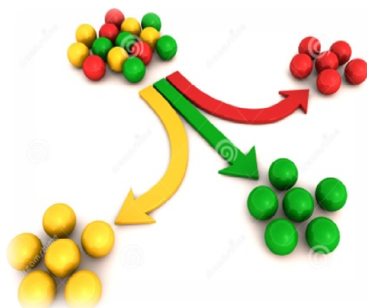

PRINCIPLES OF CLASSIFICATION - SERVICE TAX

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Service Tax was introduced for the first time in the year 1994 through insertion of Chapter V of Finance Act, 1994. There is no Service tax Act as such. The services were earlier classified as per section 65A of the Act. Section 65A provided for principles for classification of service specified in erstwhile section 65. However, in the Finance Act, 2012, radical changes have been made and now service tax law has done away with the service specific description of services.

Under the system of Indirect Taxation, classification plays a very important role. The importance of classification is, however, somewhat diluted if the rate of taxation is uniform for all the categories. Though the service tax rate is constant for all categories of services i.e., 14%, still the accurate classification of taxable services has its own importance and the uniform rate should not be taken to suggest that there is no need for classification. Thus, the classification provision was introduced by the Finance Act, 2003 by inserting section 65A. However, Classification provisions which was contained in section 65A is no longer applicable from 1st of July, 2012, by virtue of notification 21/2012-ST, dated 5th June, 2012. The law makers at the same time felt the need to introduce a new section providing for the principles/ rules to interpret specified description of services or bundled services. Hence, Finance Act, 2012 introduced Section 66F.

LAW PRIOR TO 1ST JULY, 2012

Before understanding the new provisions it is always better to get a hand of the old law. Section 65A was inserted in the Finance Act, 2003, which provided for classification of taxable services. The classification of taxable services was determined according to the terms of the definition of erstwhile 'taxable service' prescribed in the various sub clauses of section 65(105). This was given under sub section (1) of section 65A. However, when for any reason a taxable service was *prima facie* classifiable under two or more sub-clauses of section 65(105), the following rules of classification were required to be applied:

- The sub-clause which provides the most specific description was preferred to sub-clauses providing a more general description. [clause (a)]
- Composite services consisting of a combination of different services which was not able to be classified in the manner specified above was classified as if they consisted

of a service which gives them their essential character, insofar as this criterion was applicable. [clause (b)]

- When a service was not able to be classified in either of the manner specified in clause (a) or clause (b), it was required to be classified under the sub-clause which occurs first among the sub-clauses which equally merit consideration. [clause (c)]

PRINCIPLES OF INTERPRETATION OF SPECIFIED DESCRIPTIONS OF SERVICES OR BUNDLED SERVICES

After the notified date i.e., 1st July, 2012 all the services have become taxable except those specified in the Negative List. Although the negative list based taxation obviated the need for descriptions of services and classification of services, such descriptions has continued to exist in the following areas-

- In the Negative list of services.
- In the Declared list of services.
- In exemption notification 25/2012.
- In the Place of Provision Rules, 2012.
- In few other rules and notifications (e.g., CENVAT Credit Rules, 2004)

Despite doing away with the service-specific descriptions, there will be some descriptions where some differential treatment will be available to a service or a class of services. Hence, Section 66F has laid down the principles of interpreting the same.

(1) Reference to a service shall not include reference to a service which is used for providing main service

(2) Differential treatment for any purpose based on description - Category which gives the most specific description will prevail over general description

(3) (a) Bundled service – ***naturally bundled in ordinary course of business*** then treated as single service which gives such bundle its essential character

(3) (b) Bundled service – not naturally bundled in ordinary course of business then treated as *single service which results in highest liability of tax*

SCOPE OF SUB SECTION (1) TO SECTION 66F:

The sub section (1) of section 66F provides that any input service required to provide main service will not be covered in main service. This means input service will be considered as a separate service. This position was also prevalent prior to 1st July, 2012. The sub section reads as follows:

"Unless otherwise specified, reference to a service (hereinreferred to as main service) shall not include reference to a service which is used for providing main service."

The sub section (1) of the section 66F deals with interpretation of specified description of services. This is emphasizing that the classification of the main contract cannot be used for the sub-contract or any other service provided for rendering the main service. This means, if a service (main service) is specifically excluded or exempted by way of Negative List or Exemption notification then any service used for providing the main service is precluded from the same benefit.

In this regard, Budget 2015 has recently included the following illustration under Section 66F (1) for better clarity.

> "*The services by the Reserve Bank of India, being the main service within the meaning of clause (b) of section 66D, does not include any agency service provided or agreed to be provided by any bank to the Reserve Bank of India. Such agency service, being input service, used by the Reserve Bank of India for providing the main service, for which the consideration by way of fee or commission or any other amount is received by the agent bank, does not get excluded from the levy of service tax by virtue of inclusion of the main service in clause (b) of the negative list in section 66D and hence, such service is leviable to service tax*."

This principle provides that reference to output service does not includes a reference to input service. In other words reference to the main contact cannot be used for the services used for the execution of such main contract.

Examples for the above provisions

The 'Provision of access to any road or bridge on payment of toll' is specified entry in the negative list in section 66D of the Act. Any service provided *in relation to collection* of tolls or for security of a toll road would be in the nature of service used for providing such specified service and will not be entitled to the benefit of negative list entry. (Source: TRU Circular)

To illustrate with an example, say X limited has been awarded to do the construction of road of 100 km for the general public utility by National Highway Authority of India. Now X limited

sub-contracts either full contract or say 50 km to Y limited. In case both Y limited and X limited are providing the same nature of work, i.e. Construction of road and would be entitled for exemption provided in the notification 25/2012 ST dated 20.06.2013 vide Sl No 13. However in case either X limited or Y limited take some equipment on hire or take manpower contract, then such service cannot be classified as a constriction contract, because the reference of main service cannot be used for services used for providing the main service and hence such vendors would not be entitled for the said exemption.

SCOPE OF SUB SECTION (2) TO SECTION 66F

Section 66F(2) reads as follows-

"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"

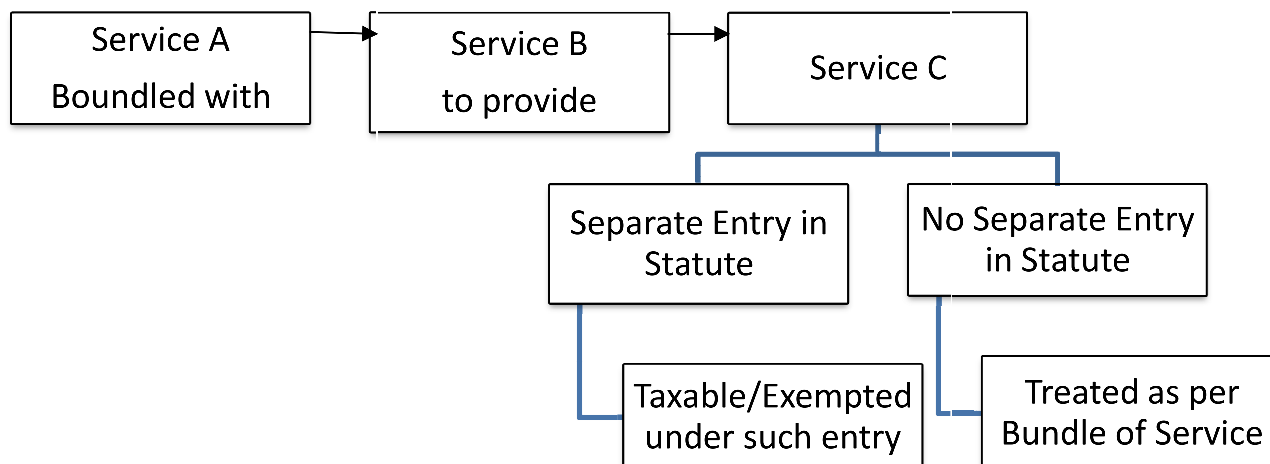
This sub section implies that if a particular service is classifiable under more than one category then the category of service which specifically covers such service will be preferred than the general category of service. The same can be understood with the examples. For example, a hotel rents out a conference room for an official conference where lunch is also served. It can be classified as 'mandap keeper' or 'convention service'. Between these two entries, 'convention service' is more specific as it covers only conventions which are like official function. 'Mandap keeper' is general description as it includes official, social as well as business functions. Hence, such service will be a 'convention service'. – CBEC circular No. 51/13/2002-ST dated 07.01.2003.

The same principle was applied in *Coal Handlers P Ltd. v. CCE (2007) 6 STT 513 (CESTAT),* where it was held that C&F Agent is specific description compared to 'business auxiliary services'.

"Pandal and Shamiana is an existing service and will remain a subject of taxation. Likewise service provided by way of catering is a taxable service and entitled to abatement. There is abatement when the two are provided in combination. Since the combination is more a specific entry than the two provided individually, there is no need to apply the later rule of bundled services, where the character could be judged by the service which provides it the essential character". (*Source:* TRU Circular)

It is also otherwise a general rule of interpretation that a specific heading should be preferred over general heading. There are many Supreme Court cases supporting the same, like CCE

v. Frito Lay India (2009) 242 ELT 3 (SC), and Hindustan Poles Corporation v. CCE (2006) 196 ELT 400 (SC), etc.



SCOPE OF SUB SECTION (3) TO SECTION 66F

It is pertinent to understand what Bundled Services is before proceeding to sub section (3) of section 66F. The meaning of **'Bundled Services'** has been given in Explanation to section 66F(3) of the Finance Act, 1994. It means a bundle of provision of various services wherein an element of provision one service is combined with an element or elements of provision of any other service or services. Basically it is a composite service consisting of two or more services. For example, an airline provides movie or catering on board. Each service involves differential treatment as the manner of determination of value of two services for the purpose of charging service tax is different.

It has been held in the case of ***Jubilant Life Sciences Ltd. vs CCE 2013 (29) STR 529 (Tri-Del)*** that when several services are laid down in a contract with separate remuneration fixed for the services, then the contract including various services need not be considered as a whole and classified considering it as a single service. This is because the services rendered under the contract are distinct in nature and the contract lays down the services as distinct services. Therefore, based on the contracts, one can conclude whether the services are bundled or not bundled.

However, if the service provider clubs two or more services to provide a single service to a service recipient and such single service is already present in the statute as a separate entry in Negative List, or exemptions or Declared services, then the same will be accordingly classified instead of following the principle of Bundled services.

Two rules have been prescribed for determining the taxability of such bundled services in sub-section (3) of section 66F of the Act. These rules, which are explained below, are subject to the provisions of the rule contained in sub section (2) of section 66F, viz a specific description will be preferred over a general description as explained above. The sub-section (3) of section 66F reads as follows:

"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;
(b) 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."

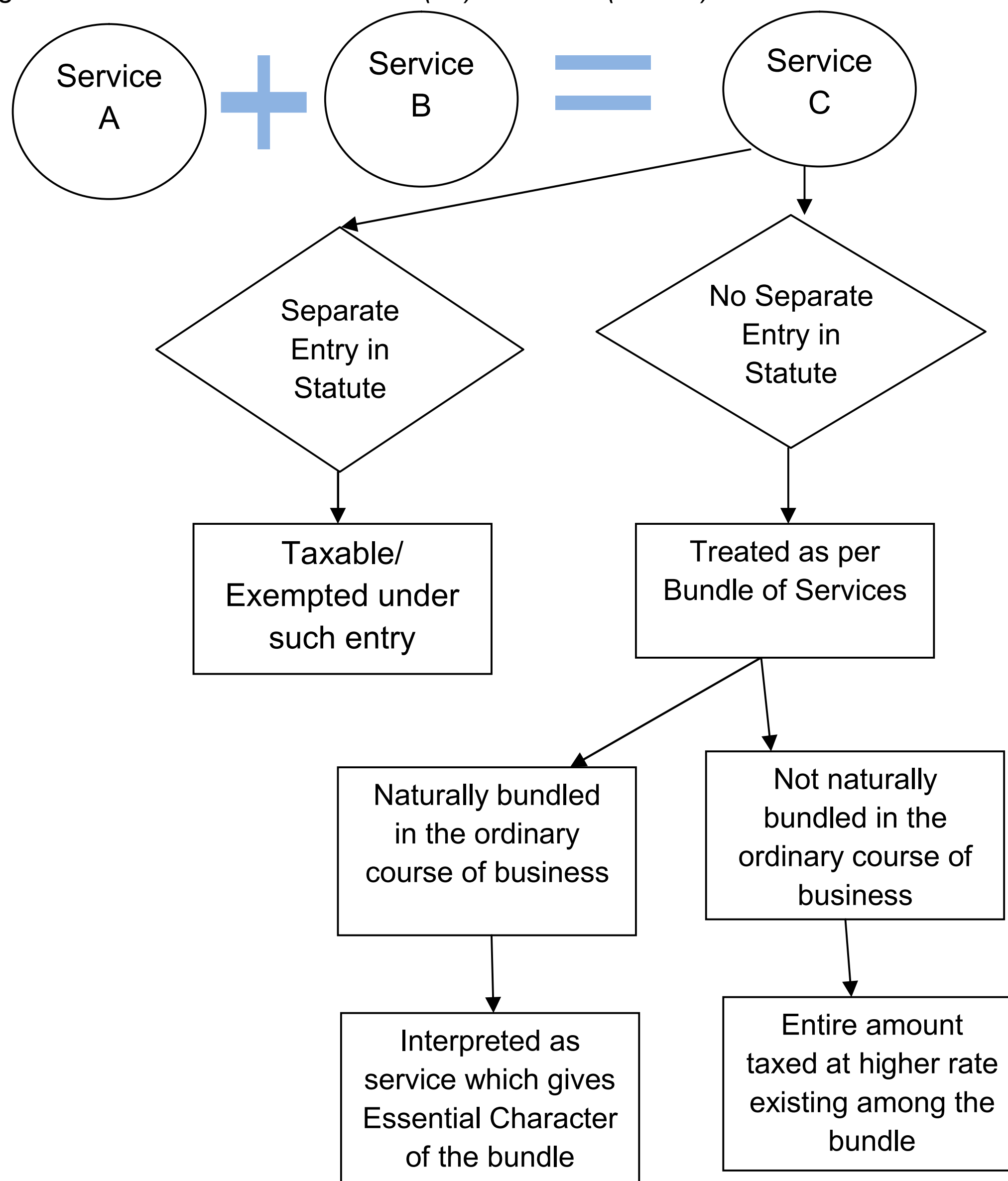
Section 66F(3)(a) explains that if services are naturally bundled in the ordinary course of business then it should be classified as per the category of service which gives it the essential character. For example, a hotel provides a 4-D/3-N package with the facility of breakfast. This is a natural bundling of services in the ordinary course of business. The service of hotel accommodation gives the bundle the essential character and would, therefore, be treated as service of providing hotel accommodation.

It is provided in section 66F(3)(b) of the Act that when various services *are not naturally* bundled in the ordinary course of business, then the service shall be the one attracting highest service tax liability.

The following has been given in the Education Guide issued by CBEC on 20th June, 2012.
For example, premises are rented which are partly for residential purposes and partly for manufacturing activity. Thus, it is not service bundled in ordinary course of business. In such case, though residential use is not taxable, commercial use is taxable. Hence, the entire bundle will be treated as renting of commercial property.

If one service is given free with another service (giving breakfast free with accommodation), or if a composite price is charged for all services, then the services would be construed as "bundled service".

In one contract there may be included activities relating to goods or immovable property. Under the bundled concept only service elements can covered. Held in the case of *Future Gaming Solutions I P Ltd. V UOI- 2014 (36) STR 733 (Sikkim).*



Conclusion: while the taxation was based on positive list of services, there was a requirement of identifying appropriate classification. Even in the newly introduced negative based taxation,, while determining taxability or even identifying whether the service is falling under negative list or exemption or for the determination of the value there may be conflicting entries or exemptions. Further also while ascertaining taxability of a particular transaction, it is essential to have some clarity.