IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
SOUTH ZONAL BENCH, CHENNAI

Appeal No. ST/184/2012

(Arising out of Order-in-Original No. LTUC/407/2011-C dated 23.12.2011 passed by the Commissioner of Central Excise, LTU, Chennai)

M/s. Sify Technologies Limited — Appellant

Vs.

Commissioner of GST and Central Excise
Chennai South — Respondent

Appearance

Shri Raghavan Ramabhadran, Advocate for the Appellant
Shri K. Veerabhadra Reddy, JC (AR) for the Respondent

CORAM

Hon'ble Ms. Sulekha Beevi C.S., Member (Judicial)
Hon'ble Shri V.Padmanabhan, Member (Technical)

Date of Hearing : **09.08.2018**
Date of Pronouncement: **30.10.2018**

Final Order No. **42732 / 2018**

Per Ms. Sulekha C.S.

Brief facts are that the appellants are registered for providing various taxable services under the category of on-line information and database access / retrieval, internet café, franchise services, etc. They are having centralized service tax registration and are a member of Large Taxpayer Unit. They are also rendering exempted services such as software development, e-learning for corporates and companies etc. during the period prior to 16.5.2008, after which date these services became taxable. As per orders of the Hon'ble High Court of Madras, Sify Communications Ltd., (Sifycom) an associate enterprise of appellant got merged with the appellant with effect from 1.4.2008. Prior to merger, Sifycom were filing separate ST-3 returns upto March 2009. Consequent to merger, appellant filed ST-3 returns for the half-year ending September 2009 onwards including the transactions relating to Sifycom also. During the course of audit, it was noticed that appellants were providing erection, commissioning and installation to their customers in the form of establishing enterprise networking.

1.1 During the course of providing this service, they were also selling bought out goods like routers, interface cards, power adapters, cables etc. These goods are either imported on payment of duty or indigenously procured by appellants from wholesale sellers / dealers. No input credit was availed on such goods and these are mentioned as traded goods in the balance sheet. The materials sold are billed separately to the end-customer and thus were engaged in trading activity also. In respect of taxable output service rendered, service bill is raised separately and service tax is paid only on the service charges billed / realized. They were also availing input tax credit on various services like advertising, air travel agents, business auxiliary service, Chartered Accountants etc. which were common input services used for both taxable services as well as trading activity. The department was of the view that the appellants are not eligible for credit on the common input services used by appellant for trading activity as per Rule 3 of CENVAT Credit Rules, 2004. On intimation, the appellant filed intimation dated 14.10.2010 to exercise option with effect from 14..2008 for reversal of proportionate credit under Rule 6(2)(ii) of CENVAT Credit Rules, 2004 and reversed an amount of Rs.44,68,272/-relating to the CENVAT credit availed on trading activities in respect of appellant and Sifycom. It appeared that appellant had considered 'trading activity' as an exempted service and had calculated and reversed the proportionate credit of common input services alone, attributable to trading as per Rule 6(3)(ii) of CCR, 2004. However, since the activity of trading was not an exempted service, the credit attributable to trading activities is liable to be reversed as a percentage of income on trading vis-à-vis total income multiplied by the total input service tax credit availed during the period. The show cause notice thus demanded recovery of CENVAT credit of Rs.13,00,75,361/- for the period from October 2005 to March 2010 (including credit pertaining to the trading activity undertaken by Sifycom during 2008 – 09 and 2009 -10) and for the period prior to merger i.e. 2006 – 07 and 2007 – 08 to be Rs.89,39,470/-. Thus the total demand of Rs.13,90,14,831/-. The amount already reversed by the appellant was proposed to be appropriated.

The show cause notice also proposed to demand interest and impose penalties. After due process of law, the adjudicating authority confirmed the amount of Rs.13,90,14,831/- along with interest, ordered appropriation of the already reversed amount and imposed equal penalty under Rule 15(4) of CENVAT Credit Rules, 2004. Aggrieved, the appellant is now before this Tribunal.

2. On behalf of the appellant, ld. counsel Shri Raghavan Ramabhadran appeared and argued the matter. He submitted that with effect from1.4.2011, an explanation was introduced to the definition of exempted services under Rule 2(e) wherein it was clarified that trading is an exempted service. The period involved in the present case is from October 2005 to March 2010. He submitted that in the show cause notice, the department has invoked Rule 3 of CENVAT Credit Rules, 2004 for the purpose of denying the credit availed on trading activity. The appellant had reversed the credit attributable to trading as per Rule 6(3)(ii) of CCR, 2004. In para 10 of the show cause notice, the department specifically states that trading is not an exempted service and therefore such reversal is not correct. The Hon'ble High Court of Madras in the case of Ruchika Global Interlinks Vs. Commissioner of Central Excise – 2017-VIL-323-MAD-ST has held that prior to 1.4.2011 also trading is to be considered exempted service and that Rule 6 is applicable to demand the proportionate credit availed on trading. In the present case, the department has not invoked

Rule 6 for disallowing the credit. Instead, they have invoked Rule 3 of CENVAT Credit Rules, 2004 and alleged that the credit availed on trading is wrong and ineligible. The recovery in the show cause notice is proposed under Rule 14 of CENVAT Credit Rules, 2004. When Rule 3 has been invoked to deny the credit, the department cannot invoke Rule 14 for recovery of proportionate credit as applicable under Rule 6. The show cause notice having not invoked Rule 6 to deny the credit, the recovery of credit attributable to trading cannot sustain. Show cause notice is the foundation of the proceedings and when the department has not invoked Rule 6 in the show cause notice, the entire proceeding fail in the light of the decision of the Hon'ble High Court of Madras in Ruchika Global Interlinks (supra). He also places reliance on the judgment of the Hon'ble Supreme Court in the case of Commissioner of Central Excise Vs. Brindavan Beverages P. Ltd. – 2007 (213) ELT 487 (SC) to argue that show cause notice is the foundation of the proceedings.

2.1 The ld. counsel has placed reliance upon the decision of the Tribunal in the case of L.G. Electronics India Pvt. Ltd. Vs. Commissioner of Central Excise – 2017 (3) GSTL 249 (Tri. All.) and submitted that on identical facts, the Tribunal has held that Rule 14 cannot be applied for recovery of credit attributable to trading alone without invoking Rule 6 when the allegation is that credit availed is not eligible under Rule 3 of CCR, 2004. It is also fairly submitted by the ld. counsel that the said decision has been appealed by the department before the Hon'ble High Court of Allahabad and that though admitted, there is no stay granted by the High Court. He thus argued that the impugned order confirming the demand of credit attributable to trading is beyond the scope of the show cause notice as the show cause notice in para 10 specifically holds that Rule 6 cannot be applied to the facts of the case. He prayed that the appeal may be allowed.

2.2 The ld. counsel also argued on the ground of limitation. He argued that the issue is one of interpretational in nature. There were decisions holding that trading is an exempted service prior to 1.4.2011 and the same has been put to rest by the Hon'ble High Court of Madras in Ruchika Global Interlinks (supra). In such scenario, the extended period is not invocable. Further, the proceedings for the disputed period was initiated after scrutinizing the returns filed and therefore the department had definite knowledge of the fact that the appellant is engaged in providing exempt service in the nature of trading. That as per the decision in Nizam Sugar Factory Vs. Commissioner of Central Excise – 2006 (197) ELT 465 (SC), thus the extended period cannot be invoked.

2.3 With regard to penalty, he submitted that since the recovery of CENVAT credit is under Rule 14 cannot sustain, the imposition of penalty under Rule 15(4) merits to be set aside. In addition, being an interpretational issue, penalty cannot be imposed.

2.4 Without prejudice, the ld. counsel submitted that the appellant, in any case is only liable to reverse the proportionate credit to trading activity as per Rule 6 and the same would be only Rs.64,08,446/- and the appellant has already reversed Rs.44,68,272/-.

3. On behalf of Revenue, the ld. AR Shri K. Veerabhadra Reddy supported the findings in the impugned order. He submitted that the appellants were very well aware that trading is not an exempted service. It is neither a service nor a manufacturing activity. Credit availed on trading activity is ineligible under Rule 3 of CENVAT Credit Rules, 2004. The said rule lays down the conditions to avail credit. Since the activity of trading does not find mention in the said rule, the show cause notice has correctly invoked the said rule to deny the credit. The total credit attributable to trading in respect of appellant for October 2005 to March 2010 was quantified as Rs.13,00,75,361/-, (which includes the credit pertaining to trading activity on Sifycom during the period 2008 – 09 and 2009 – 10) and credit attributable to trading in respect of Sifycom prior to its merger with appellant i.e. for the period 2006 – 07 and 2007 – 08 at Rs.89,39,470/-. Thus the total reversal credit amounted to be Rs.13,90,14,831/- to both appellant and Sifycom. In the present show cause notice, the allegation is not that appellant has to reverse the proportionate credit under Rule 6 of CENVAT Credit Rules, 2004. The allegation is wrong availment of credit which is not eligible as

per Rule 3(1) r/w Rule 2(l) of CENVAT Credit Rules, 2004. The argument of the appellant all along has been trading activity being an exempted service, they are liable to reverse only proportionate credit under Rule 6 of CENVAT Credit Rules, 2004. Instead the formula adopted for quantifying the demand is the proportion of value of sale of goods to the total income from sale of all goods and services applied to the total credit availed. The case of L.G. Electronics India Pvt. Ltd. (supra) cannot be applied to the facts of the case since in the said case the demand was set aside for the reason that the show cause notice did not make any allegation as to the ineligibility of CENVAT credit. That in the present show cause notice, it is clearly spelt out that the credit is not eligible under Rule 3(1) and therefore the said case law is distinguishable on facts.

4. Heard both sides.

5. The main contention put forward by the ld. counsel for the appellant is that the show cause notice itself cannot sustain for the reason that it invokes Rule 3 of CENVAT Credit Rules, 2004 to disallow the credit whereas the demand is made under Rule 14 of the said Rules disallowing credit attributable to trading as envisaged under Rule 6. Rule 14 speaks about recovery of CENVAT credit which is wrongly availed and utilized. Rule 14 as it stood during the relevant period is reproduced as under:-

> *"Where the CENVAT credit has been taken or utilized wrongly or has been erroneously refunded, the same along with interest shall be recovered from the manufacturer or*

> *the provider of the output service and the provisions of sections 11A and 11AB of the Excise Act or sections 73 and 75 of the Finance Act, shall apply mutatis mutandis for effecting such recoveries."*

5.1 Rule 14 provides for recovery of wrongly availed credit. It does not mention about Rule 3 or Rule 6. An *E*xplanation was added to Rule 2(e) with effect from 1.4.2011 making trading activity as an exempted service. Corresponding amendments were introduced in Rule 6(3A) as to how to calculate the amount that has to be reversed when trading is an exempted service. In Ruchika Global (supra) the Hon'ble jurisdictional High Court held that trading has to be considered as exempted service even prior to 1.4.2011 and only proportionate credit attributable to trading is to be reversed as per Rule 6 of CENVAT Credit Rules, 2004. Undisputedly, the appellants were availing common input services for both taxable service and trading activities and did not maintain separate accounts. In the reply to the intimation given prior to issuance of show cause notice, they have stated that they reversed an amount of Rs.44,68,272/- and informed the department that they have reversed the proportionate credit pertaining to common input services used for trading as under Rule 6(3)(ii) treating trading activity as an exempted service. In para 10 of the show cause notice, the department has stated that trading activity cannot be considered as exempt service and therefore Rule 6 of CCR, 2004 is not applicable and the reversal cannot be accepted. In para 8 of the show cause notice, the allegation is that the credit availed on trading is not eligible as per Rule 3(1) r/w Rule 2(l). There were earlier proceedings initiated against the appellants proposing to disallow credit availed by them. In such proceedings, it was noted that appellants were maintaining separate accounts for taxable and exempted services by dividing their entire organization into Strategic Business Units (SBUs). In the reply to the present show cause notice dated 6.1.2011, the appellant has explained and conceded the same. It is seen from the reply to the show cause notice that appellant splits its book of accounts into different SBUs which are named after the type of services / activities handled. Thus, these are SBUs such as Access Media, Web Hosting Services, forum Services, Online Services, Software Development and e-learning etc. It is also stated that the SBUs such as Finance, Human Resource, Administration and Corporate did not render any service and were used for accounting and support service only which were common to all SBUs. In para 4.19 of the reply the appellant has stated as under:-

> *"When the input service relates to an output services that is exempt or relating to trading activity, n o credit is taken and the entire amount including service tax thereon is debited to expenditure. Accordingly, no CENVAT credit on service tax paid on input service is taken for those input services which are used in SBUs which provide exempted service or involved in trading activity. The input services that are common are accounted under the SBUs of Finance, Human Resource, Administration or Corporate and the credit accounted under common input services. The finance department consolidates all the transactions and*

> *prepared periodical financial statements and reports required for meeting various statutory compliances."*

5.2 The earlier proceedings were initiated alleging that they have not maintained separate books of account for taxable and exempted services as required under Rule 6(2) and thus have utilized credit in excess of 20% as provided in Rule 6(3) of CCR, 2004. The Tribunal vide Final Order No. 42328/2018 dated 31.8.2018 has upheld the demand on this score by holding the issue against the appellants.

5.3 In the present show cause notice, the credit availed on trading is sought to be disallowed. The main contention put forward by appellant is that the department having not invoked Rule 6 of CCR,2004, cannot disallow the proportionate credit availed on trading. For this, the appellant draws support from the decision of the Tribunal in the case of L.G. Electronics (supra). It is correct that show cause notice does not invoke Rule 6 of CCR, 2004. But it is to be noted that the provision for availing credit is envisaged in Rule 3 of CCR, 2004. The show cause notice proposes to deny the credit availed on trading as per Rule 3 of CCR, 2004. Rule 3 does not allow credit to be allowed on trading activity. We have no quarrel that the Hon'ble jurisdictional High Court in the case of Ruchika Global Ltd. (supra) has held that for recovery of proportionate credit availed on trading, the trading activity has to be considered as an exempted service prior to 1.4.2011 also. But the said decision was in a case where Rule 6 was invoked for disallowing the credit availed on common input services used for trading also when separate accounts were not maintained. Here the appellant contends to have maintained separate accounts. But such separate accounts is not as provided by Rule 6 is the finding of Tribunal in the appellant's own case as per Final Order cited supra. It is seen that the separate accounts were maintained by appellant for serving its business purposes and not according to provisions of Rule 6(1), (2) or (3) of CCR, 2004. The Tribunal in the case of M/s. Enmas Andritz Pvt. Ltd. vide Final Order No. 42328/2018 dated 31.8.2018 had occasion to consider an analogous issue. The relevant portion is reproduced as under:-

> *"6.1 Ld. counsel has been at pains to convince us that these issues pertains to period prior to 1.4.2011 from which date trading was made a deemed exempted service. That nonetheless, even for the period of dispute the trading activity is required to be considered as an exempted service. To support this, he has relied upon the judgment of the Hon'ble High Court of Madras in Ruchika Global Interlinks (supra) to contend that the trading activity can be categorized as exempted service even prior to 1.4.2011. From the perusal of the said judgment, we however find that the Hon'ble High Court had only addressed the issue of apportionment as provided under Rule 6(3)(c) of the CENVAT Credit Rules, 2004. The Hon'ble High Court had therefore found that before and after the amendment of Rule 2(e) of the Rules, 'exempted services' meant those 'taxable services which were exempt from the whole of service tax and included those service on which service tax was not leviable under section 66 of the Act'. Based on this conclusion, the Hon'ble High Court held as under:-*
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> *"11. Having regard to the rule position and given the admitted fact that no separate accounts were maintained by the appellant, with regard to the taxable and non-taxable services, clause (c) of sub-rule 3 of Rules 6 of 2004 Rules would apply".*

> *6.2 It is therefore obvious that the Hon'ble High Court was only addressing the aspect of whether by invoking Rule 6(3) trading would be exempted services even prior to 1.4.2011. However, in the instant case, what is alleged in the show cause notice is that as per Rule 2(l) of the CENVAT Credit Rules, 2004, input service means 'any service used for providing output service'. As trading activity undertaken by the appellant is not taxable service, hence the appellant is not eligible to avail credit on the alleged / impugned input service. This being so, the appellants have clearly fallen foul of Rule 3 of the CENVAT Credit Rules, 2004 since that is the particular provision which lays down the types of duties or taxes or cesses suffered on input, input services etc. which alone can be availed as CENVAT credit. From the facts brought out in the show cause notice, it is evident that the impugned input services listed out in para 3.0 and 4.0 have all been availed in spite of the appellant having been involved in trading activity. Thus, there cannot be any credit that could be availed by the appellant ab initio and hence there is no need to examine the applicability of Rule 6 of the CENVAT Credit Rules, 2004 to their case. In any case, trading activity has been made deemed exempted service only with effect from 1.4.2011 and therefore we are not able to appreciate the argument of the ld. counsel that as per the decision of Hon'ble High Court in Ruchika Global (supra) trading is held to be exempted service even prior to 1.4.2011 and therefore credit availed on trading is admissible. In Ruchika Global, Rule 6 of CENVAT Credit Rules, 2004 was invoked to demand the proportionate credit availed on trading. In the present case, only Rule 3 and Rule 6 has not been invoked. When credit is not admissible under Rule 3, the appellant cannot content that Rule 6 ought to have invoked and that trading is held by the Hon'ble High Court to be exempted service prior to 1.4.2011. The appellant cannot blow both hot and cold."*

We, therefore, hold that the decision in the case of Ruchika Global Ltd. (supra) will be of no assistance to the appellant.

5.4 As already stated, the show cause notice invokes Rule 3 to disallow the credit for the reason that no credit can be availed on trading as per this provision. Undisputedly, the appellants have availed credit on trading activities. Therefore, the demand raised disallowing the credit on trading in our view is legal and proper. The decision in the case of L.G. Electronics Ltd. (supra) is distinguishable on facts. In the present case, the appellants have split their books of accounts into different Business Units so as to demarcate the taxable/ exempted service to be availed by a specific unit. These type of separation of accounts is not envisaged in Rule 6 of CCR, 2004. The earlier proceedings have held the issue against appellant. So the decision does not assist the appellants.

6. From the discussions made above, we are of the considered opinion that the impugned order calls for no interference. The appeal is dismissed.

(Pronounced in open court on 30.10.2018)

(**V. Padmanabhan**)
Member (Technical)

(**Sulekha Beevi C.S.**)
Member (Judicial)

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