

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 11.07.2018

Pronounced on: 25.07.2018

+ **SERTA 7/2018**

LALLY AUTOMOBILES PVT. LTD.

..... Appellant

Through: Sh. J.K. Mittal, Sh. Rajveer Singh, Sh.
Shantanu Singh and Sh. Atul Krishna, Advocates.

versus

COMMISSIONER (ADJUDICATION), CENTRAL EXCISE

..... Respondent

Through: Sh. Sanjeev Narula, CGSC.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE A.K. CHAWLA

MR. JUSTICE S. RAVINDRA BHAT

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1. The following question of law arises in this appeal:

(i) *Whether the Customs, Excise and Service Tax Appellate Tribunal was right in holding that the appellant is not entitled to set-off or benefit of service tax credit on the entire amount paid, but on the proportionate amount as substantial part of business of the appellant was trading and hence exempt?*

(ii) *Whether the Explanation added to Rule 2(e) of the Cenvat Credit Rules, 2004 with effect from 1st April, 2011 is clarificatory in nature or only prospective?*

(iii) *Whether the Customs, Excise and Service Tax Appellate Tribunal has erred in rejecting the plea of the appellant-assessee that the extended period of limitation would not apply and in confirming the demand for tax, interest and penalty?*

2. The assessee is engaged in sales and services of Honda cars as an exclusive authorized dealer. It is registered for payment of Service Tax under the categories of "Authorized Service Station" and "Business Auxiliary Service" under the Finance Act, 1994. It availed Cenvat credit of duty paid on various inputs and tax paid on better services in terms of Cenvat Credit Rules, 2004 (hereafter "the Rules"). Alleging that the assessee had trading activities which was not liable to service tax and that credit availed on input services attributable to trading activities was sought to be denied on proportionate basis. Proceedings were initiated which resulted in the impugned order.

3. The adjudicating authority held as below:

"26. The rules clearly provides that the exempted services includes services on which no service tax is leviable under Section 66 of the Finance Act, 1944. Trading is a service liable to VAT/sales tax by States and outside the purview of Service Tax. Thus, no service tax is leviable to trading under Section 66 of the Finance Act. This position was clearly upheld by CESTAT in Metro-shoes case MANU/CM/0291/2008 : 2008 (10) STR 382 (Tri.-Mumbai) wherein it was held that No Cenvat is eligible for inputs/services used for trading as the trading is an exempted service. The explanation added to the Rule 2(e) vide Notification No. 3/2011- Central Excise (V.T.) makes it more than clear as it states that for removal of doubts, it is hereby clarified that "exempted services" includes trading. This explanation only clarify the existing position as held by Hon'ble CESTAT in Metro shoe case in 2008. Therefore, it cannot be said that it is effective only from 01.04.2011.

27. The assessee contention that no Cenvat Credit is recoverable from them as they have not availed any CENVAT credit on the inputs which were exclusively used in the

exempted services under Rule 6(3) of the CENVAT credit Rules is also not sustainable as Rule 6(3) is applicable for the common inputs which are used for providing for taxable services and exempted services which is the case of the notices since they are providing both taxable services i.e. servicing of the cars and non-taxable services of trading in cars. Explanation (ii) to the rule clarify that if any input or services are used for providing exclusively for exempted service the same cannot be availed as common input service."

4. The adjudicating authority followed the procedure for calculating the value of exempted service (trading) as per the provisions introduced on 01.03.2011 as amended on 31.03.2011. Cenvat credit amounts of ₹24,84,530/- and ₹ 31,74,799/- for the periods covered by two Show Cause Notices were held to be recoverable from the assessee. Penalties were imposed, to equal extent, on the assessee under Rule 15. A further penalty of ₹5000/- each in respect of two demands were also imposed under Section 77 of the Finance Act, 1994.

5. The assessee appealed to the Customs, Excise and Service Tax Appellate Tribunal (hereafter "CESTAT") arguing that trading activity cannot be considered as exempted service prior to the introduction of explanation, in Rule 2 of Rules, w.e.f. 01.04.2011. Since trading cannot be considered as exempted service for the period prior to that date, the assessee did not have to restrict Cenvat credit attributable to that trading activity. It was submitted that there was no provision in the Rules to cover trading activity under Rule 6(3). The assessee argued that the demands were also time barred.

6. The CESTAT, by the impugned order, held as follows:

“5. We have heard both the sides and perused appeal records. The admitted facts are that the appellants availed Cenvat credit on input services and they had considerable turnover and income in trading activities. It is also admitted that the services on which credit have been availed are partly relatable to trading activities also. We note that the appellants contested the reversal of credit, to a proportionate extent, on the ground that trading is not an exempted service prior to the insertion of explanation and as such the provisions of Rule 6(3) will not apply. One main aspect is missed by the appellant in such argument. The case of the appellant is that trading cannot be considered as exempted service. It is clear that trading is not a taxable service also. In other words, trading is an activity which is not covered under the scope of Cenvat Credit Rules, 2004. The appellants should not have availed any credit on input services when such services are attributable to an activity which is not at all taxable and hence not covered by the scope of Cenvat Credit Rules, 2004.

6. A deemed fiction is apparently created by naming 'trading' as an exempted service by way of explanation in Rule 2 of Cenvat Credit Rule w.e.f. 01.04.2011. We find prior to creation of such fiction, there is no scope at all even to consider the trading activity to be covered under the credit scheme. After the explanation, the position is more clear to the effect that the trading activity can be considered as an exempted service for the operation of scheme under Cenvat Credit Rules. In other words, prior to that clarification, in the absence of such explanation, trading is not at all covered by the credit scheme. Accordingly, we find the appellants should not have availed credit for common input services which are used for taxable output service as well as trading activity, as it is imperative to identify and reverse that amount of credit attributable to the trading activity. We find no infirmity in the findings of the original authority on merit or on quantification.

7. Regarding the question of limitation and penalty, we know that the trading is not at all an activity or a service

covered by the Cenvat scheme prior to the introduction of clarificatory explanation. The appellants have no reason to avail credit on services which they are fully aware were being used for trading activity also. It is not open to the appellant to claim that they were under bonafide belief that the provisions of Rule 6(3) will not apply to this situation. As already noted, we find there is no ground for such belief. Trading activity not being covered by the credit scheme itself during the material period, the appellants having availed the credit on such input services cannot contest the demand on limitation. We are in agreement with the findings of the original authority on this issue. In view of the discussion and analysis, we find no justifiable reason to interfere with the findings recorded in the impugned order. Accordingly, the appeal is dismissed.

7. Mr. J.K. Mittal, learned counsel for the assessee argues that the rules were amended w.e.f. 01.04.2011 through introduction of Explanation to Rule 2 (e), which provided that exempted services include trading and consequential amendment was also made in Rule 6, by inserting the Explanation 1 to define the value of the 'Trading' for the purpose of formula given in (3A) of Rule 6. The Rule stated such amendment unless otherwise provided came into force w.e.f. 01.04.2011, thus having no retrospective effect. Reliance was placed on the Supreme Court's decision in the case of *AU India Federation of Tax Practitioners v Union of India* (2007) 7 SCC 527, wherein, it was held that:

" The word "goods" has to be understood in contradistinction to the word "service". Therefore, it is submitted that "trading" is goods at first place and is not service thus it cannot be put in the bracket of exempted services that too by way a Rule. Thirdly, first time a new concept was introduced in Cenvat Credit Rules w.e.f., 01.04.2011, for those assessee involved in trading activity along with taxable service, thus it cannot be given effect retrospectively [Ref: UOI v

Martin Lottery Agencies Ltd., (2009) 12 SCC 209].”

8. Learned Counsel relied on the salient principle that there exists a presumption against retrospective operation particularly when it would prejudicially affect vested rights of the taxpayers; he relied on *Commissioner of Central Excise, Coimbatore v Elgi Equipments Ltd. (2001) 9 SCC 601*]. Mr. Mittal pointed to a CESTAT Bench decision in *Mercedes Benz India Pvt. Ltd. v CCE, Pune-I, 2014 (36) STR 704 (Tri. Mum)* which held that trading was not “service” and, therefore, could not be considered as an exempted service for the period prior to 01.04.2011 and the amended provision did not have retrospective effect.

9. It was pointed out that Rule 6(3)(c), relied upon by the Revenue, was omitted w.e.f. 01.04.2008 (prior to the disputed period) by notification dated 01.03.2008. Counsel submitted that in the absence of a formula reversing input service credit for those assessee involved in trading activity along with taxable service, the entire credit previously availed had to be left intact. He relied on the CESTAT Bench ruling in *CCE, Tirupathi v Shariff Motors, 2010(18) STR 64 (Tri- Bang.)* where entire credit was allowed to the assessee, a dealer of Hero Honda motorcycles and who was also providing service and repair of motorcycles. That decision was approved by the Andhra Pradesh High Court in *Commissioner of Central Excise, Tirupathi v Shariff Motors, 2015(38) STR J53 (A.P.)*. Mr. Mittal contended, therefore, that the assessee was entitled for full input service credit or at the most could be disallowed only ₹26,19,759/- segregating the quantum of input service attributable to trading activity in terms of the Chartered Accountant’s certificate dated 17.07.2012 submitted before the adjudicating authority.

10. The demands were also challenged as beyond the normal period of limitation; it was argued that the demand confirmed by retrospective application of the amendments made by the Notification of 2011 did not justify invocation of extended period. Counsel relied on *Continental Foundation Joint Venture Sholding, Nathpa v Commissioner of Central Excise* (2007) 10 SCC 337, wherein, it was held that:

"The Suppression means failure to disclose full information with the intent to evade payment of duty"

11. The learned counsel also submitted that since the appellant undisputedly disclosed the entire Cenvat Credit availed on input service in the service tax returns for the period in question case, therefore, there was no suppression. The second show-cause notice neither invoked the extended period of limitation and nor it could have been invoked in view of law declared in *Star India Private Ltd v CCE, Mumbai & Goa*, 2006 (1) STR 73 (SC) which held that

"..liability although created retrospectively could not entail the punishment of payment of interest with retrospective effect".

12. Mr. Sanjeev Narula, counsel for the Revenue, relied on *Metro Shoes Pvt. Ltd v. Commissioner of Central Excise* [2008] 14 STT 280 wherein it was held, prior to the amendment of 2011, that where the activity is not subject to service tax levy, such as trading in goods (which is subject to some other levy), composite credit in respect of that activity and the other activity covered by service tax, cannot be granted. It was held, in that decision, that:

“6. The duty confirmed on the service directly and wholly attributable to the goods manufactured by the appellant and the demand pertaining to the credit of the service tax on the overhead expenses for running the retail outlets are eligible for credit. But as regards the service tax credit on amount of service tax taken by the appellant for the services which are directly and wholly attributable to the trading activities would not be eligible as credit, as the definition of the input services indicates that the credit is eligible only in "respect of manufacture" of the final product and clearance of the final product from the place of removal. The question of manufacturing the final product, in the case of trading activity does not arise as it is an admitted fact that the appellant purchased these goods for the trading activities, in their retail showroom. As such, we are of the view that the credit availed on the services which are directly attributable to the trading activity is ineligible to be availed as input service credit. Accordingly, we uphold the impugned order to the extent it denies the credit of the service tax paid on the services amounting to Rs. 13,27,497/-.”

13. The counsel also pointed out that the above decision was upheld by Bombay High Court in *Commissioner v. Metro Shoes Pvt. Ltd.* 2012 (28) S.T.R. J19 (Bom.).

14. It was submitted that in this case, the assessee was engaged in trading activities in common premises. Those activities were not subjected to service tax, as they involved distribution, sale or vending of goods. The question of any such activity being “exempt” on account of the 2011 amendment Rules, does not arise. The amendment only stated the obvious. However, that did not mean that trading was subject to service tax. If any activity was not subjected to that levy, the question of claiming any credit in respect of it could never arise. The Revenue submitted that in this background, the

assessee's claim that the extended period of limitation could not be invoked, is unsustainable.

Analysis and conclusions

15. Rule 6(2) of the Cenvat Credit Rules, is extracted below:

*"Where a manufacturer or provider of output service avails of Cenvat credit in respect of any inputs or input services, [***], and manufactures such final products or provides such output service which are chargeable to duty or tax as well as exempted goods or services, then, the manufacturer or provider of output service shall maintain separate accounts for receipt, consumption and inventory of input and input service meant for use in the manufacture of dutiable final products or in providing output service and the quantity of input meant for use in the manufacture of exempted goods or services and take CENVAT credit only on that quantity of input or input service which is intended for use in the manufacture of dutiable goods or in providing output service on which service tax is payable."*

16. Therefore, the issue is whether the assessee could claim the credit on input which were not services. Input credits can be used for payment of service on output service provided such services are used to provide output services. Undoubtedly, there cannot be an exact correlation between one kind of input and corresponding. That is the reason the Rules cover situations where assessees provide both exempted and taxable services. Wherever someone undertakes activities that cannot be called a service or which is not "manufacture", that activity goes out of the purview of both Central Excise Act as well as Finance Act, 1994. In such cases, an assessee would be ineligible for claiming input-service tax credit on an output which is neither a service nor excisable goods. There is no provision to cover situations where an assessee is providing a taxable service and is undertaking

another activity which is neither a service nor manufacture. In such a situation, the only correct legal position appears to be that it is for the assessee to segregate the quantum of input service attributable to trading activity and exclude the same from the records maintained for availing credit. This cannot be done in advance as it may not be possible to foretell the quantum of trading activity as compared with taxable activity. The obvious solution would be to ensure that once in a quarter or once in a six months, the quantum of input service tax credit attributed to trading activities according to standard accounting principles is deducted and the balance only availed for the purpose of payment of service tax of output service.

17. In the present case, the assessee's argument that there is no mechanism to reverse credit, once taken, in the opinion of this Court, cannot be accepted. The assessee was well aware of the exact nature and extent of its *service tax liability*. It was also aware of the eligible *service tax inputs*. Therefore, when it did claim- successfully and unchallenged input credits in respect of activities that were not subjected to service tax levy, it was aware that the claim was excessive and could not be justified. If, for instance, input credits were claimed in respect of goods or rents, attributable to retail business, those credits were clearly impermissible. In these circumstances, this Court finds no infirmity with the concurrent findings of the lower authority and the CESTAT, which concluded that Show Cause Notice and recoveries were in order.

18. As regards the method of calculation and invocation of extended period of penalty, the assessee's contentions again, to the Court's mind, are groundless. The assessee concededly did not maintain regular separate

accounts in respect of non-service tax leviable activities. Therefore, the adjudicating authority adopted the method of *proportionate* turnover based attribution to the assessee's liability:

“I find that it was clear in 2008 itself that no CENVAT Credit is available for services used for trading as decided by Hon'ble CESTAT in the Metro shoes case. The noticee has availed the CENVAT Credit used for exempted services namely trading without reversing the proportionate credit. They have never informed the department about taking the wrong credit. This would have been undetected if the facts were not noticed during audit. M/s Lally Automobiles Private Ltd. have failed to inform the department that they are not maintaining the separate records for input services used for taxable and exempted services. It is already noted that the law requires an assessee to maintain separate records of Cenvat Credit received on taxable or non-taxable services. In case the separate records are not maintained, the CENVAT credit is to be reversed as per Rule 6(3) of the CENVAT Credit Rules, 2004;. I find that :M/s Lally Automobiles Private Ltd. have not reversed the same by suppression of material facts. The excess credit availed utilized by them is liable to be recovered in terms of Rule 14 of CENVAT Credit Rule, 2004 read with proviso to Section 73(1) of Finance Act, 1994.”

19. This Court is of opinion that the lack of any method in the rules in such cases, would only mean that a reasonable and logical principle should be applied, not concededly that what should and could not be claimed as input credit, (but was in fact so claimed) ought to be “left alone” because of the *composite nature of the assessee's business*. While any assessee has a right to organize its business in the most convenient and efficient manner, it cannot claim that that such organization is so structured that its tax liabilities cannot be clearly discerned. In this case, the adjudicating authority adopted

the proportionate percentage to the turnover method approach, which in this Court's opinion, is reasonable.

20. This Court is also of the opinion that the invocation of the extended period of limitation was warranted in the circumstances of the case. Being conscious of its trading activity and that it was not liable to service tax (since it did not include the *amounts earned from that business, in its returns*) meant that the assessee was aware of what it was doing. It cannot now take shelter under the plea that non-trading activity was expressly exempt from claiming credit, in 2011. That amendment made no difference, given that trading was never taxable under the Finance Act, 1994. In these circumstances, the Revenue was justified in invoking the extended period of limitation in this case.

21. In the light of the above findings, all the questions framed are answered in favour of the Revenue and against the assessee. The appeal is, therefore, dismissed.

न्यायमेव जयते

S. RAVINDRA BHAT
(JUDGE)

A.K. CHAWLA
(JUDGE)

JULY 25, 2018