goods on which CENVAT credit has been taken are cleared after being used, then the amount payable shall be either the amount calculated on the basis of CENVAT credit taken at the time of receipt reduced by a prescribed percentage or the duty on transaction value, whichever is higher.

It is submitted that the amended rule has rendered determination of amount payable extremely complex, cumbersome and dispute prone. In case of transfer of used capital goods otherwise than by way of sale (e.g., between sister units) there is no "transaction value" since there is no sale. This leads to determination of transaction value based on interpretation.

It is recommended that Rule 3(5A)(a) of CENVAT Credit Rules 2004, relating to reversal of CENVAT credit on Capital Goods removed from the factory after use be amended to provide that in the case of removal of used capital goods otherwise than by way of sale, determination of amount payable be allowed as per prescribed formula and that in such cases payment of an amount equal to the duty leviable on transaction value be done away with.

13. Rate Of Interest For Delayed Payment Of Excise Duty Or Service Tax Should Be Restored To 13% p.a.

The rate of interest on delayed payment of excise duty/customs duty has been revised with effect from 1st April 2011 to 18% per annum. Further the rate of interest for delayed payment of service tax has been steeply increased with effect from 01.10.2014 as under:

(i) Delay up to 6 months – 18% p.a.
(ii) Delay of more than 6 months and up to 1 year – 18% p.a. for the first 6 months and 24% for delay beyond 6 months.

(iii) Delay of more than 1 year – 18% for the first 6 months; 24% for the period beyond 6 months up to 1 year and 30% for the delay beyond 1 year.

The rate of interest as has been prescribed for delayed payment of taxes is draconian and exorbitantly high and is not justifiable, especially if it is compared to the rate of interest which the exchequer would earn on deposits with nationalised banks. Such high rate of interest is more penal in nature instead of being compensatory.

It is recommended that the rate of interest on delayed payment of Central Excise Duty / Customs Duty and Service Tax should be restored forthwith to 13% per annum.

14. Export Of Capital Goods & Inputs

In case of clearance of capital goods the assessee is required to pay an amount as provided under Rule 3(5) or Rule 3(5A) of CENVAT Credit Rules 2004. Often Capital goods, on which cenvat credit has been availed, may be sent outside India by the manufacturer (for example on returnable basis, or for replacement or repair) in "as such" condition or "after use". Considering the fact that the said capital goods are exported outside the country, the manufacturer should not be required to pay the amount as provided under Rule 3(5) of CENVAT Credit Rules 2004 in view of Rule 19 of the Central Excise Rules 2002 or in case duty has been paid rebate should be allowed in accordance with Rule 18 of the Central Excise Rules 2002. The same also stands clarified by CBEC Board vide various Circulars. Considering the fact that the CENVAT Rules 2004 do not expressly provide for non-reversal/ nonpayment of an amount as provided under Rule 3(5) or Rule 3(5A) of CENVAT Credit Rules 2004, the field officers insist for payment of amount as provided under Rule 3(5) or Rule 3(5A) of CENVAT Credit Rules 2004 at the time of clearance of capital goods or inputs.

CENVAT Credit Rules 2004, should be amended to specifically provide that payment of an amount as provided under Rule 3(5) or Rule 3(5A) of CENVAT Credit Rules 2004 is not required in the event capital goods or inputs are exported outside the country and even in case payment has been made rebate shall be allowed. In the interim, relevant instructions should be issued to the field officers reinforcing the said position.

15. Applicability Of Rule 6(3A) Of The CENVAT Credit Rules 2004 Should Be Restricted Only To The Input Services Which Are Common To Dutiable And Exempted Goods Or Services

As per Rule 6(3) of the CENVAT Credit Rules 2004, the manufacturer of goods or the provider of output service, opting not to maintain separate accounts for inputs of input services used in the manufacture of dutiable goods and exempted goods or taxable services and exempted service is provided an option to pay an amount as determined under Rule 6(3A). Rule 6(3A) of Cenvat Credit Rules 2004 provides that the amount attributable to input services used in or in relation to manufacture of exempted goods and their clearance up to the place of removal or provision of exempted services should be determined after considering the total cenvat credit taken on input services during the financial year. **The said provision seeks to disallow cenvat credit even on input services which have no nexus with exempted goods or exempted services. This provision takes away the rightful cenvat credit available to the manufacturer and service provider.** In fact, it would create a disparity between manufacturer of a taxable product and manufacturer of taxable product and exempted product to the extent of availment of cenvat credit on input services used only for manufacture of a dutiable product is concerned. Similar would be the case with service providers.

CENVAT Credit Rules, 2004 should be amended to provide that the determination of the amount attributable to input services used in or in relation to manufacture of exempted goods and their clearance up to the place of removal or provision of exempted services as provided under Rule 6(3A) of the CENVAT Credit Rules 2004 should be restricted only to the input services which are common to dutiable and exempted goods/services instead of making the same applicable to entire cenvat credit availed on input services during the month or year.

16. Remission Of Duty On Goods Before Clearance From Place Of Removal

Rule 21 of the Central Excise Rules 2002 provides that where it is shown to the satisfaction of the Commissioner that goods have been lost or destroyed by natural causes or by unavoidable accident or are claimed by the manufacturer as unfit for consumption or for marketing, at any time before removal, he may remit the duty payable on such goods, subject to such conditions as may be imposed by him by order in writing.

The provision for remission of duty should not be restricted only to goods which are within the factory premises and on which duty has not been paid. In fact the remission provision should be applicable to all goods that are in possession of the manufacturer and have not been sold. It should be appreciated that excise duty is an indirect tax i.e., a tax or duty not intended by the taxing authority to be borne by the person on whom it is imposed and from whom it is collected but is intended to be passed on to those who purchased the goods on which the duty was collected; but when such a tax could not be passed on, so such a levy deprived the tax of its essential characteristic of being indirect. Therefore, the goods that become unfit for consumption in the hands of manufacturer should be eligible for remission as by not being able to sell such goods, the burden of excise duty cannot be passed on. By collecting the excise duty from the manufacturer on goods that have become unfit for consumption and sale, the excise duty partakes the character of being a direct tax instead of being an indirect tax as it deprives the tax-payer of the right of passing it on and recovering it from his buyer.

Central Excise Law should be amended to provide for remission of duty on goods that have been or destroyed by natural causes or are claimed by the manufacturer as rendered unfit for consumption or marketing any time before clearance from the place of removal.

17. Availment Of Cenvat Credit On Additional Duty Leviable Under Section 3 Of The Customs Tariff Act, Equivalent To The Duty Of Excise Specified Under Section 85 Of The Finance Act, 2005

At present the CENVAT Credit Rules 2004, allows cenvat credit on additional duty leviable under section 3 of the Customs Tariff Act, equivalent to the duty of excise specified under First and Second Schedule to the Central Excise Tariff Act, additional duty of excise, National Calamity Contingent Duty, Education Cess and Secondary Higher Education Cess. However, the additional duty of excise leviable under section 85 of Finance Act, 2005 (18 of 2005) and paid by the importer under Section 3 of the Customs Tariff Act is not eligible for CENVAT Credit. This leads to a disparity between the indigenous goods and imported goods to the extent of duty of excise leviable under section 85 of Finance Act, 2005.

Cenvat Credit Rules 2004 should be amended to provide for availment of cenvat credit on additional duty leviable under section 3 of the Customs Tariff Act, equivalent to the duty of excise specified under section 85 of the Finance Act, 2005.

18. Updation Or Complete Repeal Of Cigarette Manual

The Central Board of Excise and Customs had issued a manual of Departmental Instructions on Cigarettes, commonly called Cigarette Manual, which primarily imposes certain duties on assessee's engaged in the manufacture of cigarettes as well as on the Central Excise officers posted in the cigarette factories. It appears that the said manual was issued sometime in the early 1980 and the last edition of the manual available with the central excise authorities and in the public domain is of December, 1984

The procedures mentioned in the said manual rely on various provisions contained in the erstwhile Central Excise Rules, 1944 which are no longer in existence. The Cigarette Manual also envisages certain processes that are not in existence because of technological changes introduced in the cigarette manufacturing in the recent years. Thus, the compliance to the said processes has become superfluous and redundant. The Board may revise the said Manual to bring it in line with the extant Central Excise Rules, 2002 and the technological changes brought about in the cigarette manufacturing process.

It is suggested that the Central Board of Excise and Customs may either update the Cigarette Manual keeping in view the various changes in the extant law or repeal the same in its entirety.

19. Single ARE-1 For Multiple Clearances Of Goods Against Bulk Export Orders

In order to service bulk export orders from a single customer manufacturers often clear goods over a period of time. Typically, the goods are aggregated at a Container Freight Station and thereafter, exported.

As per existing statutory provisions, an ARE-1 is required to be filed against each day's clearance from the factory. In so far as bulk export orders are concerned, the requirement of daily filing of ARE-1 results in a large number of ARE-1 documents in respect of the same export order. Not only does this impede efficiencies of exports, given the time required for obtaining "proof of export" endorsements on each ARE-1 the manufacturer-exporter is forced to invest considerable time and effort in such cases, adding to cost and complexity of exports.

As a trade facilitation measure that will also improve efficiencies of exports, manufacturers should be allowed to clear goods over a period of time (say, one month) under one ARE-1 cross referenced to the Export Order.

Additionally, the requirement of obtaining 'proof of export" by the exporter should be done away with, instead, the proof of export endorsement and verification to be done on-line by the Central Excise and Customs authorities in their computerised systems.

20. Cenvat Credit On Capital Goods For Projects – Lock Up Of Funds

In case of investments in capital goods for projects the cenvat credit accumulation and utilisation is delayed since the cenvat credit is taken at the project stage but the utilisation of the same has to await completion of the project and commencement of commercial manufacture. In large projects the gestation period between accumulation of cenvat credit and utilisation thereof can be as much as 3 to 4 years. Consequently, significant quantum of funds gets blocked by way of cenvat credit pending utilisation. Also, there are several instances wherein a large portion of the cenvat credit on capital goods accumulated at the time of setting up the project/upgrading existing manufacturing capability remains unutilised since the assesse does not have enough duty liability to set-off the duty credit.

To avoid idling of funds in respect of construction phase of projects it is recommended that the cenvat credit laws be amended to enable refund of unutilised cenvat Credit balance if the same remains unutilised after a period of two years from date of availment of credit.

21. Provisional Assessment – Captive Consumption

In case of **movement of goodsbetween two businesses / units of the same Company for captive consumption**, the receiving unit is eligible for Cenvat credit. Accordingly, the movement of dutiable goods from one unit to the other is revenue neutral. However, as per Central excise laws even in such cases the goods have to go through a process of provisional assessment and finalisation of the same. This adds to the cost and complexity of manufacturers as well as the Department without any venue gain.

Provisional Assessment under Rule 7 of Central Excise Rules, 2002 should be dispensed with in case of movement of goods within sister units of the same Company as the duty payment and Cenvat credit are revenue neutral for department. Any way this is applicable for LTU at present and the same can be extended to the non LTU Companies.

22. Provision for Revision / Rectification of Returns Uploaded in ACES

In the ACES system there is no provision for revision / rectification of the periodic Central Excise Returns once the same are uploaded by the assessee. It is recommended that the Central Excise laws be amended to allow the assessees to make revisions / rectify the said Returns within a specified time limit – say, one month. This will go a long way in resolving avoidable disputes with the Department in respect of genuine mistakes / clerical errors that are noticed in the uploaded Returns subsequently.

23. Excise Returns ER1, ER2 and ER6 are to be filed on a monthly basis, whereas Service Tax Returns are required to be filed on a half-yearly basis. To bring them in line with each other and with an objective to ease doing business, it is proposed that monthly Excise returns should also be made on a half-yearly basis.

24. No Increase In Excise Duties

As a result of a taxation policy targeting the cigarette segment, the share of cigarettes has been declining over the last 30 years. With the last hike in excise duty effected in Union Budget 2015, the increase over the last 4 years aggregates to a 98%. The issue is compounded by arbitrary increase in State Taxes on cigarettes – with rates as high as 42%[1].

The factory shipments of legal cigarettes have declined from 110 billion sticks in 2011-12 to 95 billion sticks in 2014-15 and are further expected to decline to 83 billion sticks in 2015-16 – a decrease of 24%. The legal cigarette industry is now gasping for survival.

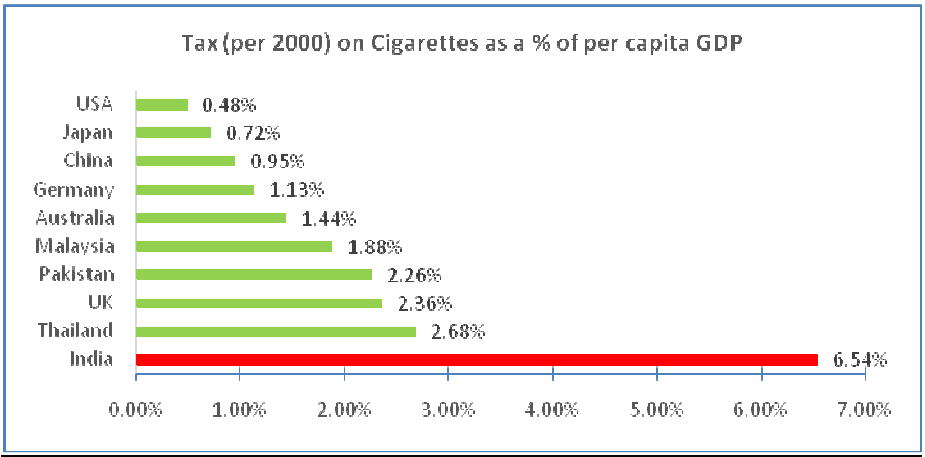
[1] J&K incl. Toll Tax

During the period 2011/12 and 2015/16, **whilst inflation (CPI) has increased by 34%, and Per Capita GDP has gone up by 51%, the excise duty rates have gone up by as much as 98%.** This confirms that the **growth in cigarette taxation is well ahead of inflation**, as well as growth in Per Capita GDP, and cigarettes have become very clearly less affordable in the country over the last 4 years.

Year	*Wtd Avg. Excise Duty Increase %*	*Index [Base 2011-12 =100]*	*Per Capita GDP (Rs.)*	*GDP Index [Base 2011-12 =100]*	*Inflation (CPI) %*	*Index [Base 2011-12 =100]*
2012-13	*22%*	*122*	*82410*	*111*	*10.4*	*110.4*
2013-14	*18%*	*144*	*91058*	*122*	*9.7*	*121.1*
2014-15	*22%*	*176*	*101563*	*137*	*6.2*	*128.6*
2015-16	*13%*	***198***	*112000*	***151***	*4.0**	***133.7***

** As on August 2015; (Source: CMIE, IMF)*

An analysis of the WHO Report on tobacco taxation, 2015 reveals that cigarette taxes (Excise Duty & State Taxes) in India at 6.5% (for 2000 cigarettes of the most popular price category, as a percentage of per capita GDP) are amongst the highest in the world. They are 13 times higher than in the USA; 9 times more than in Japan, 7 times more than in China, 5 times more than in Australia & 3 times more than in Malaysia & Pakistan.



Tax includes Excise duty, VAT/State taxes

Source: WHO Report on Tobacco Taxation, 2015

Consequently, India is amongst the countries where cigarettes are least affordable. As per the WHO Report on Tobacco Taxation - 2015, affordability of cigarettes is measured as a ratio between price of 2000 cigarettes and per capita GDP. In India this ratio is 10.8%, which is higher than most developed and developing countries (e.g. USA 1.14%, Russia 1.31%, Germany 1.55%, Canada 1.68%, China 2.14%, Australia 2.53%, UK 2.87%, Pakistan 3.73%).

The illegal cigarette segment comprising both contraband (customs duty evaded) and excise duty evaded domestic cigarettes, continued to grow and at 23 billion sticks currently accounts for nearly 20% of the total cigarettes sold in India. According to FICCI, the annual revenue loss to the Government on this account is estimated at around Rs.9000 crore[2] per annum. Legitimate domestic industry has not been able to combat the menace of illegal cigarettes due to its competitive positioning being eroded because of very high rates of excise duties and VAT.

The illegal cigarettes severely impacts the Government, the tobacco farmers as well as the industry and exposes the consumer to products of questionable pedigree and spurious quality. The benefit, on the other hand, flows to unscrupulous elements who manufacture and sell illegal tobacco products and those foreign countries from where these goods are smuggled into India – negating the "Make in India" initiative undertaken by the Government.

- The quantum of unsold tobacco stocks in the current season in Andhra Pradesh alone is estimated to be in excess of 40 million kg. Further, farmer realisations have dropped steeply by about 17% (@ Rs. 21/- per kg) over last year, leading to a value erosion of more than Rs. 600 crore of farm income.
- The unprecedented crisis faced by the farmers has already resulted in tragic cases of farmer suicides. The ability of the domestic industry to support farmers has been constrained considerably by declining volumes of duty paid cigarettes. Even as farmers are left with large quantities of unsold stocks, the industry is holding inventory of unmanufactured tobacco at levels much higher than norms.
- Declining volumes of legitimate duty-paid cigarettes in the national market has not only resulted in reduced domestic off-take of tobacco but, coupled with withdrawal of export incentives under the new Foreign Trade Policy exposed Indian farmers to exploitation by foreign buyers.
- The crisis is expected to be aggravated with a 90 million kg reduction in authorised crop size next year. Since tobacco farmers do not have the option of growing any other crop as remunerative as tobacco, this measure is expected to have an additional adverse impact of about Rs. 900 crore on farmer incomes.

The high tax cost of cigarettes also drives the shift in tobacco consumption to other forms like biris, chewing tobacco and so on which are highly revenue-inefficient by virtue of (i) these products being subjected to significantly lower rates of tax, and (ii) the rampant evasion of taxes since most of these products are manufactured in the unorganised sector. This is evident from the fact that cigarettes contribute about 85% of the total revenue from tobacco despite accounting for only about 11% of the total tobacco consumption in India. The following table illustrates this shift.

(Tobacco consumption in million Kgs)

Year	Tobacco consumed in the form of cigarettes[(a)]	Tobacco consumed in other forms[(b)]	Total
1981-82	86	320	406
2014-15	62	485	547
Increase (+)/Decrease(-)	**-28%**	**+52%**	**+35%**

[2]Illicit Markets – A Threat to our National Interests – FICCI Cascade

Source: USDA/Internal estimates

(a) – represents Legal cigarette segment only (b)– includes Illegal cigarette segment

Moreover, various studies[3&4] have established that non-cigarette products are more harmful to human health. In fact, whilst overall tobacco consumption is growing in the country, consumption in the most tax efficient form, i.e., cigarettes is declining – thereby **sub-optimising the economic potential of tobacco even as tobacco control objectives remain unfulfilled.**

Besides loss of revenue to the Government, millions of persons in the cigarette value chain - whose livelihoods are supported by the cigarette Industry like farmers who grow cigarette type tobaccos, small retailers running cigarette vending kiosks, distributors, salesmen etc. - would also be adversely impacted.

It is a well-established principle of fiscal policy that moderation and stability in rates is not only one of the most effective means of increasing tax revenue, but also of widening the tax base. The following table illustrates this principle:

	Excise Duty Rate CAGR (%)	Revenue Collection CAGR (%)	Volume CAGR (%)
2003/04 to 06/07	5.6	12.5	6.5
2007/08 to 13/14	12.0	10.6	-1.2
2013/14 to 15/16	**15.9***	**-1.8***	**-15.2***

Avg. monthly shipment volumes (Apr–Aug 2015) vis-à-vis avg. monthly shipment volume for FY 2013-14

Dr. V. Kelkar's "Report of the Task Force on Implementation of the Fiscal Responsibility and Budget Management Act, 2003" has supported this policy approach, stating that, "…India has experienced the difficulties associated with high rates…Expanding the tax base, rather than increasing rates, is hence the preferred strategy".

In order to enable the legitimate industry to effectively combat the menace of illegal cigarettes, facilitate shift in tobacco consumption into revenue-efficient cigarette form and to provide impetus to revenue buoyancy **it is strongly recommended that:**

Current excise duty rates for cigarettes be maintained to enable recovery and optimisation of Government revenue.

25. <u>Continuation Of Length Based Specific Duty Structure Of Excise For Cigarettes</u>

Length based specific excise duty structure is a simple, transparent method of taxation which is easy to administer and which has no potential for valuation disputes. Since its introduction -

3 Oxford Journals, Life Sciences&Medicine, Mutagenesis, Volume19, Issue4, Pp. 251-262

4 http://quitsmoking.about/od/teensmoking/f/bidi.com

notwithstanding WHO's claim about it being a complex structure and undermining the revenue impact - it has driven **unprecedented growth in excise duty collection** on comparable volumes without any revenues getting locked up in protracted litigation. The efficacy of the specific levy, from a revenue perspective, can be gauged from the fact that on a comparable volume base the growth in revenue has increased more than fifteen times, as evident from the following table:

	1984/85 (AD VALOREM)	**2014/15 (SPECIFIC)**
Industry Volume (Billion Sticks)	**96**	**95**
Excise Collections (Rs. Crore)	**988**	**17198**

It has enabled manufacturers to position their products at various price points, across different socio economic strata of the Indian society. It has also facilitated introduction of high quality products – benchmarked to international brands - resulting in **increased demand for high quality Indian tobaccos** leading to improved farmer earnings.

Indicator	**1986 (Ad-Valorem)**	**2014 (Specific)**	**Change**
Average Price (Rs/Kg)	7.31	110.00	1405%
Net Returns (Rs/Ha)	3,322	23275	600%
Tobacco Exports (Rs. Crore)	173	5614[5]	3145%

The ease and convenience of tax collection and administration in a specific duty levy has also prompted many countries in the world like USA, Japan, Australia, Indonesia and South Korea to adopt the structure of specific excise duty on cigarettes. Retention of this structure has been recommended repeatedly by eminent economists like Dr. Raja Chelliah and Dr. Vijay Kelkar. Recommendations of various experts on retaining specific tax levy for Cigarettes and efficacy of same over ad-valorem duty format are enclosed herewith and marked as **Annexure I** and **II** respectively. The recommendations enumerated therein very clearly amount to an explicit endorsement of a single-point, specific levy of tax on cigarettes.

Therefore, it is recommended that length based specific excise duty structure on cigarettes be retained.

26. <u>Protect Existing Length Based Segments And Facilitate Viable Offers At The Lower End To Prevent Shift To Illegal Cigarettes And Tax-Inefficient Forms Of Tobacco</u>

The existing excise duty structure where different length based segments are subjected to different rates of excise duty was designed keeping in mind the diverse socio economic profile of the Indian

5 Exports for 2014-15 – Source: Tobacco Board

populace and the need to offer products at different price points in line with their affordability-profile. Accordingly the Industry has been offering a 'laddered' portfolio of products at multiple price points catering to the needs of all sections of the Society.

However, the Union Budget 2014 has deleted the 'greater than 75mm but less than or equal to 85mm' category and combined this with 'Others' segment presumably to simplify the excise duty structure. We wish to highlight that given the diversity in the socio economic profile of the Indian populace (unlike Western Countries which have a relatively homogenous profile), it is important to have multiple length based tax points. This facilitates the industry to make offers tailored to meet the requirements of each section of the society. It may be kindly noted that **any attempt to further compress the existing length segments** into fewer length segments **will severely limit the ability of the industry to offer products across a wider range of price points**. Therefore, the industry will be incapable of meeting the requirements of certain sections of the society who will then switch to other forms of tobacco that are tax-inefficient or to illegal cigarette segment.

Secondly, in the 'less than 65 mm segment', the cumulative increase in excise duty rate has been a steep 109% in the last 2 Union Budgets. This segment – which was introduced in the Union Budget 2012 primarily as a measure to counter illegal cigarettes – had enabled the legitimate industry to hold on to Rs. 2 price point thus helping partial retention of volumes, which would have otherwise gone into illegal segment, within its fold. However, this segment was unable to fully counter the illegal cigarettes that are priced at Re.1 per cigarette due to the high excise duties. **The recent increases have forced the industry to vacate the crucial Rs. 2 price point.** There are clear indications are that volumes in the illegal Re. 1 segment have been buoyant even as legal industry volumes are declining significantly. Further, with a 15% increase in excise duty in other segments in the last Union Budget, many other cigarettes have crossed the crucial price points of Rs. 5 and Rs. 10, which is providing further impetus to growth in illegal cigarettes as well as shift to revenue-inefficient forms of tobacco like chewing tobacco, khaini, guthka etc., as well as to biris. This puts the legal industry at a severe disadvantage.

It may be recalled that in 2008, when the excise duty on plain cigarettes were increased, the legitimate industry was forced vacate the price point of Re. 1 per cigarette and the volumes declined by 9%. The resultant void was immediately occupied by domestic illegal regular size filter cigarettes (RSFT) – whose volumes quadrupled to 7.5 billion cigarettes p.a., as well as contraband cigarettes. The illegal cigarettes have only been growing from strength to strength since then.

In order to effectively combat the menace of illegal cigarettes, there is a need for a new segment of 'less than 60mm length' with an excise duty of Rs. 200 per thousand cigarettes. In addition, the excise duty on 'less than 65mm length' segment needs to be moderated to the earlier level of Rs. 689 / thousand cigarettes. These measures will facilitate the legitimate industry to make viable offers to consumers to counter the illegal cigarettes that sell at Re. 1 per stick.

Therefore it is recommended that

i. **The existing length based segments should be continued**
ii. **A new length segment of 'less than 60mm length' be introduced with an excise duty of Rs. 200 per thousand cigarettes**
iii. **In addition, the rate of Central Excise duty on the 65 mm filter cigarette slab be reduced from the existing level of Rs.1440 per thousand cigarettes to the earlier level of Rs.689 per thousand cigarettes**

27. Curb The Growing Menace Of Illegal Trade In Cigarettes

Due to the skewed taxation policies – which are focused solely on cigarettes - the illegal cigarette segment continues to grow and revenue loss to the Government on this account is estimated at Rs.9000 crore[6] p.a. According to Euromonitor International, illegal cigarettes (domestic manufacture & contraband) accounts for nearly 20% of Industry volume. The illegal volume has grown by >3 Billion sticks in just three years (2011 to 2014) and nearly doubled in last 10 years[7]. As acknowledged by the Department of Revenue in Parliament, in the last 3 years there has been a huge spurt in the smuggling of cigarettes. The details are been given in **Annexure III**. India is now 4th largest market[8] in the world for illegal cigarettes.

Domestic duty evaded cigarettes

Domestic excise duty evaded cigarettes are generally manufactured by small, 'fly-by-night' manufacturers by setting up small units for the manufacture of cigarettes without obtaining the stipulated licence from the Central authorities.

The markets are flooded with filter cigarettes that, whilst carrying MRP declaration ranging from Rs. 15/- to Rs. 18/- for a pack of 10 sticks, are sold to trade for as low as Rs. 5/- to Rs. 6/- per pack and to consumers for Rs. 10/- per pack, or, Re. 1/- per stick. Such low market prices are possible only if stocks are removed clandestinely, without the payment of excise duty and other taxes on cigarettes. This is evident from the fact that the excise duty component alone, on one filter cigarette is significantly more than Re. 1.00. Such illegal operations not only affect revenue collections and also destabilises the legitimate domestic industry.

Curtailing contraband trade in Cigarettes

High taxes on domestic cigarettes have created arbitrage opportunities for contraband customs duty evaded cigarettes. Besides leading to huge revenue losses, cigarette smuggling also affects other aspects of the industry- it aggravates under-utilisation of domestic capacity and affects farmers by eroding demand for Indian tobaccos (since these brands do not use Indian tobaccos).

As per WHO and reports in the international media multinational cigarette manufacturers, faced with declining sales in their home markets, are seeking to expand their business in developing countries. The modus operandi is to set up operations in the target countries, either through direct investments or imports, thereby creating a legitimate umbrella for distribution and demand creation activities. The demand thus created is actually fulfilled through contraband stocks that are sold through the established distribution channels. Thus, the contraband trade only benefits the foreign cigarette companies with consequential adverse impact on the exchequer and the domestic industry and its stakeholders. Moreover, cigarette imports under OGL, coupled with our porous borders renders monitoring and regulation of the inflow of smuggled stocks extremely difficult. Additionally, liberal import policy for cigarettes is in direct contradiction with the Government's tobacco control policies which include, inter-alia, stringent regulations, compulsory licensing and similar measures for the domestic industry.

Illegal trade in cigarettes (domestic duty evaded and contraband) has more than doubled between 2004 and 2014 as evidenced by the following chart:

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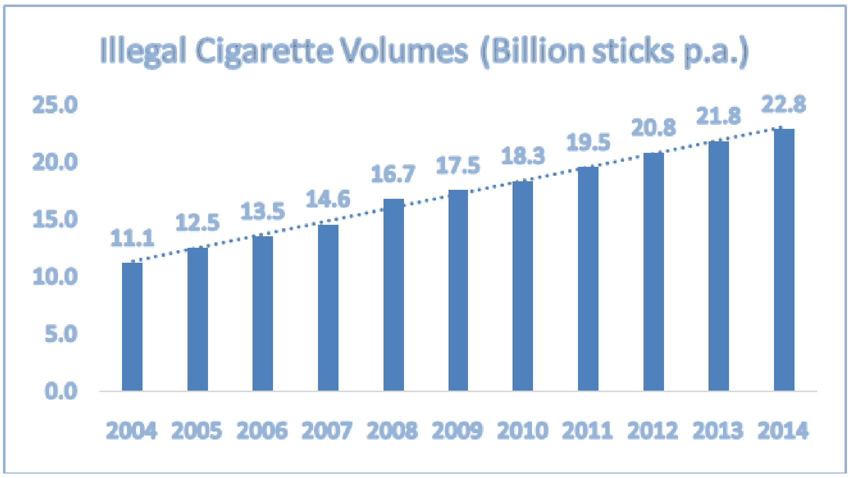
[6] Illicit Markets – A Threat to our National Interests – FICCI Cascade
[7] 2005 – 12.476 BNC, 2012 – 20.791 BNC, 2014 – 22.835 BNC
[8] Euromonitor International, Global Illicit Trade Overview, July 2010



(Source: Euromonitor International)

Besides, it is also seen that illegal cigarettes do not carry mandatory health warnings mandated by the statute. This directly impacts the tobacco control objectives of the Government.

The relationship between increases in tax rates and heightened illicit trade in cigarettes is also well established internationally. A recent study by Morgan Stanley[9] across 72 countries finds a strong correlation between government policy action with respect to tobacco taxation and rise in illicit cigarette trade. For example, in Malaysia an increase of excise rates by 172% over the period 2004 to 2011 resulted in an increase in illicit cigarette trade to 36% of total cigarettes sold in 2011 from 14% in 2004. In response to successive excise rate increases in excess of 20% p.a. in 2007 and 2008 the illicit trade grew by 130% between 2006 and 2009. Similarly, in Brazil an increase of tax rates by 41% in 2012 drove up illicit trade by 9% to 33% of total Brazilian cigarette volumes.

To curb the menace of illegal cigarettes, the following measures are recommended in this regard:

for domestic duty evaded cigarettes

i. **Continuance of cigarette manufacturing under physical control regime.**

for contraband international brands of cigarettes

ii. **Increasing the Basic Customs Duty on cigarettes from the extant 30% to the WTO bound rate of 150% subject to a minimum duty equivalent to 50% of the prevailing countervailing duty, i.e., length based, specific central excise duty applicable on cigarettes manufactured within the country. This will go a long way in resolving the problem of tax evasion by some unscrupulous importers by under invoicing the value of imported cigarettes.**
iii. **Cigarettes should be added to the list of gold and watches under Section 123 of the Customs Act, so that the onus is on the person possessing cigarettes to prove that they are not smuggled.**
iv. **Institution of an appropriate reward mechanism to informers about illegal cigarettes.**

28. Strengthen The Ban On FDI In The Tobacco Sector

The Government of India has prohibited FDI in manufacturing of cigars, cheroots, cigarillos and cigarettes of tobacco or of tobacco substitutes and has notified the same in May 2010 as a measure to

[9] **Asia Insight, Morgan Stanley Research, August 2015**

control tobacco consumption. However, multinationals have set up entities in India for wholesale trading thereby circumventing the prohibition on FDI in this sector. These wholesale ventures source and distribute cigarettes albeit from Indian manufacturers to create a small legal market for their brands with the support of disproportionate marketing and sales spends which is then met through large scale contraband / smuggling. Recognising the gravity of this problem the Reserve Bank of India has also highlighted the need to check "circumvention of FDI norms by international tobacco companies and their conduits." Such circumvention of FDI norms adversely impacts domestic farmer income, employment and revenue interests. Hence the existing ban on manufacturing of cigarettes and similar products must be strengthened by extending the ban end to end to cover FDI in manufacture as well as wholesale trade in these products.

To ensure proper implementation of the Government's tobacco control policies and to curb smuggling of international brands of cigarettes, the extant ban on FDI in the tobacco sector should be reinforced by appropriate amendments in FEMA to prohibit infusion of funds into the tobacco sector whether through (a) advances against equity, (b) preference shares and debentures – convertible or otherwise, (c) loans and other forms of debt by whatever name called, (d) advances, (e) guarantees issued by banks, corporate entities or any other third party (f) letters of comfort or (g) through any other means. Similarly in line with the extant FDI policy on the lottery, betting and gambling activities, there should be a comprehensive ban on foreign collaboration in any form, including licensing for franchise, trademark, brand name, management contract, marketing services etc. in tobacco sector.

29. <u>Provide A Level Playing Field By Standardising Tobacco Taxation Across All Types Of Tobacco Products</u>

Unlike most countries in the world, cigarettes account for only 11% of the total tobacco consumption in India. In fact, with 17% of the global population India accounts for only 1.8% of global cigarette consumption. On the other hand, India accounts for about 84% of the global Non-smoking Tobacco consumption, and even within this the consumption is highest in smokeless forms like khaini, chewing tobacco and so on. Besides, biri and smokeless tobacco forms are known to be potentially more dangerous than cigarettes since most manufacturers produce inferior quality, cheap products with higher tar, nicotine deliveries which are more harmful for consumers. Smokeless tobacco is popular amongst women and children as the fear of detection is less and it does not attract social sanction like smoking.

High level of taxation that Cigarettes are subjected to is evident from the following.

- Cigarettes contribute 85% of the total revenue collected from the tobacco sector.
- The total tax on cigarettes (Excise Duty plus State Taxes) is as high as 290% of the ex-factory price.
- India already features amongst the countries with the highest percentage in terms of cigarette duties paid per thousand cigarettes as a % of per capita GDP (India –6.54%, UK – 2.36%, Pakistan –2.26%, China – 0.95%Japan –0.72% USA –0.48%).
- Cigarettes in India cost 17 times more than biris[10].
- The current tax burden on cigarettes on the basis of per kg of tobacco used is over 47 times higher than other forms of tobacco. (Cigarettes Rs. 3419 / kg vis-à-vis Rs. 73 / kg for other forms of tobacco)

[10] World Tobacco Atlas, 4th edition

While overall tobacco consumption is growing in India, the cigarettes' share of total tobacco consumed has declined from 23% in 1971/72 to approximately 11% in 2014-15. The skewed consumption pattern of tobacco is further confirmed by the findings reported in the recent Global Adult Tobacco Survey (GATS) India, 2009-10 study, conducted by the Ministry of Health & Family Welfare, to the effect that whilst the consumer base of tobacco stands at 34.6% of adults, the adult cigarette consumer base is only 5.7%. In view of the high prevalence of smokeless tobacco among males and females, the GATS has also recommended **'targeted interventions'**[11] as a step towards tobacco control.

Without cognizing for the above, increasing tax on cigarettes is often sought to be justified on the grounds of related health care costs on the exchequer without any data to suggest that cigarette smokers place any additional burden on the public health-care system. The majority of this smokeless consumption is in the lower economic strata who are dependent on the public health-care facilities. The fact that the majority of tobacco related health issues are on account of consumption in non-cigarette, smokeless form is also borne out by the findings of various independent studies and reports as well as data presented by health activists such as Dr. Pankaj Chaturvedi/Campaign for Tobacco Free Kids[12].

In this context, WHO has stated that all tobacco products should be taxed in a comparable way as appropriate, in particular where the risk of substitution with another product exists. It needs to be emphasised that moderation in taxes on cigarettes and widening the tax base on other tobacco products are perfectly aligned to the objective of tobacco control as such a policy will only help in shifting tobacco consumption from revenue-inefficient and potentially more dangerous forms to revenue efficient forms without increasing the overall tobacco consumption.

In order to ensure sustainable tax buoyancy from tobacco it is recommended that the tax base is widened by bringing in the large unorganised segment of the tobacco sector into the tax net, and the large differential in central excise rates between cigarettes and other tobacco products reduced gradually. Registration of all manufacturers of tobacco products must be made compulsory.

It may be remembered that moderation in taxes on cigarettes and widening the tax base on other tobacco products are perfectly aligned to the objective of tobacco control as it only help in shifting tobacco consumption from revenue-inefficient and potentially more dangerous forms to revenue efficient forms without increasing the overall tobacco consumption. This principle stands reinforced by experience of China where, due to a calibrated moderate tax levy, cigarettes account for 96% of tobacco consumption (India 11%) and tax revenue from cigarettes is USD 146 billion (India 4.2 billion).

30. Ban On Cigarettes In Personal Baggage Allowance And Duty Free Shops

Sale of cigarettes through duty free stores and duty free personal baggage allowance for cigarettes for incoming international passengers undermines the tobacco control objectives of the Government besides revenue loss. Leakages from Duty Free Stores and personal baggage allowance are significant source of contraband cigarettes in the country. **Therefore, it is recommended that sale of cigarettes through Duty Free Stores and duty free personal baggage allowance for cigarettes should be banned.** It may be noted that such a ban has already been put in place in various countries, the details of which are given in **Annexure IV** hereto.

[11] Page 95 of Chapter 4 of GATS India, 2009-10.
[12] Presentation by Dr. Pankaj Chaturvedi and Shri Sanjay Seth to the Empowered Committee of State Finance Ministers on 11th May 2013.

31. Exempt Excise Duty On Cigarettes Used Captively For Testing

Currently excise duty is applicable on all cigarettes which are used in non-destructive quality testing. Innumerable disputes have arisen with the Department on what machine tests are destructive. Further, costs have also increased by way of duty paid on cigarettes used in non-destructive quality tests. **It is recommended that full duty exemption to cigarettes used for quality testing purposes should be provided.**

32. Tax Paper Rolled Biris On Par With Cigarettes

In order to evade high excise duty that is payable on cigarettes, certain smoking products masquerading as "Paper Rolled Biri" have mushroomed in the market. These products are claimed to be hand-made and are sold at about Rs 0.25 paise per stick. They look and smoke like regular cigarettes and are sold in packages which are also very similar to cigarette packages and yet they are claimed to be Biris and therefore escape all taxes that are payable on Cigarettes. Currently Paper Rolled Biris are classified under 2403 19 29 as "Biris – Others".

A Chapter Note in Chapter 24 of the Central Excise Tariff should be inserted to clarify what constitutes a Biri and how the so called "Paper Rolled Biri" is to be classified. It is suggested that for this purpose reliance is placed on the definition of biri as stated in the Indian Standards (IS) 1925:1992. The Chapter Note must also clarify that a product comprising of tobacco wrapped in paper must be classified as cigarettes. A suggested draft of the Chapter Note is given below.

"Biris shall be either conical or cylindrical in shape and only consist of biri tobacco mixture and the wrapper leaves to hold the contents. Any smoking product comprising of tobacco wrapped in paper, with or without filter, will be classifiable as cigarette."

It is recommended that paper rolled biris be classified as cigarettes and appropriate excise duty based on length be imposed.

Annexure I

Recommendations of Experts for Retention of Specific Tax Levy for Cigarettes

The recommendations enumerated below very clearly amount to an explicit endorsement of single-point, specific levy of tax on cigarettes.

Committee / Study & Year	Extracts of Recommendations
Tax Reform Committee (TRC) headed by Dr.Chelliah a) Interim Report (Para 12.62) b) Final Report (August, 1992)	"for administrative considerations,...commodities like tobacco products,...may continue to have specific rates". "...Committee is of the opinion that ....Tobacco ...need not be brought under the proposed VAT system."
Reforms of Domestic Trade Taxes In India, Issues and Options – NIPFP (April 1994)	"...retain..the present incidence on a number of commodities where the duty is specific and the revenue yield is substantial. Such commodities include petroleum products, cigarettes..."
Gopinath Sarangi Committee on Excise Structure Rationalisation (Jan 1999)	"The Specific rates for levy of duty on cigarettes should continue."
Report on Indirect Taxes (December 2002), headed by Dr. V. Kelkar	"It is recommended that whereas AED may continue for textiles up to 2005, it may continue even thereafter for cigarettes which should not be subjected to VAT" (Para 6.4, page 212) "Specific Duty levy to be retained for cigarettes." (Page 264)
Report of the Task Force on Implementation of the FRBM Act, 2003, headed by Dr. V. Kelkar	"There should be no specific tax rates except for petroleum and tobacco products." (Para 5.3.3, Sl. No. 5, pp. 56) "The right to tax tobacco will continue to remain with the centre." (Para 5.3.12, Sl. No. 10, pp. 74)

Report on Tobacco Control in India – Ministry of Health and Family Welfare, Govt. of India (November 2004)	"Specific tobacco taxes are generally preferred over *ad valorem* taxes as they allow greater flexibility …" (Pp. 237)
World Bank / IMF – "Curbing the Epidemic, Governments and the Economics of Tobacco Control", World Bank, May 1999	"If a primary purpose of the excise is to discourage tobacco consumption, a strong case can be made for specific excises… Specific taxes also are easier to administer because it is only necessary to determine the physical quantity of the product taxed, and not necessary to determine its value." (Pp 87)

Annexure II

Benefits of Specific Levy over Ad-valorem Levy of Taxes on Cigarettes

Ad Valorem Structure	Specific Duty Structure
• Rate of growth of duty collections come down under an ad valorem duty structure since manufacturers tend to minimise the price of cigarettes with a view to reduce the impact of excise duty. Consequently, the quality of cigarettes suffers as well, since there is shrinkage in the use of high quality tobaccos.	• Excise revenues from the cigarette industry have grown multi-fold under the Specific Duty structure. On a comparable industry volume, the duty collection under the specific duty structure has grown by 17 times from Rs.988 crore in 1984/85 to Rs. 17198 crore in 2014/15. This huge growth in revenue collection is singularly attributable to the benefits of a specific duty structure.
• Farmers are affected adversely by the shift to lower quality tobaccos by the domestic manufacturers since they are left with large stocks of unsold high quality tobaccos. Farm incomes also reduce drastically as the farmers are forced to grow only low quality tobaccos.	• As this levy avoids the multiplier effect of an ad valorem system, it has enabled the domestic cigarette industry to provide value added products to the consumer. The use of high quality tobacco and raw materials has resulted in protection of the farmer's interests.
• The export potential of tobacco gets seriously affected due to lack of high quality tobacco. This has a significant negative impact on the foreign exchange earned by the country through tobacco exports. Currently, tobacco exports contribute in excess of Rs. 3000 crore by way of foreign exchange earnings.	• Specific Duty structure has also encouraged tobacco crop development efforts resulting in higher quality tobaccos for the domestic market as well as for exports, thereby improving farm incomes and export earnings.
• Manufacturers are forced to lower the cost of the product by using cheaper packing materials. In order to reduce costs further there is a reduction of investments in state of the art technology in the cigarette industry, further compromising the ability to ability to compete against the international cigarette brands.	• Substantial sums have been invested by the industry over the last decade towards technology up gradation and substantial investments are in the pipeline. A change in the current configuration of the duty structure will result in these investments being rendered unproductive with serious adverse consequences upon investors, lenders, employees and the farming community.
• In a highly taxed commodity like cigarettes, the impact of a levy based on an ad valorem structure is such that a small increase in the manufacturing cost or any cost in the trade chain results in a multiplier effect leading to very high increase in the prices of the cigarettes due to the high level of duties. This is most unfair to the consumer who is already being offered a debased product.	• The length related specific duty structure, which provides for various rates for different lengths of cigarettes, takes into consideration the value addition. For example, a King size cigarette is taxed at a much higher level than the regular sized filter cigarette.

• Due to the cascading effect of taxes, any levy at high rates, based on the value of products always provides in-built inducement to suppress value (prices). Thus, such a levy is prone to manipulation by unscrupulous manufacturers and traders and results in rampant evasion due to the high incidence of tax.	• The transparency and simplicity of the length related specific duty structure ensures that it is totally free of manipulation.
• There is a quantum increase in litigation resulting in large amounts of revenue getting locked up as a result of court cases.	• Levy of duty on the basis of specific duty has been virtually without litigation. This has enabled buoyancy in tax collections. Since March 1987, when ad valorem duty was replaced by specific duty, there has been no litigation between the Government and the Industry on issues related to valuation.
• Smuggling of cigarettes, which has already assuming alarming proportions, gets a further impetus as premium brands of domestic manufacturers are unable to compete with the lower prices of the smuggled goods. This accelerates the growth of the burgeoning contraband trade and is highly detrimental to the exchequer and the domestic industry.	• The stability of the specific excise duty structure has encouraged manufacturers to move towards international quality by investments in technology, crop development, etc. The resultant marked improvement in the quality tables in the cigarette industry has helped the industry compete against international cigarette brands which come in to the Indian market, mostly through the contraband route.

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Annexure III

Year	Quantity of Cigarettes of foreign brands seized	Value of Foreign Currency Seized
	(In Thousands)	**(Equivalent Value in Rs. Lakh)**
2012-13	51,768.880	453.460
2013-14	26,435.920	1,382.940
2014-15	114,330.000	2,889.288
2015-16 (todate 24/07/2015)	55,890.060	718.890
TOTAL	**248,424.860**	**5,444.578**

Annexure IV

Countries which have banned Cigarettes in Personal Baggage Allowance

- Singapore has a ban in place from 1991. All passengers carrying tobacco must declare at Customs & pay duty
- Sri Lanka
- Brunei
- Bhutan
- European Union – for travellers within EU, Tobacco / Cigarettes are permitted as part of personal baggage allowance only if duty has been paid at the originating EU country

In addition, following restrictions are applicable on Personal Baggage Allowance

- Bangladesh – Bangladesh Citizens not permitted any duty free cigarettes
- Hong Kong - Duty free baggage allowance restricted to 19 cigarettes
- Bulgaria, Greece, Hungary, Lithuania, Poland, Slovakia - Duty free baggage allowance restricted to 40 cigarettes
- Guatemala - Duty free baggage allowance restricted to 80 cigarettes

Countries which have banned sale of Cigarettes in duty free shops

- Bhutan
- Nepal
- Romania
- Singapore – Does not permit sale of tobacco products in duty-free shops on the 'arrivals' side
- Sri Lanka – Does not permit sale of tobacco products in duty-free shops on the 'arrivals' side
- Hong Kong – Does not permit sale of tobacco products in duty-free shops on the 'arrivals' side
- Indonesia - Does not permit duty free shops on arrival
- European Union - Banned duty-free sales to travellers within EU
- Canada - Federal Tax applied on tobacco products sold in duty free
- Bulgaria - Banned duty-free sales at land borders with non-EU countries

There are articles calling for ban on duty free sales across several countries but not implemented - Russia, Australia, NZ and Israel among others.

33. Increase In Excise Exemption Limit For Biscuits From Rs. 100/Kg(MRP) To Rs. 125/Kg (MRP)

At present lower priced-biscuits (i.e. biscuits sold at a MRP equal to or less than Rs. 100/Kg) enjoy an exemption from central excise duty. The exemption was granted in the Year 2007 taking into consideration that lower priced biscuits are a healthy, hygienic, safe and nutritious staple intended for mass consumption by the lower income strata of the society.

Since 2007 the cost of raw materials used in the manufacture of biscuits (primarily wheat flour, oil and sugar) have more than doubled, along with sharp increase in labour, transportation and energy costs. In the current cost scenario it is increasingly difficult and economically unviable to maintain a sub Rs. 100/Kg MRP for the popular variants of biscuits that are meant for the consumption of the common man is proving to be inadequate to cover a wide variety of biscuits consumed by the masses across the country.

It is recommended that the exemption limit be increased from Rs. 100/Kg to Rs. 125/Kg such that the popular variants of biscuits remain within the reach of the common man.

34. IncreaseIn Time Limit For Excise Exemption From 10 Years To 15 Years In The States Of Himachal Pradesh / Uttarakhand

Area base exemption provided by the Government in Himachal Pradesh and Uttarakhand has resulted in significant investments in these States despite the extreme logistical complexities inherent in these areas. However, over and above the normal gestation period of 3 to 4 years, the modest growth in the overall economy over the last few years has resulted in less than optimum utilisation of the investments made in these excise free zones.

The investments made in these regions have given a fillip to the local economy and increased employment opportunities – both direct and indirect. In order to sustain this position, encourage further investments in these areas and to provide existing units with a viable time-frame to optimise capacity utilisation a deferment of the sunset clause of the excise exemption period may be considered favourably.Already, in anticipation of expiry of the exemption period some Units have closed down and diverted to regions with more congenial logistics.

Accordingly, it is recommended that the existing exemption period of 10 years from the date of Commercial Production be extended to a period of 15 years from the date of Commercial Production. This will encourage further investments, sustain improvement of the local economy and employment prospects and also provide an opportunity to optimise the investments that have already been madein these industrially backward regions.

35. Excise Duty On Captively Consumed Intermediate Product – Biscuits

At present, Biscuits up to MRP of Rs. 100 per Kg are exempt from payment of excise duty. During the course of manufacture of biscuits, intermediate products like invert (sugar) syrup/cream are produced and consumed almost immediately within the manufacturing process. Whilst the Government has been pleased to exempt such intermediate goods from excise duty with effect from September 2011 the Department, however, continues to raise duty demands for the past period – disregarding the submission of the manufacturers to the effect that these intermediate products don't have any shelf life and are consumed captively, almost immediately, within the manufacturing process.

It is therefore requested that in order to avoid vexatious litigation in the matter the exemption from excise duty be given retrospective effect from April 2007.

36. **Extension Of Concessional Rate Of Excise Duty On Capital Goods For Food Processing Industry**

Vide Notification No 12/2104 C.E. dated 11th July, 2014 concessional rate of excise duty has been provided for process / packing machinery used in the manufacture of agricultural / apiary / horticultural / dairy / poultry / aquatic / marine produce and meat.

While the food processing industry welcomes the above initiative which will help reduce the capital cost, a large portion of processed food industry which deals with basic essential packaged foods for common man such as staples, biscuits and so on are deprived of the benefit of concessional rate of excise duty on process / packing machinery. Organised packaged food processing industry procures substantial process / packaging machinery and this discrimination within the same industry is inequitable.

It is recommended that concessional rate of excise duty on process / packing machinery be extended to the entire food processing industry instead of limiting the same to certain sectors within the industry.

37. **Taxation Of Educational Products**

Education is one of the key priority areas of Government and *Sarva Shiksha Abhiyan* is a Government of India flagship programme for achievement of Universalisation of Elementary Education. In the last Union Budget the Central Government has allocated about Rs. 22,000 crore for *Sarva Shiksha Abhiyan* and additionally, about Rs. 3,548 crore towards *Rashtriya Madhyamik Shiksha Abhiyan.*

At present, Educational products like exercise books, pens, note-books, pencils and geometry boxes are subject to 2% excise duty (without cenvat credit) plus Education Cess. Additionally, most of these products suffer State VAT @ 5%.

It is recommended that in order to promote education and to make available educational aids at an affordable cost, particularly to the lower economic strata of society all educational products meant for use by school and college students should be exempt Central as well as State taxes.

Going forward, in the GST scenario also these products as well as inputs required for manufacture of these products should also be exempt from tax.

38. **Reduction Of Excise Duty On Poly-Coated Paper And Paperboards – Central Excise Tariff No. 4811 51 90 And 4811 59 90**

Background

i. The market size in India for disposable cups is close to 40 billion cups per year out of which 10 billion cups are paper cups. The balance 30 billion is plastic cups - here too there are two varieties viz., HIP (High Impact Polystyrene) and PP (Polypropylene). Among plastic cups, 60% of the market is for PP, 30% is for Recycled HIPS and 10% is for Virgin HIPS.
ii. Poly coated paperboard is used for manufacture of paper cups, which contains more than 90% by weight of bio-degradable food grade paperboard and is an eco-friendly substitute for plastics.

iii. The global trend is to actively discourage the use of plastics (which do not conform to requisite hygiene and environmental standards) and to replace it with poly coated paper / paperboard.

Paper Cups – Green Credentials

i. Raw material for paper cups is paperboards primarily manufactured from wood species such as eucalyptus, subabul and casurina. Environmentally responsible Paper Mills in India source these species of wood from sustainably managed social and farm plantations.
ii. Pioneering work has been carried out by many Corporations over the last 3 decades in India in producing saplings which are disease and drought resistant and can be grown in a variety of agro climatic conditions. This work needs to be protected, incentivised and encouraged.
iii. The above species of wood are largely grown in marginal/sub-marginal lands, which are potentially unfit for other uses. An estimated 5 lakh farmers are engaged in growing plantations of Eucalyptus/Subabul / Casuarina/ Acasia/ Bamboo, over an estimated 10 lakh hectares. This has generated significant employment opportunities for the local communities. In view of the green cover that these plantations create, carbon sequestering also take place from the atmosphere.
iv. Planning Commission intends to bring 33% of land mass in India under tree cover. To achieve this objective nearly 43 million ha of land is to be afforested which inter alia would also include development of degraded forest lands to the extent of 15 million ha.
v. Many of the Paper Mills in India also employ green processes like Elemental Chlorine Free bleaching. Some Paper Mills also are certified with internationally environmentally acclaimed certifications such as the Forest Stewardship Council, membership of bodies like Worldwide Fund for Nature – Global Forest & Trade Network and such paperboards are converted in systems that are certified by the British Retail Consortium – Institute of Packaging etc. The entire paper cup chain is thus environmentally friendlier in manufacture, usage and disposal.

Advantage Of Paper Cups Over Plastic Cups

i. Inputs for paper cups are wood, trees etc. which form the 'new carbon' on the surface of the earth. It takes less than a year to replenish the same. Even if such inputs are converted to polymers, chemicals and fuels, it takes about 5 to 10 years to get replenished by natural fixation. In contrast, plastic cups use fossil fuels as raw materials which take more than a million years to replenish and are therefore in our comparatively shorter lifespan termed – non-renewable
ii. Usage of paper cups will be the best option as compared to usage of plastic cups for reduction of carbon footprint.
iii. Although paper and plastic cups are meant for single-use, clearly paper-cup is considered superior to plastic cups - on parameters like convenience, hygiene, and visual appeal.
iv. End–of-life disposal systems already exist for recycling paper cup. It is possible to recover pulp from the disposed cup (93% by weight of the cup) which can be used to produce paper again. Similarly the poly extracted from the surface can be suitably recycled. There are many organizations working towards better disposal of paper and its recycling. It does not pose a litter problem like other materials.
v. Life Cycle Assessment Studies have been conducted on many product categories including paper cups. Even for a short life product like a paper cup the environmental benefits outweigh that of plastic cups.
vi. Further usage of poly coated paper cups will be a much greener option as opposed to using plastic cups & containers, since poly coated paperboard is manufactured using food grade paperboard with a very thin layer of coating that too using virgin plastic.

vii. Plastic cups are not bio-degradable and when left to litter can cause major environmental damage and also end up clogging drains leading to floods.

Excise Duty On Poly Coated Paper And Paperboards

Paper and paperboard that is coated / impregnated / covered with poly coating are classified under Central Excise Tariffs 4811 51 90 *(Bleached, weighing more than 150 g/m2* - Other*)* and 4811 59 90 (*Other* - Other) with an excise levy of 12.5% ad valorem – even as a large number of paper / paperboard items covered by Central Excise Tariff 4802, 4804, 4805, 4807, 4808 and 4810 are excisable to excise duty only at 6% ad valorem.

In India major consumers of this type of paper / paperboards are SSI / SME units engaged in manufacture of paper cups that are increasingly being supplied to institutional customers like the Railways, the FMCG sector and the Household sector. Paper cups are used for mass consumption items such as tea, coffee, fruit juices, soft drinks, ice cream etc.

The SSI/SME Units are not able to avail Cenvat credit for the higher excise duty paid on the base board used for manufacture of poly coated paper cups.

The Poly coating is necessary for manufacturing of paper cups /glasses as the coating acts a sealing /binding medium and makes cup/glasses moisture proof against hot / cold beverages

Further , the purpose of levying higher duty on plastic goods is to reduce the use of plastic material which is not eco-friendly as compared to paper, which is more eco-friendly and bio-degradable . Generally the poly coated paper has the ratio of paper and poly at 92:8 and treating such paper on par with plastic goods will not serve the purpose of replacing plastic products with paper based products

Even under the various State VAT laws, the cups and glasses made of poly coated papers are classified as "Cups, plates and glasses made of paper" / "Cups and glasses of paper" and attract **lower rate of taxes i.e., 5%** as against the plastic products which attract tax @ 14.5%.

Recommendation

It is recommended that excise duty on poly coated paper / paperboards, classifiable under Central Excise Tariffs 4811 51 90 *(Bleached, weighing more than 150 g/m2* - Other*)* and 4811 59 90 (*Other* - Other) is reduced to 6% from 12.5% - in line with most other paper / paperboards classifiable under Chapter 48. Such a move will also be a "green" initiative in line with global trends.

39. Cenvat Credit On Capital Goods

Setting up of projects like paperboards manufacturing facility involves on-site assembly and installation of many types of plant and machinery that are significantly large in size. Consequently, a lot of plant and machinery are brought into the plant site in a 'knocked-down' or unassembled state and, thereafter, assembled at location. Also, many of the equipment are fabricated and installed directly at the site on procurement of basic materials like HR Plates, Plates, MS Plates, MS Channels, MS Angles, etc. classified under Chapters 72 and 73 of the Central Excise Tariff.

In case of turnkey projects, the Engineering, Procurement and Construction (EPC) would be placed on a vendor, who in turn procures sub-equipment /components from various sub-vendors. It has been the industry practice that the credit of cenvat charged by these sub vendors are availed by the manufacturer (who is a consignee) for whom the equipment is ultimately meant for.

Central Excise Department routinely issues Show Cause Notices to assessees alleging that these items cannot be treated as capital goods as per the definition under 2(a) (A) of the Cenvat Credit Rules and hence, no cenvat credit can be taken. Also Department, in some instances, alleges that credit of cenvat charged by the sub-vendor should be availed only by the buyer (i.e. EPC contractor) and not the manufacturer/consignee.

Consequently, even after making significant investments on capital goods that are required for manufacture of excisable products, a large number of assesses are denied cenvat credit / allowed to take credit only after considerable delay – on settlement of avoidable litigation. This results in blockage of significant amount of working capital over and above extensive effort in settling needless litigation.

Recommendation

To resolve the aforesaid problems,

i. **the definition of capital goods be modified such that it covers all goods used for setting up of plants/projects including all inputs required for the manufacture of capital goods.**
ii. **assessees are permitted to avail and utilise the Cenvat Credit in full in the year of receipt instead of splitting it into 50% in the year of receipt and the balance 50% in the subsequent years – in terms of extant legislation.**
iii. **Allow the consignee / manufacturers at whose premises the equipment is erected/installed and for whom the equipment is ultimately meant for, to avail credit of cenvat charged by the sub- vendors on the basis of invoices issued by such sub-vendors**

40. Incentives For Investments In Environment Friendly "Clean" Technologies By Paper Industry

Today technology stands out as the most critical factor in achieving sustained competitiveness and industry performance. Indian Pulp, paper and paperboard Industry is a signatory to the Government of India's Charter on Corporate Responsibility for Environmental Protection (CREP). This calls for substantial investments in green technologies such as introduction of ECF (Elemental Chlorine Free) pulp manufacture, Ozone bleaching etc. to ensure a positive environmental footprint. The domestic manufacturers are consciously focusing on clean technologies which involves significant capital investment, to ensure compliance & improve performance in the area of environment, without much return from such investments. Hence such investments affect the profitability/viability of the business.

Hence in order to encourage manufacturers within the industry to adopt environment friendly "clean" technologies that ensure, inter-alia, reduced carbon footprints, better emission norms, better effluent treatment norms, usage of renewable sources of raw material and energy, improved waste recycling, etc., appropriate fiscal benefits should be provided.

Recommendations:

i. **Exports by manufactures who have adopted environmentally friendly technology are granted additional incentives in the form of cash incentive of 5% of FOB.**

ii. **Following additional benefits are provided for paper board industry for investing in clean technology (Clean technology parameters/norms to be defined by Ministry of Environment, Forest and Climate Change):**
    a. **Entitlement for import of all raw materials at a 50% concessional rate of duty**

b. **Full exemption from excise and VAT taxes for paper and paperboard produced using clean technology**
c. **Accelerated tax depreciation @ 150% of the normal depreciation rates under income tax laws for investments on environment friendly technology**

These measures will not only promote preservation of ecology, it will also incentivise all players in the Indian Paper Industry to adopt 'green' technologies, thus aligning domestic industry to international eco-friendly norms.

41.<u>End Use Certificate For Import Of Waste Paper</u>

As per Customs Notification no.21/2002 as amended from time to time, provides for import of waste paper at nil rate of customs duty, provided the importer furnishes an End Use Certificate (EUC) from the jurisdictional excise authorities.

<u>Recommendation</u>

It is recommended that furnishing of end-use certificates should be dispensed with for manufacturer importers as the process of obtaining EUCs is highly time consuming and results in higher transaction costs. The private records maintained by manufacturers – which are relied upon by Central Excise Audit also – should be prescribed as appropriate documentation for verification of end use of imported waste paper.

42.<u>Central Excise Levy On Bakery Products</u>

Presently Central Excise is chargeable on Bakery and Confectionery items (Central Excise Tariff Headings 19051000 to 19059090, 18069010 to 18069090 and 17049010 to 17049090) sold in hotels. This forms a small portion of the hotels' Food & Beverage Revenue. No other food item is excisable. Due to this hotels are subject to the cumbersome administrative formalities of Central Excise without any significant contribution to the exchequer.

<u>Recommendation</u>

In case of Hotels all bakery and confectionery items should be exempted from Excise Duty. Alternately, an exemption from excise duty for a turnover limit of Rs. 3 crore – computed on the basis of the Turnover of the Excisable products of each Unit having separate Registration number, instead of the total turnover of the Hotel or the Company – be prescribed.

43.<u>Reduced rate of Excise Duty at 10% adv. should be extended for a further period of one year to ensure economic growth of the relevant sector of industry.</u>

In the Interim Budget dated 17.02.2014, Excise Duty rate was reduced from 12% to 10% adv. on goods falling under Chapter 84 and 85 (except specified items) and specified motor vehicles under Chapter 87 and had been extended till 31.12.2014. From 01.01. 2015, the Excise Duty rate has been increased to 12% and from 01.03.2015, it has become 12.5% which is harsh to those industry / goods. Effective Excise Duty Rate of 10% or lower be re-introduced for a minimum period of 1-2 years to help such industries / products which would also give boost to overhaul economy.

GST – Budget Recommendations

1. Stability Of Taxes

It is well established that stability in tax rates encourages growth in tax revenue. In a federal set-up like India stability in tax rates across the different tax jurisdictions also enable the creation of a common market across the country. The introduction of VAT was supposed to usher in further stability and transparency in the tax regime so as to achieve the objectives of revenue growth, an Indian common market and increased cost competitiveness of Indian industry. Unfortunately, in the run-up to GST the States have indulged in unilateral and frequent increases in the standard rate of VAT and changes in VAT laws that further restricts/delays availability of input tax credit. It is apprehended that such action on part of the States will dilute and undermine the long-term objectives of modernisation of the tax structure and greater efficiency, transparency and equity in taxation sought to be achieved through introduction of, initially, VAT and thereafter, GST. Accordingly, the Empowered Committee should ensure that there are no further increases in the rates of VAT or changes in VAT laws that bring about cost inefficiencies by delaying/restricting input tax credits.

2. Classification Of Goods And Services

(i) Classification of goods should be uniform across the Centre and the States. Differences in classification and consequently, applicability of different rates of tax – as is the case under VAT, leads to avoidable litigation and lock-up of tax revenue. It is strongly recommended that the internationally accepted Harmonised System of Nomenclature (HSN) be adopted for classification of goods under GST. It would be pertinent to note that the HSN has been adopted for the Central Excise Tariff and the Customs Tariff and logically, the same should be adopted for GST – this will put an end to all classification related disputes.

(ii) In so far as services are concerned, the Negative list of Services – implemented with effect from 1st July 2012 has obviated the need for classification since almost all services are now under the Service Tax net.

3. Rates Of Tax

(i) The rate of GST applicable to goods and services should be the same. The common tax rate will put an end to interpretation and disputes regarding what are "goods" and what are "services". For example, in the extant tax regime there are divergent views between tax-authorities and tax-payers on whether "software licences" should be taxed under VAT or Service Tax. The issue has been made more complex by the fact that the various CESTATs have also passed differing Orders in this regard. Moreover, a common rate will also do away with the cumbersome and dispute prone method of segregation of works-contracts between goods portion and service element to determine the tax liability.

(ii) For a particular category of goods/services the rate of GST should be applied uniformly across the country. Under the VAT regime, in many cases, due to differences in classification, a category of goods is taxed at the standard rate by some States whilst other States tax identical goods at the concessional rate – this creates scope for tax-evasion across State borders.

(iii) The tax structure should be simple and have minimal rates. It is recommended that (a) there should be one Standard Rate (RNR) applicable on all goods and services, (b) a common list of goods and services under a Concessional Rate (e.g., for basic necessities and public utilities), and, (c) a common list of exempted goods and services.

(iv) The exemption list should be determined in accordance with the nature of goods and services. For example, essential goods like medicines and pharmaceuticals, hygiene and healthcare products (e.g., water purifiers & its parts, sanitary napkins, diapers, toilet soaps, sanitizers and so on) food products (including primary foods and processed foods, tea, branded or otherwise), products required for educational purposes (e.g., notebooks, pencils and the like) should be exempt from GST along with services that are currently included in the Negative List of Services or Exempted Services. This will ensure that the tax cost of these goods do not put them beyond the reach of the common man. If this is not possible,in line with the prevailing tax position (Nil or token excise duty @ 2% and VAT at concessional rates), it is suggested that these goods be exempt from CGST and be subjected to a concessional rate of SGST only.

(v) The Standard Rate of GST should be moderate and equitable such that it delivers against the twin objectives of (a) yielding required revenue for the exchequer, and, (b) keeping tax cost of goods and services low for the consumer. Consequent to modernisation and simplification of tax structures, the ratio of unregistered component in manufacturing, as a percentage of total value added in the manufacturing sector, has declined from about 34% in 1999-00 to about 30% in 2006-07[13]. It is anticipated that this ratio will decline further on introduction of an improved tax regime like GST since GST is expected to widen the tax base – both in terms of goods and services covered as well as in terms of the number of tax-payers. Thus, under GST it should be possible to achieve revenue targets with a moderate rate of tax which would also ensure that the tax cost of goods does not increase post introduction of GST.

(vi) The Constitution Amendment Bill provides for a band of rates in the GST regime – in line with the practice adopted by the European Union – in order to have flexibility in the rate structure. Adoption of a band of rates is undesirable since the resultant differential tax rates between neighbouring tax jurisdictions creates tax arbitrage opportunities through contraband trade. In the European Union smuggling of goods like mineral oil, cigarettes, alcohol, perfumes and the like have reached alarmingly high levels with huge revenue losses for the member countries. Given the existence of such large-scale smuggling of goods across countries within the European Union, despite regulatory and enforcement oversight at the international borders, differential tax rates within the country, it is apprehended, may spur trade circumvention to unprecedented levels in India.

4. Subsumation Of State And Local Level Duties Under SGST

GST is to be levied on “supply” of goods. The term “supply” has not been defined in the Constitution Amendment Bill on GST. The Select Committee of the Rajya Sabha has also observed that the term “supply” will get defined in the respective Central and State GST legislations. **Care must be taken to ensure a uniform definition of “supply” across the different GST statutes – differences in the definition of this term will result in differing tax treatment in respect of identical transactions in different States, interpretational issues, increased complexity for tax-payers and avoidable disputes and litigation with the Department.**

[13] Goods and Services Tax for India, R. Kavita Rao, NIPFP Working Paper 2008-57, November 2008

Whilst internationally the term "supply" is understood to mean "supply against consideration", i.e., sale for purposes of VAT / GST, in India it is envisaged that even supplies without a consideration, e.g., internal stock-transfers, samples, gifts and similar transactions will attract GST. There may be some justification for taxing inter-state stock transfer of goods (i.e., internal "supply" from one State to another) in order to prevent breakage of the tax chain, the statutory provisions must ensure that "supply" of internal services (e.g., from the Corporate Head Office to various Branch Offices and Factories) remain outside the ambit of GST. Failure to do so, it is apprehended, will give rise to significant complexity, dispute and litigation on valuation of such internal services, the place of supply and so on without any commensurate gain to the exchequer.

5. <u>Subsumation Of State And Local Level Duties Under SGST</u>

(i) There is no proposal for abolition of certain indirect taxes like Electricity Duty and certain taxes on supply of goods like Entry Tax in lieu of Octroi, Octroi, Toll Tax, Carriage Tax, Local Area Development Tax, Agricultural Produce Market Fees and so on that are levied by some States. Such levies contribute to cascading of taxes and also create logistical hurdles in the supply chain. Specifically, electricity generating companies enjoy several indirect tax concessions. If electricity is kept out of GST, then the concessional treatment will not be available, thus making electricity costlier – further pushing up cost of manufacture across all industries, and, consequently, cost of manufactured goods. Further, petroleum and alcohol sector should be included in GST. The non-inclusion of these sectors will add to the economic distortions and impact economic growth. If, for any reason it is not possible to include these goods under GST, at least petro-products used as industrial inputs (as opposed to use as fuel) and "industrial alcohol" should be included in GST whilst petro-products used as fuel and "potable alcohol", i.e., alcohol meant for human consumption may be kept outside the ambit of GST.

(ii) Upon introduction of GST all other indirect taxes on supply of goods and services, levied at the Central, State and Local level must be abolished to ensure free flow of goods in the common Indian market. In this connection it would be pertinent to note the views of the Department of Revenue, MoF in their comments on the First Discussion Paper on GST issued by the of State Finance Ministers Committee – "Electricity duty, Octroi, purchase tax and taxes levied by local bodies should also be subsumed under GST."

(iii) As far as funds for local bodies are concerned, a part of the GST collection could be earmarked for this purpose as recommended by the Task Force on GST of the 13th Finance Commission. In fact, Punjab adopted a similar approach a few years ago when, on abolition of Octroi across the State, a portion of the VAT collections were earmarked for funding the local bodies.

6. <u>Threshold Limits</u>

(i) As far as threshold limits are concerned, it is understood (as per the First Discussion Paper on GST issued by the Empowered Committee) that different threshold levels are proposed for CGST - Goods (Rs. 1.50 crore p.a.), CGST-Services (appropriately high) and SGST (Rs. 10 lakhs p.a.). In addition, a Composition Scheme has also been suggested – with a gross turnover limit of Rs. 50 lakhs p.a.

(ii) Different threshold levels may, it is apprehended, cause confusion amongst the trade and also encourage unethical practices for the purpose of tax evasion. Ideally the threshold level should be uniform across goods and services and be the same for both CGST and SGST. A sufficiently high threshold level will enable ease of tax administration since the tax will be collected from only those tax-payers who have a sizeable turnover (and thus, tax liability) instead of millions of small and marginal traders. A high threshold level will also ensure that small and marginal traders do not face any hardship on account of the rigorous record-keeping and compliance requirements anticipated under GST.

(iii) A large segment of trade and industry comprises of micro, small and medium scale enterprises which will require time to ensure full compliance with GST. Suitable threshold limit and composition scheme should be provided for in the statutes to provide relief to the MSME scale industry from the complexities of a full-fledged GST system.

(iv) Accordingly, it is recommended that the uniform threshold level for registration under both CGST and SGST be set at a gross turnover above Rs. 50 lakhs p.a. A composition Scheme could be introduced for annual gross turnover between Rs. 50 lakhs and Rs. 1 crore.

7. Tax Credit For Capital Goods

Capital goods are not defined consistently under different State VAT laws. Moreover, different States have provided for varying time-lines over which input tax credit on capital goods may be availed by assessees. In capital intensive industries these differences result in (i) disputes over which capital goods qualify for input tax credit and (ii) locking up of funds due to differing periods over which credit of input tax can be availed.

Under GST there should be a common definition of capital goods and the input tax credit on procurement of capital goods should be allowed as soon as the capital goods are received into the assessee's production facility.

8. Area Based Exemption Schemes

(i) Exemption from indirect taxes like Central Excise and VAT has been extended to industry under various schemes of the Central and the State Governments. These exemption schemes serve the twin objectives of development of industrially backward areas as well as encouragement to industries that are considered to be critical for the economic development of the country.

(ii) Based on the nature of exemptions and the time period for which such exemptions have been granted, industry has made investments running into several thousand crore across the country. Scrapping such exemption schemes at the advent of GST will put such investments into severe jeopardy – more so since a lot of these investments are in areas that have very complex and difficult logistics. In fact, without the tax exemptions, investments in these areas would be economically unviable. Therefore, there is no basis or justification for causing financial hardship for industry by scrapping the exemption schemes upon the introduction of GST.

Accordingly, existing tax exemption schemes should be grandfathered to continue up to their legitimate lives. This could be done by granting exemption from GST where the current exemption is for both Central Excise and VAT or by granting exemption from CGST in cases where the existing exemption is from Central Excise and exemption from SGST if the existing exemption is from VAT.

(iii) In this context, for identification and appropriate exemption it may be necessary to disaggregate IGST in to "deemed CGST" and "deemed SGST". Accordingly, the provisions of GST laws must enable such disaggregation of IGST. In order to ensure that there is no break in the GST chain, conversion of the exemption schemes to cash refund schemes may be considered wherever necessary.

9. Inter-State Stock Transfers

(i) Intra-company transfer of goods across States does not involve any "sale or supply for consideration" and, consequently, does not entail any value addition. Levy of GST on such stock-transfers would be a tax on the movement of goods prior to sale. It is apprehended that this would result in avoidable blockage of working capital of assessees with consequential adverse impact the cost of the goods. In order to ensure an unbroken GST chain without any blockage of capital, inter-state stock transfers may be subjected to the IGST [SGST & CGST] that has been proposed for inter-State sales in the First Discussion Paper on GST issued by the Empowered Committee of State Finance Ministers.

(ii) The inter-State stock transfers and allocation of IGST to States should be the responsibility of an independent nodal agency – like a central Clearing House – to ensure that tax credits are available at the destination State on an on-line basis such that there is no blockage of funds in the hands of the assessees.

10. Statutory Forms And Check-Posts

(i) In a GST regime there is a free flow of taxes across different tax jurisdictions and input tax credit is available to the assessee in all cases. Thus, there is no incentive for "misuse" of consignment or stock transfers unlike the situation under CST wherein unscrupulous assessees try to avoid CST by passing off inter-state sales as inter-state stock transfers.

(ii) Moreover, if inter-State stock transfers as well as inter-State sales are covered under IGST, it would pre-empt the possibility of any apprehended "misuse" while ensuring continuity of the tax chain on movement of goods from one State to another. Accordingly, it is recommended that the existing scheme of Statutory Forms (Form F, Form C, Way Bill) and check-posts – which, more often than not, create barriers to free flow and trade of goods across the country be abolished.

11. Neutralisation Of Taxes

(i) In a GST regime full neutralisation of taxes must be guaranteed to remove the cascading effect on tax to tax. The efficiency of neutralisation would, to a large extent, ensure the success of this fiscal policy initiative. Accordingly, the common list of exempt goods and services should be kept to minimal and, wherever required / desirable, goods and services should be "zero" rated. This will ensure that the tax chain is not broken.

(ii) Input tax credit of GST on goods and services must be allowed to all tax-payers without any restrictions like nexus of inputs to output or disallowances on account of stock-transfers. Getting refunds in the existing VAT regime is a long drawn process since the authorities are extremely reluctant to allow refunds and assessees have to follow cumbersome procedures and, frequently, engage in litigation with the Commercial Tax Department. To avoid such a scenario under GST an automatic refund system should be put in place for input taxes related to "zero" rated goods and services.

12. Uniform Laws And Simple Tax Administration

(i) To ensure seamless implementation of GST and full compliance the provisions of GST, including documentation like Invoices and Returns, Forms, Challans, Accounting Codes and so on must be uniform across the country. In addition to being uniform, the procedures and documentation for collection and payment of tax, movement of goods, returns, assessments, etc., under GST must be simple, transparent and assessee friendly with reliance on private records rather than maintenance of voluminous statutory records.

(ii) Multiple jurisdictions and filing of returns is undesirable under GST. Assessees should be required to submit one composite return covering CGST, SGST and IGST and be subjected to one common jurisdiction with uniform assessment proceedings unlike the current scenario of different assessments for CST and VAT. It is recommended that the jurisdiction and consequently, assessment, scrutiny, audit, etc. be the responsibility of a single authority.

(iii) To ensure administrative convenience, it is also recommended that a Central authority be given jurisdiction over large tax-payers, i.e., assessees having multi-State operations and/or annual gross turnover in excess of Rs. 1,000 crore whilst the smaller assessees are kept under the jurisdiction of the respective State authorities.

(iv) Under the prevailing tax regime assessees are subjected to audits by the central tax authorities, i.e., Central Excise and Service Tax Audit. At the State level, VAT was supposed to usher in an era of self-assessment and audit of a few assessees on a sample basis. The reality is that whilst the Department has continued with "scrutiny-assessment" and audit of almost all assessees, over and above this, most VAT laws require audit of assessees records by an independent Chartered Accountant. Under GST the concept of self-assessment must be encouraged with audit by the Department only in cases of any suspected tax evasion.

(v) The adjudication and appellate processes under State Commercial Taxes need to be upgraded significantly in order to ensure professional administration of taxes and uniformity in approach – this will minimise the scope for diverse interpretations and proceedings and, simultaneously, aid the evolution of a uniform fiscal law across the country.

13. Trade Discounts And Sales Incentives

Under the present VAT law, there is an ambiguity regarding treatment to discounts, sales commission and incentives given post sales through issue of credit notes. Whilst most State VAT laws do not allow any tax relief on account of such transactions, the statutory provisions in other States are so complex and cumbersome that the cost and effort of claiming tax relief is often higher than the benefits derived. Under GST unambiguous provisions should be made for treatment of discounts, commission and incentives in the taxable value to avoid valuation disputes and disallowance of credits.

14. Damages And Obsolescence

An integral part of the FMCG industry is the damages to the goods in the course of movement prior to sale and sale returns on account of obsolescence of goods in the market. It is recommended that GST laws should recognise these as business losses and allow the same without complex procedural formalities and/or reduction or restriction of input tax credit entitlements.

15. Deposit Of Taxes And Refund Of Excess Input Tax Credit

(i) Procedures for deposit of taxes must be simple and tax-payer friendly. For instance, a tax-payer having pan-India sales and purchases should not be required to provide State-wise break-up of tax liability.

(ii) The provisions related to refund of excess input tax / refund of input tax to exporters and so on must be simple, not involve voluminous paper-work. Refund within a bound time period must be made mandatory.

16. MSME And Village Industry

A large segment of trade and industry comprises of micro, small and medium scale enterprises which will require time to ensure full compliance with GST. Suitable threshold limit and composition scheme should be provided for in the statutes to provide relief to the MSME scale industry from the complexities of a full-fledged GST system.

17. Eco Taxes In The GST Regime

With effect from 1st July 2010 a Clean Energy Cess is being levied on coal, lignite and peat. Presumably, this levy has been introduced on the principle of "Polluter Pays". It may be noted that such eco-taxes are not in alignment with the principles of GST wherein a full flow through of taxes is envisaged in order to avoid cascading of taxes and to increase cost competitiveness of industry.

If levy of an eco-tax is considered to be necessary then they should be levied only on those players in the industry who do not adopt green, eco-friendly processes. Not only will this be an equitable position vis-à-vis assessees who have made considerable investments towards sustainable "clean" and "green" processes, it would also provide an incentive to other players to adopt such processes and come out of the ambit of eco-taxes – paving the way for environment friendly practices across the board.

18. Computerised Systems

Most industry, particularly the large and medium scale players, operate their businesses with complex Enterprise Resource Planning systems. These systems are complex in nature and will have to be re-configured to ensure compliance with GST laws. Vendors of these systems have indicated that at least six to eight months' time will be required for reconfiguration once the GST laws are made available in the public domain. Accordingly, it is recommended that industry be given a six month window for reconfiguration of systems once the GST laws are published. During this period a lenient view must be taken in matter of procedural lapses without invoking penal provisions.

19. Transitional Issues

There is no indication, as on date, on how transitional issues will be dealt with upon introduction of GST. For a seamless changeover to GST it is vital that information on transitional provisions is placed in the public domain well in advance to enable industry and policy-makers to engage in determining the best way forward. Particularly, the following issues are foreseen as on date of changeover to GST:

(i) Treatment of accumulated Cenvat and VAT credits in the hands of the tax-payers.
(ii) Treatment of tax-paid inventory – both with manufacturers as well as trade.
(iii) Taxability of un-invoiced services.
(iv) Taxation of transactions that straddle the date of implementation of GST – both in respect of domestic transactions as well as imports.

Suggested measures to resolve the afore-stated issues are as follows:

(i) As far as accumulated credits of taxes are concerned, it is recommended that the same be converted to deemed GST credits. Credits of all central taxes can be deemed to be CGST credit while credit of State / Local level taxes can be deemed to be SGST credits.

(ii) Embedded taxes in inventories could also be dealt with in a similar manner – all central taxes embedded in inventory could be deemed to be CGST credit and State/Local taxes as SGST credits.

(iii) As far as inventories of finished goods in the hands of trade is concerned, the GST laws may provide for a one-off window of say, three months from date of implementation of GST wherein goods can be sold at the pre-GST MRP. This will ensure equitable treatment of goods – on which excise duty and VAT have been paid – remaining unsold at the time of implementation of GST.

In the event this is not possible, credit of embedded excise duty may be allowed on the basis of certified stock in hand and a declaration from the manufacturer – endorsed by the manufacturer's jurisdictional excise office – of the excise duty per unit paid by the manufacturer at the time of clearance of goods.

(iv) In case of un-invoiced services, the same to be taxed at the rate of Service Tax prevailing prior to GST in case the service was completed before implementation of GST. In case of continuous services, the portion completed before GST implementation to be taxed at the Service Tax rate and the services provided thereafter to be taxed at the Standard Rate of GST.

(iii) In respect of transactions that straddle the date of implementation of GST, embedded taxes (Central Excise and/or VAT) should be allowed as CGST/SGST credits, as the case may be, and all forward transactions thereafter should be under GST. Similarly, in respect of imports, all goods reaching Indian ports before implementation of GST should be subjected to CVD and SAD (as applicable), with credit of such CVD and SAD extended to the importer under CGST and SGST, respectively.

20. <u>Advance Ruling</u>

GST laws must provide for appropriate Advance Ruling and dispute settlement provisions – outside the courts of law. This will enable quick settlement of disputes and interpretational issues. Tax authorities should not be empowered with discretionary authority regarding tax assessment, pre-deposit of taxes, waiver of interest and so on since these provide avenues for arbitrariness and misuse of legal provisions.

21. <u>Dialogue With Industry</u>

It is suggested that in order to address concerns of industry a mechanism of structured and periodic dialogue between industry and a panel of the Empowered Committee be put in place while formulating the draft GST legislation of the Centre and the States. Such a mechanism will help address industry concerns with GST and, at the same time, provide the Empowered Committee a better appreciation of GST related issues specific to different industries.

22. Swacchh Bharat Cess – The Government has proposed to levy Swacchh Bharat Cess on some services that may be notified. It is proposed that with the implementation of GST and subsuming of all Cess in GST, this new Cess may not be levied. This will go against the basic concept of GST.

23. Restrictions On Input Tax Credit

The implementation of the concept of Negative List of Services is obviously, a precursor to the introduction of GST in the country. Whilst practically all activities done by one person for another for a consideration, with the exception of activities restricted to transfer of titled in goods, have been brought under the service tax net, the restrictions, exceptions and limitations on availability of input tax credit still continues. This is clearly an anomaly and has led to an inequitable situation whereby the taxation of services is based on the principles of GST whilst the credit for the tax paid on input services continues to be restricted, as was the case during the regime of taxation of services based on a Positive List.

In order to correct this inequity and to provide much needed relief to industry the service tax laws in general and, specifically, the definition of input service should be amended to allow input tax credit without any restrictions – in line with the principles of GST. Moreover, on deletion of the phrase *"activities related to business"* from the definition of input service, the authorities tend to interpret the amended definition of input service as an exclusive definition despite the fact that even after amendment the definition continues to be an inclusive one. However, the position adopted by the authorities result in avoidable disputes and litigation on availability of input tax credit on services which are, bona-fide, related to manufacture of excisable goods and / or provision of taxable output services.

Accordingly, it is recommended that the definitions of input service be reinstated to what it was prior to amendments brought about by the Union Budget of 2011 such that service tax credit is also available for all input services used in connection with activities related to business and additionally, there is no restriction, as prevails currently, on availing credit of tax on certain specified services.

Service Tax – Budget Recommendations

1. 100% Cenvat to be allowed for NBFCs (Service Tax)

Under the **Rule 6(3B) and Sec. 65 of the Finance Act 1994**, a banking company and a financial institution (FI) including an NBFC, providing taxable service shall pay for every month an amount equal to 50% of the CENVAT Credit availed on inputs and input services in that month. Tax research unit of Ministry of Finance explained vide D.O.F.No. 3345/3/2011-TRU dated 28th February 2011, Para 1.16 of Ann-C, that substantial part of the income of a bank is by way of interest in which a number of inputs and input services are used. There have been difficulties for the department in ascertaining the amount of credit flowing into earning these amounts. Thus, a banking company or an FI, including NBFC, providing banking and financial services, is being obliged to pay an amount equal to 50% of the credit availed.

We most humbly like to submit that every loan transaction which fetches interest income is associated with various fees income viz. Management Fees, Processing Fees, etc. which are already subject to Service Tax. Interest income from Loan is out of the purview for valuation of Service Tax, but its associated fee based incomes are subject to Service Tax.

Accordingly, it is suggested that –

The need of the hour is a circular for clarification. A circular under Sec. 65 may be issued to the effect that ***those NBFCs which deposit an amount of Service Tax in relation to fee based income which is associated with loan transactions must be allowed to avail 100% Cenvat Credit on input services availed instead of arbitrary 50% Cenvat Credit availed as per prevailing provisions****.*

2. Service Tax vis-à-vis Securitization

A Non-Banking Finance Company (NBFC), registered with the Reserve Bank of India, is *inter alia*, engaged in the business of advancing finance to its customers for infrastructure and/or assets financing. The method of financing of equipment and infrastructure could be either of the following:

- Finance in the form of loan against hypothecation.
- Finance in the form of offering equipment's and assets under lease.

On various occasions, after having extended term loans to various customers, in order to maintain a reasonable good cash flow liquidity in the business operations an NBFC sells of these loans to various banks and other financial institutions and creates loan pools having a size of either 50/100 or more loans in each pool. In pursuit to such sale of loan pools/collective debts (which stands as currents assets in the books of account), the NBFC recoups the funds which were earlier extended as loan to various customers. This sale of loan pools to banks/financial institutions ultimately tantamount to obtaining of commercial borrowings from these banks and financial institutions at specific rate of interests which may or may not vary to a significant extent. This activity of selling of loan/current assets in the form of loans and advances in common parlance is termed as **"Securitization"** transaction wherein the funds provided to various borrowers are recouped back in order to maintain cash liquidity stability. In this whole process, there could be many instances where the rate of interest at which loans have been extended to various customers by NBFC is higher than at which the collective loan pools have been sold to banks/financial institutions. **This would lead to a resultant interest gain out of pure commercial borrowing and lending.** Apart from this gain there actually appears to be no profit/gain/income etc in the whole transaction of securitization. An NBFC does not provide any service to the Banks except minor services like documentation viz maintenance of sub-ledger of the borrowers etc. Main intent of Securitization transaction is to earn income from net interest gain.

For ready reference the meaning and scope of the term 'securitization' used in this very context is here as under:

"Securitization is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations and selling said consolidated debt as bonds, pass-through securities, or collateralized mortgage obligation (CMOs), to various investors. The principal and interest on the debt, underlying the security, is paid back to the various investors regularly. Securities backed by mortgage receivables are called mortgage-backed securities (MBS), while those backed by other types of receivables are asset-backed securities (ABS)."

Unfortunately, **tax officers** across the country have developed a mindset wherein they **perceive Securitization as something which leads to tax leakage/ evasion**. The moment tax officers find "Securitization" in any balance sheet; they resort to treat the entire Securitization transaction as sham. Accordingly demand for Service Tax, interest, penalties, running into hundreds of crores of Rupees, are being across the country on various NBFCs.

As a matter of fact, there does not exist any service consideration (as per the Finance Act) other than the gain of interest i.e. "Difference between the interest earned from commercial lending and interest spent on commercial borrowings". The levy of Service Tax on interest element embedded in the securitization of a financial asset on the presumption that some element of service is also involved is not only illegal but also ultra vires.

Accordingly, it is suggested that –

Suitable clarification should be issued by CBEC clarifying that no Service Tax would be levied on any financial gain arising to the Originator (i.e. NBFCs) on account of securitization of any financial assets such as loan, receivables etc. No service tax should be levied on the assumption/presumption that the NBFCs provide any services on account of securitization of financial asset or receive any consideration for such transactions.

3. **Payment of Service tax on Receipt Basis in case of services provided to Government or Local Authority**

Services provided by Government and Local Authority is exempt under Section 66D of the Finance Act, 1994, barring a few such as services provided by Department of Post, Life Insurance and Agency services, services in relation to aircraft, etc. Point of Taxation has been framed and made effective from 1st April, 2011, primary object of the same is to tax each and every transaction on earlier of invoicing date, date of receipt of advance, and completion of provision of service date if invoice is not issued within 30 days of the completion of provision of service. Rule 3(b) (ii) provides for exemption to service providers in telecommunication, credit card business receiving payment up toRs. 1,000/- in excess of the amount indicated in the invoice, the point of taxation shall be raising of invoice.

Service providers who provide services to Government / Local Authority in discharging sovereign duties such as providing maintenance of roads, sewage treatment, water treatment, electrical supply maintenance, etc. have also been forced to make payment of tax on earlier of invoicing date, date of receipt of advance, and completion of provision of service date if invoice is not issued within 30 days of the completion of provision of service. This effectively means that irrespective of any delay in payment by the service receiver, service tax is to be paid by the service provider based on the date of issue of invoice. There has been a considerable delay in receiving payment of government agencies/local authorities, besides due to cumbersome process involved it is near impossible to ascertain payment which is going to be received unless it is received.

Many a times deductions are done on the invoice value by service receiver on the basis of service level agreements which are known only at the time of receipt of payment, while service tax has already been deposited on the total invoice value. In the existing set-up there is no provision for reclaiming service tax amount on the deduction made by service receiver.

Accordingly, it is suggested that –

There is a very strong case of allowing service providers rendering services to Government Companies on the basis of Receipt of Payment, by making an amendment similar to Rule 3(b) (ii) of Point of Taxation Rule, 2011. Such a move would also make Local Authority / Government Company to attract competitive agencies.

4. **<u>Increase in the Effective Rate of Interest towards delay / overdue payment of Service Tax</u>**

As per the Notification No. 12/2014 – ST dated 11.07.2014, the Rate of Interest for delayed / overdue payment of Service Tax would progressively go up with the increase in the period of delay as under: -

Extent of delay	Interest Rate p.a. (w.e.f. 1st Oct, 2014)
Upto 6 months	18%
More than six months &up to one year	18% for first 6 months, AND 24% for delay beyond 6 months
More than 1 year	18% for first 6 months, AND 24% for second 6 months, AND 30% for delay beyond 1 year

The aforesaid concept of "Progressive Rates of Interest" for delayed payment of Service Tax would cause immense hardship to the assessee.

Although statutes had given powers to the Government to notify Interest Rates up to36% p.a., but in last one decade the Rate of Interest has never been fixed beyond 18% p.a.

Considering the fact that a large number of cases are pending for quite some time before Appellate Authorities (including CESTAT, HC & SC) all over the country for which the assesse is neither responsible nor has got any role to play, the recovery of interest at the Rate as high as 30% p.a. would act as deterrent for the Economic Growth of the Country.

Accordingly, it is suggested that –

The proposal to levy interest at Progressive Rates ranging from 18% p.a. to 30% p.a. may be withdrawn and the existing Provision to levy interest at the Rate of 18% p.a. may be continued.

5. Non-levy of Service Tax on Government Grants/Support Fund/Viability Gap Fund

Many a times Private Entrepreneurs join hands with Government Authorities for developing infrastructure facilities across the country and especially in the Rural areas for masses to achieve the overall socio-economic objectives of the Government of India by forming Public-Private Partnerships.

For providing concessional and/or free of cost aforesaid type of services, the Government gives grant on Revenue as well as Capital Account to the assessee. Such grants do not represent any consideration for services provided by the assese, **by whatever name it may be called**.

However, Service Tax Authorities have been issuing show cause notices and also raising demands for Service Tax on the aforesaid Grants received by assessee from Government Authorities.

Accordingly, it is suggested that –

(i) A suitable clarification should be issued so as to clarify that the Government Grants – Capital or Revenue in nature is not subject to levy of Service Tax, OR

(ii) The receipt of Government Grant should specifically be covered by the Negative List of services specified in the Act.

6. Mandatory Pre-deposit at the time of filing 1st stage and 2nd stage Appeal

There is a provision of mandatory pre-deposit of 7.5% and 10% respectively for filing and appeal before the Commissioner (Appeal) at the first stage and before the Tribunal at the second stage against the disputed demand of duty or duty and penalty or disputed penalty where only penalty has been imposed. The amount of pre-deposit payable would be subject to a ceiling of Rs. 10 crore. All pending appeals / stay application would be governed by the statutory provisions prevailing at the time of filing such stay applications/appeals. The aforesaid implementation of this new provision can be abused by Revenue Authorities in order to harass honest assesses. Further, provision of mandatory deposit is creating an unnecessary extra financial burden on assessee against the remedial measures undertaken by the assessee against the disputed demand.

The aforesaid implementation of this new provision would encourage the Revenue Authorities to maliciously issue demand notices on honest assesses to extract revenue.

Accordingly, it is suggested that –

The aforesaid proposal for mandatory fixed pre-depositing of taxes / duties may kindly be withdrawn.

7. **<u>Adjustment of Service Tax paid when amounts due are 'written-off'</u>**

After implementation of Point of Taxation rules payment of service tax has been changed from receipt basis to accrual basis and is required to be deposited irrespective of receipt of payment from service recipient. Rule 6(3) of Service Tax Rules 1994 provides that:

"Where an assessee has issued an invoice, or received any payment, against a service to be provided which is not so provided by him either wholly or where the amount of invoice is renegotiated due to deficient provision of service, or any terms contained in a contract, the assessee may take credit of such excess service tax paid by him, if the assesse –

a) Has refunded the payment or part thereof, so received for the service provided to the person from whom it was received; or

b) Has issued a credit note for the value of the service not so provided to the person to whom such an invoice has been issued."

A situation where the service recipient does not make the payment towards the service and the amount is required to be written off, is not covered in the provisions under Rule 6(3) of Service Tax Rules 1994 as no credit note is normally issued, in such circumstances. It causes hardship to the service providers as they are made to bear the service tax on value of services not realized from customers.

The new system does not offer any relief if service providers are unable to collect dues from the service recipient. The objective of the service tax credit mechanism is to mitigate the cascading effect of service taxes. **The absence of relief for bad debts** apart from militating against that objective also imposes unnecessary costs and burden on service providers.

Accordingly, it is suggested that –

It should be provided in service tax rules by way of suitable amendment that credit of service tax already paid by the service provider will be available in line with the provisions under rule 6(3) of the Service Tax Rules in case the outstanding dues for the services rendered are not received and are required to be written off. It is recommended that the service fee reversed / written off be allowed to be adjusted against service tax liability for the subsequent period.

8. <u>Inadmissibility of availing Cenvat Credit on Debit Notes</u>

Service Tax Law lays down that the transactions under debit/credit notes is an income and is liable to be taxed. The CENVAT Credit Rules 9(1) allows admissibility of CENVAT Credit on Invoice and Challan. This provision is not in line with the basic fundamental of CENVAT Credit scheme which had been introduced in order to nullify the cascading effect of taxes.

Further, it is an ironical situation while department is collecting service tax on the strength of such debit/credit note transactions, Cenvat Credit is being denied to a recipient of service on the basis of such documents.

Accordingly, it is suggested that –

CENVAT Credit Rule 9(1) should be suitably amended for admissibility of CENVAT Credit against debit notes.

9. Non applicability of Service Tax on deputation of Employees from One Company to another Company under the same Umbrella

In the present regime of Service Tax, deputation of employees from One Company to another Subsidiary Company under the same Umbrella is taxable under the category of Supply of Manpower Services. In fact, Service Tax should not be applicable in the aforesaid proposition because deputation of employees from one Company to another company of the same holding company are generally undertaken for improving the productivity, control and management of the Holding Company. Both the companies share common interest and objective of the Holding Company. The consolidated financials of the holding company depicts the picture as that of one whole entity.Under such circumstances, such deputation of employees should not be liable to service tax as it is a service for oneself i.e. for holding company.Again, these companies are not in the business of Supplying of Manpower Services.

Accordingly, it is suggested that –

A suitable clarification/notification is to be issued by the Government of India for Non-applicability of service tax on the above proposition.

10. Shortened time limit for making Payment to Service Providers under RCM

As per the Notification No. 13/2014 – ST dated 11.07.2014, the Time span for payment to vendors (service providers) is shortened from 6 months to 3 months. If the payment is not made within 3 months then the point of taxability would be the date of invoice of the service provider.

In many cases the Service Receiver enjoys credit period from Service Providers for the period exceeding 3 months. Further, in many cases, the verification, accounting and processing payment of Bills of Service Providers may take more than 3 months as a result of which it will not be possible to comply with the proposed changes by the Service Receiver. This will also lead to further procedural complications like maintaining date-wise details of payment of bills etc.

Accordingly, it is suggested that –

The reduced time span for payment to Service Providers may kindly be restored to the existing time-limit of 6 months.

11. Shortened time limit for availing Cenvat Credit

As per the **Notification No 21/2014 dt. 11-7-2014,with effect from September 1, 2014**, the manufacturer or the service provider should avail of CENVAT credit of the duty paid on inputs or the service tax paid on input services, **within 6 months from the date of the relevant document specified in Rule 9(1) of the CCR, 2004,** e.g. Invoice, Bill etc. Vide the Finance Act 2015, this time limit has been increased to 1 year. The proviso to Rule 4(7), in terms of which, the service recipient who has taken CENVAT credit on the basis of the receipt of the documents referred to rule 9(1) of the CCR, 2004 is required to reverse the credit if the payment is not made within 3 months of the date of the input Invoice, Bill etc.

Presently there is no time limit under Cenvat Credit Rules, 2004 for availment of CENVAT credit. The abovementioned Notification disallows CENVAT Credit if Credit is not availed within 6 months (now 1 year) from the date of the Invoice, Bill etc.

The restriction is against the spirit of principles of Cenvat credit which is meant to avoid cascading effect of levy of taxes/duties on taxes/duties resulting into general price level of all the commodities and services. This would also lead to unwarranted work of checking bills for which credit is not availed within 6 months for both Assesses and Departmental Authorities.

Accordingly, it is suggested that –

Proposal to bring in restriction of availingCenvat Credit within 6 months from the date of issue of Invoice, Bill or Challan may kindly be withdrawn.

12. <u>Recovery proceedings pending disposal of Stay Petition</u>

Central Board of Excise and Customs (CBEC) issued Circular No. 967/01/2013-CX dated 01.01.2013, instructing Departmental officers to initiate recovery proceedings in cases where the assessee has not filed an application for stay or has not obtained a stay order or on lapse of a specified period of time after passing of stay order. The Circular is draconian in nature and is against the principles of natural justice in as much as it seeks to deny rightful legal remedies available to assessee.

The assessee is, invariably, not in a position to expedite the litigation and hasten proceedings before quasi-judicial authorities and courts of law. The taxpayer can only file an appeal before the Appellate Commissioner / Tribunal within the statutory period. It is not within the competence of the taxpayer to ensure that his stay application is also disposed off within 30 days of filing of appeal.

Again, Stay applications hardly get disposed off in a short time span of 30 days by Appellate Commissioner / Tribunal due to various reasons such as leave of Appellate Commissioner/CESTAT Members, pendency of matters, etc.

Accordingly, it is suggested that –

On grounds of natural justice CBEC Circular No. 967/01/2013-CX dated 01.01.2013 be withdrawn and Departmental officers should be instructed not to resort to coercive action during pendency of Applications for Stay or in cases where Stay Order has been granted but the matter is pending disposal.

13. <u>Safeguards against Coercive Measures</u>

There have been instances reported of field officers threatening assessee with arrest / prosecution unless disputed amounts of tax discovered during investigations / audit are immediately paid up even before an opportunity is provided to the assessee by issuing him a show cause notice to explain the “short payment / non-payment” etc.

It is requested that adequate safeguards be provided in law in order to ensure that coercive measures are not used to demand excise, service tax, and customs duties in case of disputes involving duty payments/credits (especially in cases involving duties / taxes in excess of Rs. 50 lakh).

It is recommended that suitable administrative measures need to be put in place to deter the officers from routinely summoning senior executives and issuing threats of arrest and prosecution while seeking to demand payment of disputed tax amounts.

Guidelines be prescribed listing out the specific Do's and Don'ts for the officers to observe in situations where the officers feel that there has been a short payment or a non-payment and they seek to recover the amounts even before a show cause notice is issued. Correspondingly there should be a charter of rights for the taxpayers to ensure that the officers do not misbehave with the taxpayers.

Accordingly, it is suggested that –

No coercive measures should be initiated till at least the adjudication is over.

14. Prosecution Provisions for Indirect Taxes

Customs, Central Excise and Service Tax laws envisage prosecution of specific offences. Pursuant to the enactment of Finance Act, 2013 some of these offences have been made cognizable or non-bailable with the power of arrest being granted to relevant officers.

While the safeguard of provisions relating to prosecution as well as arrest of offenders may be necessary, the circumstances warranting the same should be clearly specified under the statute. In the absence thereof, industry apprehends misuse and abuse of these provisions.

The following among other offences are specified to be cognizable or non bailable:
"Contravenes any of the provisions of the Central Excise Act, 1944 or the rules made thereunder in relation to credit of any duty allowed to be utilized towards payment of excise duty on final products".

The provision in its present form can be invoked against even a perceived incorrect utilization of credit based on a different interpretation of the provisions of law on eligibility to credit while the intention of the law is to invoke power to prosecute and arrest in relation to incorrect utilization of credit in a situation where the credit is fraudulently availed in respect of goods not received.

It is desirable to specify explicitly in the law itself the situations which may warrant the arrest of the offenders. It should be specifically stated in the law that, provisions relating to prosecution and more specifically provisions relating to arrest shall not apply inter alia to the following cases:

(i) Where the taxpayer is registered under the relevant law and there is no risk of flight of the taxpayer;

(ii) The taxpayer has been subjected to periodic audits and has duly co-operated during the course of audit / investigation proceedings; and

(iii) The issue involved concerns a specific tax position adopted by the tax-payer (i.e. the tax was not paid or an exemption / drawback was claimed or credit was utilized) based on an interpretation of a provision of law including a judicial ruling.

Accordingly, it is suggested that –

The cognizance of offences including the power to arrest should be confined to cases where there has been a blatant and fraudulent evasion or in cases where tax has been collected but not deposited with the Government for over 6 months. The power to arrest should be withdrawn in respect of all other cases.

15. Definition Of Exempted Service

The definition of exempted service as provided under Cenvat Credit Rules 2004 includes service on which no service tax is leviable under Section 66B of the Finance Act but excludes service which is exported in terms of Rule 6A of the Service Tax Rules, 1994. **This would imply that even though the place of provision of service is outside India, the same would be considered as an exempted service until and unless it satisfies all the conditions for export of service as provided under Rule 6A of the Service Tax Rules, 1994.** One of the conditions to be satisfied for export of service is that the payment for such service has been received by the provider of service in convertible foreign exchange. This creates a disparity in respect of export of services made against convertible foreign exchange and that made by any other mode (including Indian Rupees).

Accordingly, cenvat credit related to such export of service is not admissible to such service provider. Similarly, the activity specified under the Negative list of services covers activity such as trading of goods, any process amounting to manufacture or production of goods etc. which are either not service or are coming under the purview of excise duty. Therefore, an activity which is not under the scope of service tax cannot be said to be an exempted service.

Definition of exempted service as provided under Rule 2 (e) of the Cenvat Credit Rules 2004 should be amended to provide that exempted service shall not include a service where the place of provision of service is outside India and also shall not include any activity as specified under the Negative List of Services.

16. Requirement of Standardization of Records to be maintained

It is a general practice for Service Tax Department as part of EA2000 Audit, to seek voluminous details and information for several years in self-specified formats (e.g. Annexure-VI and Annexure-XV of Service Tax Audit Manual). These formats require an assessee to prepare detailed reconciliation and voluminous information which is otherwise not maintained in the normal course of business and these are not particularly specified under Service Tax Act and Rules.

The Finance Act, 1994 and the rules made there under do not prescribe the voluminous details and information in formats / annexure which are sought during Service Tax Audits. As these requirements are not standardized, the businesses cannot automate such requirements in their computerized accounting software.

Accordingly, it is suggested that –

It is suggested that the information which an assessee needs to maintain must be clearly specified in the Service Tax law itself.

17. Cascading Of Service Tax For Brand Owners When Manufacture Is By Job-Workers

As per the provisions of CENVAT Credit Rules, 2004 CENVAT credit on inputs and capital goods may be availed by a manufacturer as long as such inputs / capital goods are physically received in his factory premises (or outside the factory of the manufacturer of the final products for generation of electricity for captive use within the factory in case of capital goods) under cover of a valid Central Excise Invoice and are used by him in or in relation to manufacture.

However, under the same Rules, credit of service tax may be availed by an assessee on payment of the same to any input service provider, as long as the input service is received in or in relation to manufacture. The credit is, thus, only available on the basis of Invoice payments.

In the case of Brand Owners who employ job-workers exclusively for manufacture of goods, the benefit of CENVAT credit on inputs is available since the job-worker can claim the CENVAT credit and offset his central excise liabilities against the said credit. However, as far as service tax is concerned, since the payments for taxable input services are generally effected by the Brand Owner instead of the job-worker, the benefit of service tax credit is not available. This is due to the fact that the Brand Owner cannot avail the credit since he is not the manufacturer and the manufacturer, i.e., the job-worker, cannot avail the credit since he does not pay for the taxable input service. Consequently, under the Rules the Brand Owner employing job-workers exclusively is discriminated vis-à-vis Brand Owners having their own manufacturing facilities, in so far as credit of service tax is concerned.

The CENVAT Credit Rules also provide for an Input Service Distributor (ISD) mechanism whereby the credit of service tax can be distributed by an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under Rule 4A of the Service Tax Rules 1994 towards purchase of input services. Hence, by definition, the ISD cannot distribute credit of service tax to job-workers in case the input services are paid for by the principal, i.e., the Brand Owner.

Accordingly, the provisions of the CENVAT Credit Rules, 2004 creates an inequitable situation, in that, the benefit of CENVAT credit pertaining to inputs and capital goods is available to the assessee irrespective of whether manufacture is in-house or at job worker premises whereas the benefit of service tax credit is available only if the manufacture is at the assessee's own unit. This inequity dilutes the cost competitiveness of assessees who own brands and use job-workers exclusively for manufacture of goods – more so since, the scope of the service tax has been expanded following the introduction of 'negative list' based approach to Service Tax.

It is recommended that the CENVAT Credit Rules be amended to provide a mechanism that enables availment and distribution of credit of service tax by brand owners to job-workers. This will ensure cost competitiveness of the brand owners and protect the long-term interests of job-workers.

18. Reimbursable Expenditure Or Cost Incurred By Service Provider To Be Excluded From The Value On Which Service Tax Is Charged

Section 67 of the Finance Act has been amended to provide that consideration on which service tax is chargeable will include any reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service except in such circumstances and subject to such conditions as may be prescribed.

Under the Service Tax (Determination of Value) Rules, 2006 the taxable value of a service is to be computed inclusive of cost of any reimbursements made to the service provider. The only exception is in respect of reimbursements made to a pure agent.

There could be situations where the service provider, in the course of providing a taxable service incurs expenditure on services on which the service provider pays the service tax. Alternately, such services could also be exempted from service tax or declared in negative list. However, pursuant to the amendment of Section 67 and in line with the Valuation Rules, the value of taxable service provided to the service recipient by the service provider would be inclusive of the expenditure incurred by the service provider towards service which have already suffered service tax or exempted service or services declared in the negative list. Accordingly, service tax is payable by the service recipient even on such expenditures though, in terms of Service Tax laws such services are outside the scope of tax.

It is recommended that the Service Tax laws be amended such that expenditure incurred by the service provider on behalf of the service receiver in connection with providing taxable services are excluded in computing the value of such taxable services.

19. Credit Availment For Input By The Works Contractor

Service Tax (Determination of Value) Rules, 2006 provides that the provider of taxable service opting to pay service tax under clause 2A (ii) [on deemed value of service] is not entitled to take CENVAT credit of duty on inputs, used in or in relation to the said works contract, under the provisions of the CENVAT Credit Rules, 2004.

There is no restriction to take CENVAT credit of duty paid on capital goods and/or service tax paid on input services.

It is recommended that the laws be amended appropriately to allow CENVAT credit in respect of inputs to works contractors who have opted to pay service tax on deemed value of service as provided under clause 2A (ii) of Service Tax (Determination of Value) Rules, 2006 in line with similar credit allowed for input services and capital goods.

20. Service Tax Should Not Be Levied On Any Transaction Whether Monetary Or Non-Monetary Between Employer And An Employee

Provision of service by an employee to the employer in the course of or in relation to his employment has been excluded from the definition of "service" itself. The exemption is to service provided by employee to employer and not vice versa. Therefore services provided by employer to employee can be subject to service tax.

During the course of employment there are various monetary and non-monetary transactions which take place between an employer and an employee. Such transactions are usually in the nature of recovery of expenditure by employer from the employee towards services which are utilised by the employee for his personal purposes.

Service Tax law be amended to provide that nothing in the definition of service as provided in Section 65B (44) of the Finance Act,1994 would apply with regard to any kind of a transaction,

whether monetary or non-monetary between an employer and an employee during the course of employment.

21. Value Of Service Portion In Case Of Works Contract

The manner for determining the value of service portion of a works contract from the total works contract is provided in Rule 2A of the Service (Determination of Value) Rules, 2006. As per sub rule (i) of the said Rule 2A the value of the service portion in the execution of a works contract is the gross amount charged for the works contract less the *actual* value of transfer of property in goods involved in the execution of the said works contract.

Where the value of the service portion has not been determined in the manner as provided in clause (i) of rule 2A the value shall be determined as noted in the Table.

Where works contract is for	**Value of the Service portion shall be**
(A) execution of original works	**40%** of the **total amount charged** for the works contract
in case of works contract, not covered under sub-clause (A), including works contract entered into for, - (i) maintenance or repair or reconditioning or restoration or servicing of any goods; or (ii) maintenance or repair or completion and finishing services such as glazing or plastering or floor and wall tiling or installation of electrical fittings of immovable property,	**70%** of the **total amount charged** for the works contract

When actual value of transfer of property in goods involved in works contract is not determined, deeming provisions will come into force both under Service Tax and under State VAT laws. Neither Service Tax law nor State VAT laws recognise the deeming provision that exist in the other law. The deemed value of service as provided in the Service Tax law is at variance with the deemed value of service provided under various State Laws. As a result, an assessee is forced to pay a higher VAT as well as a higher service tax on the same works contract on account of variation in the deeming provisions between State Laws and Central Laws. The effect of such difference results in payment of tax (both VAT and Service Tax) by the assessee on more than 100% of the value of works contract - once in the form of VAT and another in the form of Service Tax.

The under mentioned table (containing few such examples) reflects the impact of such deeming provisions:

Nature of Works Contract	Value of Service Portion in Works Contract on which Service Tax will be paid as per Service Tax laws	alue of Labour Portion in Works Contract as per VAT laws	Value of Works Contract on which VAT is paid	Effective Total Value of Works Contract on which Service Tax and VAT is paid
Installation of Plant & Machinery	**40%** of the total amount charged	5% of the total amount charged Karnataka VAT Rules,2005)	**85%** of the total amount charged Karnataka VAT Rules,2005))	**125%** (i.e., 40%+85%)
Civil Works like construction of Building	**40%** of the total amount charged	0% of the total amount charged Rajasthan VAT Rules,2006)	**70%** of the total amount charged (Rajasthan VAT Rules,2006)	**110%** (i.e., 40%+70%)
Works Contract Not Specified	**70%** of the **total amount charged**	5% of the total amount charged Karnataka VAT Rules,2005)	**75%** of the total amount charged Karnataka VAT Rules,2005)	**145%** (i.e., 70%+5%)

The above scenario is illogical and inequitable and cannot continue.

Service Tax (Determination of Value) Rules, 2006 be amended so as to clearly exclude the portion of works contract that is taxable under State VAT laws (whether on the basis of 'actuals' or on 'deemed' basis) from the levy of Service Tax.

Alternatively, Service Tax (Determination of Value) Rules, 2006 be amended so as to provide a uniform rate for arriving at the value of service portion for all kind of works contract. It is also recommended that such rate should be fixed taking into consideration the deemed value of service portion under various state laws. The value of service portion in all kinds of works contract should at best be restricted to 15%-20% of the total value of works contract.

22. <u>Reverse Charge Mechanism</u>

Prior to introduction of the Negative List of Services, only three types of services were taxed under the reverse charge mechanism – services provided by GTA, sponsorship services and services provided by persons outside India in case such persons did not have any establishment in India.

With the advent of the Negative List of Services a whole host of services have been notified under the reverse charge mechanism, including services of works contracts, manpower supply and security provided by non-corporate service providers to corporate bodies. Also, penal provisions that are applicable to service providers have been made applicable to service recipients as well in case of the services that are under the reverse charge mechanism. The issue has been made more complex by the fact that for different types of services the ratio of tax payable by the service provider and the service recipient are different.

The undesirable consequences of these changes in the service tax laws include:

i. significant increase in complexity and cost of compliance in case of corporate bodies in terms of identification of status of service provider, payment of tax per applicable ratio for the specific type of service, maintenance of records, submission of returns, Departmental audits and so on.
ii. undermining of threshold limits and exemptions prescribed under service tax laws. This is due to the fact that in case of payment of tax under the reverse charge mechanism threshold limits are not applicable, leading to situations where the service recipient, being a corporate body, has to pay service tax in respect of specified services provided by non-corporate service providers even if such service providers are below the prescribed threshold limits.
iii. chances of short/excess payment of service tax consequent to differences in understanding of service provider and service recipient on whether a particular service falls under the services notified for taxation under the reverse charge mechanism.
iv. scope for dispute and litigation with the Department on interpretation and valuation. For example, whether a particular service is a manpower supply service (to be taxed under reverse charge mechanism) or not would depend on the facts of the case and is open for interpretation. Similarly, the laws prescribe that in case of works contract services it is open to the service provider and the service recipient to follow different options of valuation. It is apprehended that issues like these will give rise to disputes with Department, resulting in avoidable litigation and lock-up of revenue.

In an era of growing transparency and simplicity in tax laws the enlargement of list of services under the reverse charge mechanism is a retrograde step and has burdened the service recipient with responsibilities that are rightly those of the Department. In addition to increasing the complexity of compliance, the enlargement of the list of services under the reverse charge mechanism has also diluted the threshold levels prescribed under law since, even if a service provider is exempt from tax by virtue of being below threshold limits, under reverse charge mechanism the service recipient (body corporate in this case) will have to pay the service tax. To remove this inequity it is recommended that the list of services under reverse charge mechanism be pruned. For the sake of administrative convenience it is recommended that the list be restricted to services provided in India by parties outside India, services provided by non-executive directors to a company and road transportation services provided by GTA.

In the event the above is not feasible, at the least the ratio of tax payable by the service providers and the service recipients must be made uniform across all category of services – if need be the whole tax should be payable by the service recipient. Such a move will mitigate some of the complexities faced under "reverse charge mechanism" by the assessees today.

23. Amendment Of The Provisions Related To Point Of Taxation

Rule 7 of the Point of Taxation provides that the point of taxation in respect of the persons required to pay tax as recipient under the rules in respect of services notified under sub section (2) of section 68 of the Finance Act,1994 shall be the date on which payment is made.

Proviso to Rule 7 of the Point of Taxation Rules provides that where the payment is not made within a period of three months of the date of invoice, the point of taxation shall be the date immediately following the said period of three months.

The raising of the invoice by the service provider and its receipt by the service recipient is not something which is under the control of the service recipients. There may be instances where the invoice is not received by the service recipient within 3 months from the date of invoice. Moreover, it becomes very difficult on the part of the service recipient to track each invoice and the date of its payment especially in case of large corporate assessee.

Considering the fact that without receipt of the invoice within 3 months from the service provider the value of the service may not be determined accurately, service recipient would be made liable to pay interest for no fault on its part and may also be subjected to penal provisions by the Department under the Service Tax laws.

Point of Taxation Rules be amended so as to fix date of payment as the point of taxation in respect of the persons required to pay tax as recipient under the rules in respect of services notified under sub section (2) of section 68 of the Finance Act, 1994 irrespective of the time gap between date of invoice and date of payment.

24. <u>Service Tax Law Should Be Amended To Do Away With Penal Provisions In Cases Not Involving Fraud Or Collusion Or Wilful Misstatement Or Suppression Of Facts Or Contravention Of Any Provision Of The Act Or Rules With The Intent To Evade Payment Of Service Tax</u>

Section 76 of the Finance Act, 1994 provides for penalties, in cases not involving fraud or collusion or wilful misstatement or suppression of facts or contravention of any provision of the Act or rules with the intent to evade payment of Service Tax.

Penalty should be imposed only where there is an intention to evade payment of duty by the assessee. The impugned provision to the extent of providing for mandatory or minimum penalty without any *mens rea* and without any element of discretion is excessive and unreasonable restriction on fundamental rights and is arbitrary. *Mens Rea* should be made an essential ingredient under the Statute for imposing penalty. In case details of all transactions are available from the records maintained by the assessee, there is no reason to believe that there can be intent to evade payment of any duty as all such records are available to the department during the course of audit/ inspection or verification. Such non-payment of duty can be as a result of interpretational issues or a genuine mistake or error on the part of assessee.

Service Tax Law should be amended to do away with penal provisions in cases Not Involving fraud or collusion or wilful misstatement or suppression of facts or contravention of any provision of the Act or rules with the intent to evade payment of service tax. Further, the Revenue Statutes should be amended so as to bestow discretion on to the Adjudicating Authority and Appellate Authority to waive / set aside penalty provided under the respective statutes. Similar amendment should be made in Central Excise Act and Customs Act.

25. <u>Amendment To The Definition Of Service And Negative List Of Services</u>

The definition of exempted service as provided under Cenvat Credit Rules, 2004 includes service on which no service tax is leviable under Section 66B of the Finance Act. Further Section 66B of the Finance Act, 1994 states that there shall be levied a tax on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed. The Negative List of services includes any process amounting to manufacture or production of goods or trading of goods.

By virtue of the above provision, any process amounting to manufacture of goods or trading of goods would be regarded as an exempted service. However, it may be noted that a process amounting to manufacture or production of goods or trading of goods should not be regarded as a service, much less an exempted one. This is in view of the fact that trading of goods is subject to local tax and that of process amounting to manufacture or production of goods to Central Excise.

Considering the fact that the intent is to exclude such activities from levy of service tax, it is recommended that the same should be excluded from the list of negative services and the scope of service tax definition. In fact, the activity of transfer of title of goods is already excluded from definition of service.

Service Tax Law should be amended to provide that definition of service under Section 65A (44) of the Finance Act, 1994 to exclude any process amounting to manufacture or production of goods or trading of goods and "process amounting to manufacture and production of goods or trading of goods" be removed from the Negative List of Services.

26. **Definition Of Service Under Section 65A(44) Of The Finance Act, 1994 Not To Include Any Service Provided By A Job Worker To The Principal Manufacturer**

The job workers are engaged by principal manufacturers to manufacture final or intermediate goods on their behalf. In order to manufacture the goods, there are various activities which the job worker may undertake for keeping the manufacturing facility in the state of readiness. Accordingly, the job worker either seeks financial assistance or commitment charges from the principal manufacturer.

Since payments made by the principal manufacturer to the job worker as assistance or commitment charge are in connection with the manufacture or production of final goods, service tax that should not be levied on such payments. Also, in case the service tax is charged by the job worker, the same will not be available to credit by the principal manufacturer, thus leading to cascading of taxes

Further, carrying out production process by job worker in relation to any goods on which appropriate duty is payable by the principal manufacturer has been exempted from service tax. This leads to a situation wherein a job worker in relation to the said activity is regarded as a provider of an exempted service. The job worker would, therefore, is not entitled to cenvat credit on input or input services. Since a job worker under the Central Excise is regarded as a manufacturer, he cannot be said to be a service provider concurrently.

Definition of service under Section 65A (44) of the Finance Act, 1994 to be amended so as to exclude any service provided by a job worker to the principal manufacturer directly or indirectly in or in relation to and in connection with the manufacture and production of goods or processing of any goods by the job worker for further use in the manufacture and production of final product by principal manufacturer.

27. **<u>Distribution Of Credit By Input Service Distributor</u>**

Rule 7 of CENVAT Credit Rules pertaining to manner of distribution of credit by an input service distributer (ISD) has been amended with effect from 01.04.2012 and further with effect from 01.04.2014. The following additional conditions have been imposed in relation to distribution of credit:

i. credit of service tax attributable to service used wholly by a unit shall be distributed only to that unit; and
ii. credit of service tax attributable to service used by more than one unit shall be distributed pro rata on the basis of the turnover of such units during the relevant period to the total turnover of all its units, which are operational in the current year, during the said relevant period.

Given the fact that most multi-unit businesses have a large number of invoices against which the input tax credit related to service tax has to be distributed, linkage of invoices to specific units – in order to establish quantum of service tax to be distributed to each unit – becomes a cumbersome and error prone exercise. The inevitable consequence of this is disputes and litigation with the Department.

It is submitted that there is no adverse impact on revenue in the event the service tax credit is distributed to multiple units or to any one unit manufacturing excisable goods / providing output service.

It is recommended that the CENVAT Credit Rules 2004 be amended appropriately to allow distribution of eligible input credit of service tax by the Input Service Distributors to any unit of the entity so long as the unit to which credit is getting distributed is manufacturing dutiable goods or providing output service.

28. <u>Availment Of Cenvat Credit On All Services Used In Relation To The Business Of Manufacture Or Provision Of Service</u>

With effect from 01.04.2011, the definition of input service has been amended by excluding certain services. The amended definition tends to restrict the scope of credit. The service tax by itself adds to the cascading effect of taxes and by restricting the scope of availment of cenvat credit to certain services compounds to the overall cascading effect. Such restricted scope also leads to a lot of litigation. To add to it, the removal of the word activities relating to the business is interpreted by the Department to disallow cenvat credit on services which are not specifically mentioned in the definition of input service although the said services are eligible input services.

Cenvat Credit Rules 2004 should be amended to allow manufacturers and service providers for taking cenvat credit on all services used in relation to the business of manufacture or providing of service.

29. **<u>Insertion of a "Remarks" Column in Form ST-3</u>**

In line with similar column provided in Form ER-1 of Central Excise, a "Remarks" column to be inserted in the format of Service Tax Return (Form ST-3) to enable the assessee to provide clarifications / explanations, if required.

30. **Service Tax Credits By Brand Owners When Manufacture Is By Contract Manufacturers**

A substantial part of the Fast Moving Consumer Goods (FMCG) industry operates under a model of contract manufacturing whereby the Brand Owner focuses on distribution and marketing of the products whilst the manufacturing activity is undertaken in a distributed manner through contract manufacturing facilities across the length and breadth of the country. This model also has the salutary effect of incentivising MSME units, development of the local economy and opportunities for local employment generation without adding the burden of any marketing risks on the Contract Manufacturer.

The Brand Owners (Principal Manufacturer), incur substantial sums in the course of marketing and distribution of the products to the end consumers by engaging various service providers whose services are liable for service tax.

The prevailing rules do not allow set off of service tax credits available with the Brand Owner against the excise liability of the Contract Manufacturer on the goods manufactured by the Contract Manufacturer and distributed by the Brand Owner. It is pertinent to note that there is no such restriction on availing cenvat credit on input materials or capital goods, supplied by Brand Owner to the Contract Manufacturer. Consequently under the Rules, the Brand Owner is disadvantaged and the cascading effect leads to increase in cost of the product for the end consumer.

It is recommended that the Cenvat Credit Rules be amended to provide a mechanism that enables availment and distribution of credit of service tax by Brand Owners to Contract Manufacturers. This will ensure cost competitiveness of the Brand Owners while ensuring protection of long-term interests of the Contract Manufacturers as well as the end consumers.

Alternatively, the Brand Owner should be permitted to use the credit of service tax to off-set any Central Excise or Service Tax liability in respect of his own manufacture of any other goods or taxable services provided by him.

31. Levy of service tax on radio taxis or radio cabs bringing them at par with rental cab is not as per industry norms. This first one operates by meters whereas the other one operates on a per day/km basis. Infact radio taxis or radio cabs are equivalent to a normal metered taxi service. Thus levy of service tax on radio taxis is a blow to the industry and increased cost of travel for common people.

32. The proposal for increasing rate of interest from the current 15%/18% to upto 30% is a very big financial hardship cast upon the assessees and is quasi-penalty. This may be reviewed and rationalized. A suitable power may be given to the adjudicating authority to waive some portion of the interest may also be provided.

33. Service Tax Audit or Service Tax Compliance Certificate on the lines of Income Tax Audit u/s 44AB or Secretarial Audit under the Companies Act, 2013 may be introduced. This will ensure that all companies/ firms, etc. are complying with service tax laws in the country and lower the burden on Departmental officers.

34. The challan of service tax/ excise duty may be amended to include the Financial Year in the same.

35. A registration scheme for casual assessees who may require registration for one off transactions may be introduced. This will assist the assessees who have to take registration for payment under reverse charge for simple transactions and then need to immediately surrender the same.

36. A fast track exit scheme for assessees who want to surrender their registration may be introduced. All old and pending registrations that are pending with the department may be taken up under this scheme also for fast disposal. Assessees who have paid all their taxes and do not have any pending audit/ demand may be allowed under the scheme. All assessees who have stopped filing their returns after submitting a request for surrender may also be exempted for filing their previous returns. This will go a long way in the Hon'ble Prime Minister's scheme for facilitating business in India.

37. Representational services provided by professionals (CA/ CS/ CWA) before the Commissioner/ Hon'ble Tribunal may be exempted so as to bring them in line with the services provided by Advocates which is exempt. By taxing the services on professionals, other than advocates for the same service, it amount to injustice and does not provide a level playing field to all professionals.

38. **Service Tax On Rentals Paid For Immovable Property**

The rental of immovable property constitutes around 50% of total operating cost of retail store. The service tax on rentals paid for immovable property has a huge adverse cost impact on the retail sector since the tenants / lessees are not in a position to avail credit of the service tax.

Recommendation

Appropriate abatement be provided for determining the value of taxable services relating to renting of immovable property on similar lines as provided to several services vide Notification No. 26/2012-Service Tax dated 20th June 2012 amended by Notification No. 8/2014 – Service Tax dated 11th July 2014.

39. **Availment Of Credit Of Service Tax Paid On Transportation Of Coal By Rail**

Service Tax on transportation of goods by Rail was introduced with effect from 01.10. 2012.

As per Rule 4A of Service Tax Rules, inter alia every person providing taxable service shall issue an Invoice, a bill or as the case may be a Challan and such Invoice, bill or challan shall be serially numbered and shall contain the details such as the name, address and the registration number of such person etc.

As per Rule 9(1) of the Cenvat Credit Rules (CCR) 2004, CENVAT credit shall be taken by the manufacturer or provider of output service on the basis of an Invoice, Bill or Challan issued by a provider of Input service.

Railways, being Service Tax registrants have been bound by the Service Tax provisions and are not relaxed from issuing a formal Invoice as per Service Tax Rules. However, the Railways continued to issue only Railway Receipts for the goods transported by them.

Vide their Rate Circular No 29/2012 dated 28.09.2012 (No TCR/1078/2011/2) it has been clarified by the Deputy Director of Railway Board that customers can get credit of Service Tax based on the consolidated Certificate issued by an authorised Officer of Railway. The relevant extract of the Circular is reproduced below:

"4(xiii) On any written request from customers, CCM Office will issue a monthly consolidated certificate to be signed by an Officer authorised by CCM and duly countersigned by Dy.CAO/T or officer nominated thereto, for each customer giving details of Service Tax collected from them during the previous month, date-wise and rake-wise with breakup of (a) Service Tax, (b) Education Cess, (c) Higher Education Cess and (d) Total Service Tax. This can be used by the customers for getting credit of Service Tax from the concerned Superintendent of Central Excise as due to them"

However, no corresponding amendment was immediately made by Ministry of Finance in Rule 9 of CCR 2004, which deals with the list of eligible documents for availment of CENVAT.

Vide Notification No 26/2014-C.E. (N.T.) dated 27.08.2014, Rule 9 of CCR 2004 has been amended to insert the following clause to include the certificate issued by Railways as an eligible document for the purpose of availing CENVAT.

"(fa) a Service Tax Certificate for Transportation of goods by Rail (herein after referred to as STTG Certificate) issued by the Indian Railways, along with the photocopies of the railway receipts mentioned in the STTG certificate; or"

Issue

Paper industry transports coal through rail rakes from collieries to the railway sidings. Coal is used for producing steam and power for use in the manufacture of paper and paperboards.

Manufacturers avail credit of service tax on rail transportation based on the certificates issued by Railways along with the photo copies of Railway Receipts, on the strength of the Circular No 29/2012 dated 28.09.2012 issued by Railway Board.
CERA / Departmental Auditors, however, raise objections to this practice and contend that the certificate issued by Railways Department is a valid document for purposes of credit of service tax only w.e.f. 27.08.2014. Service tax credit is, accordingly, sought to be denied. Unnecessary disputes in this regard have arisen consequently.

It may be noted that till Rule 9 of CCR Rules was amendment w.e.f 27.08.2014, no such objection was raised by the Jurisdictional Excise Authorities or the Departmental Auditors.The audit objections raised now defeat the very purpose of Cenvat Credit scheme and the aforesaid amendment. Denial of rightful cenvat credit on the basis of certificates issued by Railway Board causes financial hardship to manufacturers and is utterly inequitable.

It may be noted that during the MODVAT regime, it was clarified by CBEC that duty payment certificates issued by Public Sector Undertakings are valid documents for availing credit of Excise Duty

Recommendation

It is recommended that a clarification is issued by Ministry of Finance to the effect that:

i. **monthly consolidated certificates (service tax certificates) issued by Railways prior to 27.08.2014 would be valid documents for the purpose of availing cenvat credit and**
the credit already availed prior to 27.08.2014, on the basis of such certificates, would be valid.

40. **<u>Cenvat Credit On Inputs And Input Services Used In Relation To Construction Of A Factory Building Or Civil Structure Or Laying Foundation Or Making Of Support Structure For Plant / Equipment</u>**

The current definition of inputs and input services under Cenvat Credit Rules 2004, exclude the following from the respective definitions i.e., any goods or services used for:

i. construction or execution of works contract of a building or a civil structure or a part thereof; or

ii. laying of foundation or making of structures for support of capital goods,

In capital intensive industries like Paper industries construction of plant involves a huge expenditure o civil constructions to accommodate heavy machines within the premises, laying equipment foundations for wobble free operation of equipment's. Most of the structures made in support of these equipment's are imperative for operation of the equipment/ plant. All these equipment's are movable and can be relocated to any other location.

However due to above provisions of cenvat credit Rules , all the inputs and input services although used in construction factory buildings, equipment foundations or structures for equipment operations , though are in relation to manufacture, are not available for availing cenvat credit.

Due to non-availability of cenvat credit, it has greater effect on the growth of capital intensive industries and its financial viability. Further the above provisions defeat the very purpose of cenvat credit scheme which intends to allow credit of duty / tax paid on goods and services used for / in the manufacturing of final goods. Value of such final goods includes the cost incurred towards inputs and input services for construction factory buildings, equipment foundations or structures for equipment operations. There is a spate of avoidable litigation as to what constitutes the main structure or support structure of equipment.

<u>Recommendation</u>

To widen the definition of inputs and inputs services to include the inputs and input services used in construction of buildings or civil structures or laying foundations or making of structures for support of the equipment/ plant.

Specific exclusion of inputs and input services used should be restricted to "inputs or input services used in construction of buildings/civil structures as office premises".

41. <u>Service Tax – Agricultural Produce</u>

As per extant Service Tax laws the agro-sector has been supported by keeping a bulk of services relating to agriculture or agricultural produce in the Negative List or in the list of exempted services. However, there are some services like Warehouse Management Services, Security Services, Laboratory Testing Services and so on – which are essential to secure storage of agri-produce and to determine quality of the agri-produce – are subjected to Service Tax.

It is recommended that all services provided for agricultural produce be kept outside the ambit of taxable services.

42. Service Tax – Reimbursements

Finance Act 2015 has included the reimbursements sought by service providers within the definition of "Consideration" for the purpose of determining the value of taxable service. It may be pertinent to note that Clearing & Handling Agents (CHAs), during the course of providing CHA service also make payments for certain expenses, on behalf of service recipient on a Principal to Agent basis and seek reimbursements of the same from the service recipient. The imposition of service tax on such reimbursements adds to the overall cost structure of the exporter. Exporters can seek refund of service tax either on-line at a prescribed rate (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) or seek refund manually establishing the actual service tax suffered by the exporter in the course of export. The rate prescribed for claiming refunds on-line has not been increased appropriately to cognise for the additional service tax suffered on reimbursements.

Recommendation

Reimbursements claimed by Service Providers purely on a Principal to Agent basis, as above be specifically excluded from the definition of "consideration". Alternately, the prescribed rates (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) be increased appropriately to cover for the incremental cost on account of service tax on such reimbursements.

43. Service Tax On Processing Of Agri-Commodities (Pulses)

Negative List of Services includes Processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but makes it only marketable for the primary market. In case of processing of whole pulses to split pulses, such activity is carried out in factories. The prices of the pulses is showing an upward trend in last few years owing to lower production, impact of weather, etc. Levy of service tax on such processing activities adds to the higher prices of pulses, which is a staple diet for the common man. On a similar corollary, Finance Ministry has exempted levy of service tax on processing of paddy into rice.

It is recommended that the processing of whole pulses into split pulses should be covered under negative list of service tax.

44. Utilisation Of Input Credits

Currently the credit for service tax on input services can be utilised only if there is a correlation between such input services received and output goods or services. In case of conglomerate Companies, there are many input services which are received in respect of businesses (especially those relating to agriculture) which are not associated with output of any taxable goods or services. Due to the requirement of correlation, service tax paid on such input services cannot be utilised and therefore adds to the cost table.

It is recommended that input service tax paid on input services be allowed to be utilised against excise / service tax payable on any other taxable outputs (goods or services) produced / rendered by other businesses of the Company.

45. <u>Service Tax On Marketing And Brand Promotion Activities In Rural Areas</u>

It is estimated that more than 35% of the demand for fast moving consumer goods in India is in the rural markets. However, the awareness about high quality consumer goods in rural India is relatively poor. Unscrupulous players take advantage of this by flooding rural markets with goods of sub-standard quality and, very often, counterfeit products. Apart from the hardship faced by the rural consumer, the exchequer is also deprived of rightful revenue since these unscrupulous players, more often than not, evade taxes.

One of the key challenges facing the country, therefore, is that of harnessing economic growth to consolidate the recent gains in making development more inclusive. Whilst the Government has taken several initiatives like NREGA, *Indira AwasYojana, Bharat Nirman*, etc., for development of the economically weaker sections of society in the rural areas, the weak infrastructure of rural markets make the cost of penetration prohibitive.

Given the imperatives of ensuring inclusive growth the need of the hour is for government to partner the private sector in developing the market infrastructure in rural areas. This may be done by way of providing appropriate incentives to private players who make investments in stimulating the demand creation for high quality, branded products and to promote availability of such products in the rural areas. One approach to this is by way of providing exemption from Service Tax in respect of input services that are used for strengthening the infrastructure of rural markets.

Accordingly, it would be appropriate for Government to consider exemption from Service Tax all services used in this regard. This would also be in line with the philosophy of excluding from the purview of service tax a lot of farming / agriculture related services like leasing of land and agricultural equipment, agri-extension services etc. To prevent misuse of the exemptions appropriate rules can be framed for certification of services provided in rural areas by governmental bodies like the village panchayat, the village post-master, etc.

46. <u>Amendment Of The Definition Of "Board" Under Section 65B Of The Finance Act 1994</u>

As per Section 66D of the Finance Act, 1994 the Negative List of Services includes:

"(d)(vii) Services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;"

Under Section 65B (*6*) "Agricultural Produce Marketing Committee or Board" has been defined to mean any committee or **board constituted under a <u>State law</u> for the time being in force for the purpose of regulating the marketing of agricultural produce.**

In this connection it would be pertinent to note that by virtue of it being expedient in public interest, the Union Government has taken under its control several agri industries and has set up Boards for such industries. The duties and objectives of such Boards include, inter-alia, regulating the relevant agri commodity and promoting its sale – both within the country as well as exports, having due regard to the interests of all the stakeholders like the farmers / growers, manufacturers, dealers and the government.

Examples of such Boards include Spices Board of India, Tobacco Board, Coffee Board of India, Coir Board and Tea Board of India.

Recommendation

In line with the inclusion in the Negative List of services provided by Agricultural Produce Marketing Committees or Boards, the services provided by Boards set up under Central enactments for similar purposes should be included under the definition of "Board" under Section 65B of the Finance Act, 2003. This will ensure that the tax cost of the services are not embedded in the export cost of the agri-products or in the cost of the agri-products sold in the domestic market, as is the case today.

47. **Extension To The Scope Of Negative List Of Services**

A negative list of services has been provided by introduction of section 66D to the Finance act, 1994 with effect from 1st July 2012 through which any services included in the list are outside the ambit of service tax

In this regard, it is important to mention that Specified Services relating to agriculture or agricultural produce have been included in the negative list of services e.g. Agricultural operations, supply of farm labour, processing of agro produce, loading, unloading, storage, renting or leasing of vacant land or agro machinery etc. It is observed that entities engaged in the agricultural sector carry out activities that are not taxable on account of the negative list and other exemption notifications.

However, there are certain other input services received by such entities which are not included in the negative list of services such as Transportation of packing material, works contracts, manpower supply,security,import of services for installation and erection of agro related plant and machinery etc.

Non-inclusion of complete list of services availed by the service recipients/entities engaged in agricultural sector is leading to increase in cost base of these entities, as these entities do not have any output service tax liability

Recommendation

CBEC should issue an amendment notification extending the scope of Section 66D to all services, whether direct or indirect to agriculture or agricultural produce instead of limiting the exemption to the specified services

48. **Service Tax Exemption To Hotels For Services Provided Against Convertible Foreign Exchange**

Hotels and other tourism related services is an integral part of the Service Export Promotion Council set up by the Ministry of Commerce. The Council is engaged in promoting exports of services from India and creating a powerful "Served from India" brand.

The Hotel industry, unlike other services that are included in the Council, is not in a position to export services. However, the industry earns significant foreign exchange for the country by offering services within the country. Since the services offered by the Hotel industry are not "exported", there is a tax cost embedded in the same by way of service tax. This is not the case in respect of services that are actually exported since such exports are at nil tax cost.

Recommendation

In order to provide a level playing field to Hotel and tourism services vis-à-vis other services included in the SEP Council the services provided by this sector, including services like banquet rentals, dry cleaning, health club and fitness centre, beauty parlour, internet, business support and auxiliary services, management consultant services, renting of immovable property and so on, be exempted from service tax to the extent such services are provided against convertible foreign exchange.

49. Service Tax On Room Rent And On Sale Of Food And Beverages

In Finance Act 2011 the scope of Service Tax was expanded to levy Service Tax on renting of Rooms and Food and Beverages sales by Air Conditioned Restaurants having liquor license (subsequently the coverage was extended to all restaurants) despite the fact that in hotels Luxury Tax is charged on renting of Rooms and VAT is charged by all hotels and restaurants on Sale of Food and Beverages.

Whilst the current abatement in respect of service tax has been provided @ 40% for Rooms and @ 60% for Food & Beverage, on the balance portion there is an element of double taxation – Service Tax and Luxury Tax in the case of Rooms and Service Tax and VAT in the case of Food & Beverages.

The total tax outflow for the Guest works out to more than 20% on an average. Consequently, this tax levy is a significant deterrent to the Hospitality Industry which is already impacted adversely by the general slowdown of the global economy.

Recommendation

The levy of Service Tax on renting of Rooms and sale of Food and Beverages be discontinued to provide some relief to the industry.

50. Distribution of credit as per rule 7 of the Cenvat Credit Rules, 2004 providing for proportionate distribution of credit based on turnover

The CBEC should clarify the methodology of distribution of credit of service tax paid on certain expenses relating to products yet to be manufactured.

Whether credit of service tax on common expenses is required to be distributed to factories manufacturing intermediate products used only for captive consumption for manufacture of finished goods?

To allow and permit distribution of cenvat credit by the ISD's to dutiable factories instead of strict provision of where there is not sufficient duty liability to utilize the credit.

51. Inclusion of certain services in the mega exemption notification

Canteen services provided in branch offices / factory offices / corporate office having A.C. facility should be included in the Mega Exemption notification since cenvat credit is often denied on the said service and service tax suffered on input services become cost to the company.