

Bundled Service- ST - Practical aspects

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Introduction:

W.e.f. 01-07-2012, with the introduction of negative list based service tax law, majority of the tax payers felt that the requirement of classification of a service was not required under the new law and ambiguity in the classification of the service would come to an end. This was not to be. Govt. went back on its promise and classification is necessary even today and reason provided for such requirement was for administrative/ statistical purpose.

Further while analyzing and applying the various other provision of the new service tax law, the tax payers understand the importance of classification of service even under the new service tax law. Also the CBEC vide circular ([No. 165/16/2012 –ST dated 20th November 2012](#)) has re-introduced the entire list of old services for the purpose of compliance as to computation of tax liability, payment of tax, filing of returns. The classification merits importance in the following situations.

- a. To ascertain whether the activity carried under negative list / mega exemption notification?
- b. To ascertain the availability of abatement provided under notification issued?
- c. To ascertain the valuation of Taxable service to be followed for a particular service?
- d. To ascertain the applicability of Joint and Reverse Charge?
- e. In making payment of Service Tax as tax payer requires to pay the tax after interpreting their service in one of the heads provided under the challan.
- f. In filing of returns where the tax payer requires to select the Service Tax category.

Analysis of statutory provisions on interpretation of nature of service:

[Section 66F](#) of the [Finance Act, 1994](#) dealt with Principles of interpretation of specified descriptions of services or bundled services for the following three different scenarios.

- a. ***Principles of Interpretation for the services of the main services provider and services used for such main contract:***

[Section 66F\(1\)](#) reads as follows.

Unless otherwise specified, reference to a service (herein referred to as main service) shall not include reference to a service which is used for providing main service.” “(1)

As per the above provision, classification / interpretation of the nature of the **Main Contract** cannot be used for the services used for the execution of such main contract. Which means if any exemption

is given to any service of particular description, the same should not be considered to include the services received for providing such services.

To illustrate the 'Provision of access to any road or bridge on payment of toll' is a specified entry in the negative list and service tax not applicable on such transaction. Any service received as Input Service (viz, security in toll, supply of manpower for collecting the amount in toll) by authority collecting the toll, would be in the nature of service used for providing main service and will not be entitled to the benefit of the negative list entry. Similarly the activity carried out by the sub-broker to the main broker is exempted from payment of Service Tax under entry no. 29 of the mega exemption notification. However, exemption is not available to the input services used by the sub-broker such as Telephone, Renting of Immovable property, consultant for providing the main service.

The main reason behind introducing this provision may be to tax the services which are used for providing the services which covered under negative list / exemption notification and thereby there would be break in the CENVAT chain and such CENVAT would be a cost to the service provider who are providing the main service. Further, if the element of CENVAT Credit is more in execution of contract, the main contractor would examine whether to avail the exemption or not, thereby it would increase the revenue to the government. However, to avoid extra burden of Taxes to the main contractor, the mega exemption notification vide entry 29 exempts few of the sub contractor for service provided to the main contractor.

b. ***Principle of Interpretation in case of Service based on specific description Vs general description:***

[Section 66F\(2\)](#) reads as follows.

“(2) Where a service is capable of differential treatment for any purpose based on its description, the most specific description shall be preferred over a more general description.”

The above provision provides that the most specific description shall be preferred to a more general description. This rules of interpretation has been followed even under old service tax law where the most specific description to be selected over general description. Further, the education guide issued by the CBEC has provided few illustrations on this.

c. ***Principle of Interpretation in case of Bundled Services:***

Bundled Services:

The phrase 'bundle of services' has been defined vide explanation to [section 66F](#) of the Finance Act, 1994. Further [section 66F \(3\)](#) provides the principles for determining the method of tax liability. The definition provided reads as follows.

“For the purposes of sub-section (3), the expression “bundled service” means a bundle of provision of various services wherein an element of provision of one service is combined with an element or elements of provision of any other service or services.”

From the analysis of the above definition it can be understood that to constitute as a Bundled Services,

- There should be provision of various services
- Such provision of various services should be provided combined with an element of one service with other.
- Bundle of such provision of various services is a Bundle service.
- This combination may be of natural i.e. by regular trade practice or unique.

Further, if the service provider clubs various service to provide a single service to the receiver and if such single service finds place in the statute book as a separate entry vide negative list or exemptions or declared services, then the service would be classifiable under that specific entry instead of applying the provisions of bundle of services. Example a software development service which includes implementation and training. Only if the single service is not finding a specific entry in statute, then the concept of bundle of services would be applicable and taxability to be determined as explained below. Example Child care services which includes pick up and drop, food in the afternoon etc.

Taxability when services are naturally bundled in the ordinary course of business:

[Section 66F\(3\)](#) reads as follows:

“(3) Subject to the provisions of sub-section (2), the taxability of a bundled service shall be determined in the following manner, namely : -

(a) if various elements of such service are naturally bundled in the ordinary course of business, it shall be treated as provision of the single service which gives such bundle its essential character;

From the analysis of the above provisions, it is clear that if the various elements of service are naturally bundled in the ordinary course of business, then the same should be taken as a provision of the single service which gives essential character. Hence, the tax payer requires to apply the principles provided in [section 66F\(2\)](#) to determine the essential character of the Bundled Services. Further, the service tax which is applicable to the essential character to be applied and service tax liability to be computed. Few of the examples for naturally bundled service as per the observation of the paper writer are as follows.

| Naturally Bundled Service | Essential Character of the Service |
|--|---|
| Services provided by school i.e. Education along with other services such as Canteen, Residential facility, Cab, Health checkup etc | Education service |
| Services provided by Amusement parks i.e. entry to a entertaining event, stay facility, recreational facility, healthcare, food and other facility | Entry to an Entertaining event |
| Services provided by Telephone operator i.e. Telephone service along with other value added service such as Hello Tunes, SMS, Data usage, missed call alert | Telephone Service |
| Services provided by Hospitals i.e. Healthcare service, Accommodation service, laundry service, serving of food | Health care service |
| Services provided by public transport agency i.e. transport of public facility, serving of food in Bus, Insurance to the passengers, entertainment facility in Bus etc | Transport Service |

Taxability when services are not naturally bundled in the ordinary course of business:

[Section 66F\(3\)\(b\)](#) reads as follows.

if various elements of such service are not naturally bundled in the ordinary course of business, it shall be treated as provision of the single service which results in highest liability of service tax.” “(b)

When the bundled services provided are not naturally bundled in the ordinary course of business, the entire service shall take the color of the service which results in highest tax liability. E.g. a house is given on rent by the landlord in the first floor and in the next floor the rented out the floor to the same tenant for commercial activity. In such a cases, as these are not naturally bundled in the ordinary course of business, the tax rate which is applicable to the renting of commercial place applicable to the entire value of the transaction including renting of the residential complex.

The service provider who is providing a Bundled service which not exists in natural practice and consists of both exempted services and taxable may examine the entering the same in two different contracts to avoid the applicability of this provisions and payment of additional taxes. Accordingly, he requires to pay the service tax at the rate which is applicable for the essential character of the bundled service. Few of the examples for not naturally bundled service as per the observation of the paper writer are as follows.

| Nature of Bundled Service which are not naturally bundled | Service which attract highest tax rate |
|---|---|
| Bundle service of sale of space in magazine and also preparation of contents i.e. write up for advertising | Preparation of Advertising material |
| Bundle service of Education say 1 st Std in the first half and child care service in the second half | Child care service |
| Bundle service provided by an Advocate consisting of Legal service along with Manpower supply service | Man power supply service |
| Bundled service of renting of residential complex along with commercial complex | Renting of commercial complex |

Factors to be considered for determining if the services are not bundled in the ordinary course of business or not

This assumes significance because as presently there is no clarity from the government on how to determine whether the services are bundled in the ordinary course of business or not. Hence, as per the view of the paper writer, the following are some of the indicators to prove that the services are naturally bundled.

- a. The perception of the consumer of the service receiver as a whole.
- b. Module adopted by the majority of the players in the Industry.
- c. There is a single price or the customer pays the same amount, no matter how much of the package they actually receiver or use.
- d. The different elements are integral to one overall supply – if one or more is removed, the nature of the supply would be affected.
- e. Definition provided under the old service tax law.
- f. Advertisement provided in TV's, print media etc.

However, in a large country like India, there would be existence of different trade practices which

would vary from State to State, religion to religion. Hence, there may be possibility of different views on the Bundling of service in the ordinary course of business. Considering these factors, it is always ideal for the tax payer to intimate the department at the initial state of the transaction on the understanding to avoid allegation of suppression of facts from the department. Also, the tax payer can examine the collection of various documents to prove the same to the department if asked at the later stage.

Further, if the tax payer felt that the essential character of his activity (which consists of both exempted as well as taxable) as an exempted service. Further, such bundling is done naturally in the ordinary course of business. In such a situation, he would adopt the tax rate which is applicable to exempted service i.e. nil and not pay any service tax. However, if the department felt that such bundling is not done in the ordinary course of his business, then they would demand the service tax on the entire bundle of services at the rate which is applicable to the taxable portion of the Bundled service. To illustrate,

| Particulars | Tax payer view – Bundling in natural course and in ordinary course of business | Department view – Bundling is not done in ordinary course of business |
|--|--|---|
| Total value of the Bundled service | Rs.100 Lakh | Rs.100 Lakh |
| Portion of the Exempted service | Rs.90 Lakh | Rs.90 Lakh |
| Portion the Taxable service | Rs. 10 Lakh | Rs. 10 Lakh |
| Essential character of service | Exempted service | Exempted service |
| Whether Bundled naturally in the ordinary course of his business | Yes | No |

| | | |
|---------------|-----|--|
| Tax liability | Nil | Rs.12 Lakh + (Interest + Penalty if found by dept at the later stage) |
|---------------|-----|--|

From the above we can see that, in case of disputes on the validity of whether bundling is done in the ordinary course of his business; the tax payer has a high risk of paying unnecessary taxes from the customer. To avoid this, at the initial time of the transaction itself, tax payer requires to collect the documentation to prove that bundling is done in the natural course of his business and same can be intimated to the department.

Practical Issues:

- a. The new provisions of service tax not provided the definitions / instructions for classifying the service and as per the paper writer way it seems that as provided by departmental circular, the tax payer requires classifying / interpreting their activity as per the definition provided under the old provisions which are not deleted but ceased to effect. The question arises on the validity of definition provided under the old law and whether court would agree the same or would adopt the definition exists in the general parlance. Till date, there is no clarifications issued by the CBEC on this aspect and education guide issued by the CBEC contains few examples.
- b. For few services say works contract, support services etc, definitions provided under the new service tax law leading to confusion in the minds of the tax payer whether to classify / interpret the services as per definition provided under old service tax law or new service tax law. To illustrate: the work of interior work along with transfer of property in goods would be covered under Works Contract under the new service tax law. However, under the old service tax law, the same may be covered under Interior decoration service.
- c. Lack of clarity on how to determine whether the service is naturally bundled or not.
- d. Different business modules exist in all over the country and manner to determine whether the services are naturally bundled or not.
- e. Lack of clarify whether the activity is a bundled various service in case of services provided in separate agreements to the same customer.
- f. Lack of clarity whether the activity is a bundled service in case of various services provided in a single agreement having different line item and having different price for each work.

- g. No definition for the '*Ordinary course of business*'. This may be different from region to region, religion to religion, big player to small player, business to business, past to future.

Practical Solution

- a. The clarity on whether the activities are co-terminus or not maybe ensured in the contracts.
- b. Where there is a doubt whether bundled or not, a disclosure of the same with the reason for such decision may be communicated and confirmation sought.
- c. The service provider can insert a clause in the agreement with the customer for payment of taxes (if possible along with interest also) if the department not accepted the view of the assessee on whether bundling is done in ordinary course of his business or not.
- d. Collection of documents to prove that the bundling is done in ordinary course of business. In future, the perception may differ.
- e. Take in writing from customer on his perception of the bundling whether in ordinary course of business or not.
- f. Bifurcation of such contracts may also be a wise decision to avoid dispute.

Paper writer has attempted to examine a possible area of dispute on a new concept. For queries please host on pdicai.org.