



## **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 However, Classification provisions which was contained in section 65A is no longer applicable from 1st of July, 2012, by virtue of notification 21/2012-ST, dated 5th June, 2012.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*