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## EY Tax Alert

Tribunal rules that exemption to services provided to SEZ units / developers is a conditional exemption and hence restrictions under Rule 6 of Cenvat Credit Rules would not apply



This alert summarizes the recent unreported decision dated 28 June 2011 of the CESTAT - Bangalore ('Tribunal') in the case of Sobha Developers Ltd Vs CCE, LTU, Bangalore, wherein the Tribunal has held that Notification 4/ 2004-ST dated 31 March 2004 (Notification) (providing exemption to services provided to SEZ units / developer) is a conditional exemption and hence, restrictions under Rule 6 of the Cenvat Credit Rules, 2004 (Credit Rules) would not apply.

## Factual Background

- ▶ Sobha Developers Ltd (Sobha) was engaged primarily in the activities of construction of commercial and industrial buildings, construction of residential buildings etc.
- ▶ The dispute in the present case was in respect of construction services provided to Special Economic Zone units / developers (SEZ), which Sobha has treated as export of services and accordingly, Sobha did not observe any restrictions prescribed under Rule 6 of the Credit Rules.
- ▶ However, the Tax Department contended that since services provided to SEZ enjoyed specific exemption Sobha ought to have observed the restrictions prescribed under Rule 6 of Credit Rules.

## Questions before the Tribunal

- ▶ **Question 1** : Whether the services provided by Sobha to SEZ amounted to export of services and hence should not have been liable to restrictions of Rule 6(1) of the Credit Rules?

- ▶ **Question 2** : Whether the relief provided with effect from 1 March 2011 to service providers when services provided to SEZ (by inserting Rule 6A in the Credit Rules) should be held to applicable retrospectively?
- ▶ **Question 3** : Whether the relevant exemption notification viz. Notification 4 /2004 - ST dated 31 March 2004 applicable to services provided to SEZ is a conditional notification, which does not attract provisions of Rule 6(1) of the Credit Rules?

## Decision of the Tribunal

### Decision on Question 1

- ▶ Based on the relevant provisions of SEZ Act 2005, Credit Rules and Export of Services Rules, 2005 (Export Rules), the Tribunal has observed the following:
  - Rule 6(6) of the Credit Rules granting relief from restrictions of Rule 6 applies only to manufacturer of goods.
  - Under the Export Rules, export for the purpose of service tax is export outside India and it does not include supply to SEZ. There exists an exemption in relation to services provided for various operations in SEZ.
  - Section 51 of the SEZ Act is not applicable in the present case since there is no conflict, as Tax Department has not contended that the tax is required to be paid in relation to services provided to SEZ.

- The benefits under Section 26 of the SEZ Act are intended to be provided by the provisions made under the relevant Act / Rules.

- ▶ Given the above, the Tribunal held that services provided by Sobha to SEZ will not qualify as export and will be considered as exempt services covered by provisions of Rule 6(1) of the Credit Rules.

### Decision on Question 2

- ▶ The Tribunal held that the relief provided with effect from 1 March 2011 to service providers when services are provided to SEZ will not apply retrospectively.

### Decision on Question 3

- ▶ In its submissions, Sobha had contended that exemption contemplated under the Credit Rules is an absolute and unconditional exemption and Rule 6(1) does not cover the exemptions which are subject to condition and tax is recoverable from supplier if the conditions are not fulfilled.
- ▶ In support of the said argument, judgements in the case of Bajaj Tempo Ltd Vs CCE, Pune (1994 (69) ELT 122 (Tri-Mum)) and Sterlite Industries (I) Ltd. Vs CCE, Pune (2005 (183) ELT 353 (Tri - LB)) were relied upon.
- ▶ The Tribunal upholding this argument held that the relevant exemption notification read with Rule 25 of the SEZ Act is a conditional exemption and therefore, above decisions squarely apply in the present case.
- ▶ Hence, the Tribunal held that the demand / restriction under Rule 6 of Credit Rules would not be applicable in the present case.

## Conclusion

- ▶ The services rendered to the SEZ would not amount to exports under Export Rules.
- ▶ Rule 6(6A) inserted with effect from 1 March 2011, granting relief to service providers supplying services to SEZ under an exemption will not have retrospective effect.
- ▶ Due to conditional nature of the exemption notification, restrictions under Rule 6 of Credit Rules would not be applicable.

## Summary of key Legislation

### Credit Rules

- (1) **Exempted Services** : During the relevant period under dispute, exempted services meant the services which were exempted from the whole of service tax leviable thereon and included services on which no service tax was leviable.
- (2) **Rule 6(1)** : The CENVAT credit shall not be allowed for inputs / input services used in or in relation to the manufacture of exempted goods or for provision of exempted services.
- (3) **Rule 6(2)** : Where a manufacturer or provider of output service avails of CENVAT credit in respect of any inputs or input services and manufactures both taxable / exempted goods or provides both taxable / exempted services, the manufacturer or provider of output service shall maintain separate accounts for the receipt, consumption and inventory of inputs used-for manufacture of

exempted / taxable goods or exempted /taxable services rendered. Further, such manufacturer/ service provider shall be entitled to avail credit of inputs / inputs services used for manufacturing taxable goods / providing taxable services.

- (4) **Rule 6(3) and 6(4)** : Notwithstanding anything contained in sub-rules (1) and (2), the manufacturer of goods or the provider of output service, opting not to maintain separate accounts, shall follow any one of the following options available under the said Rule 6(3) and Rule 6(4).
- (5) **Rule 6(6)** : Provisions of Rule 6(1), 6(2), 6(3) and 6(4) would not be applicable in cases where the excisable goods are cleared to a unit / developer of a SEZ for their authorized operations.
- (6) **Rule 6(6A)** : Provisions of Rule 6(1), 6(2), 6(3) and 6(4) would not be applicable in cases where the taxable services are provided to a unit/developer of a SEZ for their authorized operations.

### SEZ Act

- (1) As per **section 26** of the SEZ Act, exemption from service tax is granted to taxable services provided to a developer or SEZ unit to carry on the authorized operations in a SEZ.
- (2) The said section further provides that the Central Government may prescribe the terms and the conditions subject to which the exemption may be granted to the SEZ developer or SEZ unit.

- (3) Further, **Section 51** of SEZ Act provides that the provisions of SEZ Act shall have overriding effect over any other law in force in case of any inconsistency
- (4) **Rule 25** of the SEZ Rules provides that where goods / services on which exemptions have been availed are not used for authorized operations, the developer / entrepreneur claiming such benefits / exemption shall refund an amount equal to the amount of benefit / exemption claimed.

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