THEME

Practical Tips To Avoid Unintended Charge of Service Tax on Welfare Activities To Employees

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Taxation laws are said to be merciless and the wordings of the statute prevail over the intention. As is often said, soon there will be a tax on every sphere of life. Unintended charge of tax and resultant surprise can be avoided by proper planning and documenting in advance, and without compromising on the benefits. The author shares some interesting ideas to avoid unintended levy of Service Tax and the resultant litigation on welfare facilities offered to employees in enterprise managed residential townships.

Since the introduction of Service Tax by Finance Act 1994, the coverage of this Tax has been extended by successive Finance Ministers and the Finance Act 2005 is no exception. Several new services have been brought into the tax net, while the scope of 12 existing services has been further enlarged. More than 80 services are now subject to tax, which will take the total revenue beyond Rs. 17,000 crore.

When Service Tax was first introduced and till the end of 2003 the approach of administering was lenient and the focus was more on self-compliance without selecting the cases for verification, scrutiny etc. As all things good come to an end, the honeymoon period is over and Service Tax has become the focal point both in terms of expansion as well as administration. A number of contentious issues have opened the floodgates of litigation.

This write-up tries to bring out some cautious approach to avoid unintended levy of tax particularly, in the situations, where the facilities or services are being extended against payment of a very nominal or token amount as part of welfare activities.

In the case of *CIT vs. Tajmahal Hotel 82 ITR 44* it was held by Apex Court that "it is well settled that where the definition of a word has not been given, it must be construed in its popular sense if it is a word of every day use. Popular sense means that sense which people conversant with the subject matter with which the statute is dealing would attribute to it."

Taxation laws are said to be merciless. It is said that in a taxation institute one has to look merely at what is clearly said. There is no rule for any intendment. There is no equity about a tax. Nothing is to be read in, nothing is to be implied. One can look fairly at the language used. It is a cardinal principal of interpretation that a statute should be read in its ordinary, natural grammatical sense.

As held by the Apex Court in *CIT vs. N.C. Buddharaja & Company 204 ITR 412* "A liberal interpretation of a taxation provision cannot be adopted on the plea that this would advance the purported object of the Act."

The furore and controversy created by clarification issued by Director General of Service Tax (DGST) by letter F. No. V/DGST/43-GTO/02/2005/19879 dated 30.03.2005 [2005 (182 ELT T22)] denying benefit of abatement to service receivers in case of Goods Transport Agency Service is a living example, how tax collecting authorities go by pro-revenue interpretations.

The issue pertained to abatement in relation to Goods Transport Agency Service. Notification No. 32/2004 dated 03.12.2004 provided for exemption from so much of the Service Tax as is in excess of the tax calculated on a value which is equivalent to 25 per cent of the gross value charged from the customer. The net impact of the notification is that tax is payable on 25 per cent of the bill amount.

Notification No. 35/2004 dated 03.12.2004 amended rule 2 of the Service Tax Rules to provide that in certain circumstances the person liable for payment of tax would be the person who is liable to pay freight i.e., recipient of service.

DGST in aforesaid letter declared (in the name of clarification) that abatement of 75 per cent is applicable only when the transport agency pays the tax and not when the consignor or consignee pays it.

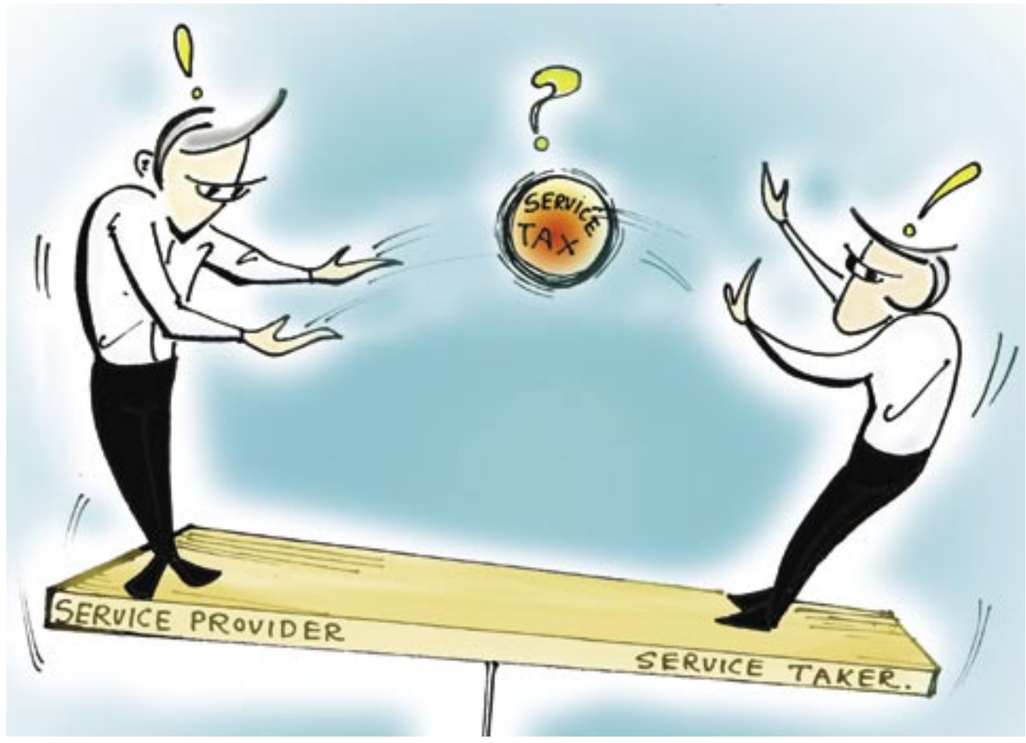
The interpretation put by DGST is not correct. What is the subject matter of abatement is the tax which is in excess of the figure calculated on value equivalent to 25 per cent of the gross amount charged from the customer. The Notification No. 32/2004 nowhere discriminates between taxpayers for the purposes of abatement.

As soon as this clarification was released, assessees in the capacity of service receiver started getting calls from field authorities inquiring as to on which value tax has been paid with a advice that returns for prior period should be revised and balance tax be paid.

Till date, CBEC has not issued any clarification negating the interpretation put by DGST. However, a circular no. 21/2005-Cus., dated 06.04.2005 was issued [2005 (182 ELT T22)] clarifying that a statutory notification cannot be amended by an executive circular and inspite of the existence of such a circular, the notification will prevail. It is believed that CBEC was compelled to issue the circular only to negate interpretation put by DGST, though indirectly.

Services offered by enterprises to its employees against nominal recoveries

It is very common for the enterprises to offer several services to their employees either free of cost or at very nominal token amount, particularly at the places where townships are maintained by company for residence of employees and employees of close business



associates. In these townships flats/bungalows are maintained by the Company. To make the living cheerful for the employees and their families a host of services including maintenance of recreational clubs and health centers etc., are also provided. Facility of Cable TV is also provided from Central Signal Receiver. In all the above efforts, the purposes are not to provide services or to make money but to make the living conditions cheerful. However, as explained in opening paras, even recovery of token amounts may lead to liability of Service Tax without going into the intention.

As we all have the experience, it is not the small amount of tax, which people try to avoid but it is the cost and efforts required to put into compliance. It is also not uncommon nowadays that front line authorities simply assess and raise the demand though in informal discussions they may be agreeing that the event is or should not be liable to tax. A careful understanding of the provisions and planning will avoid lots of effort and compliance cost.

It is interesting to note that in the Finance Act, 2005 nowhere the terms like 'commercial concern' or 'agency' have been used. The intention behind this seems to enlarge the scope of new services and to avoid the controversy in defining and interpreting these terms:

Cleaning activity

It is proposed to insert Clause (zzza) to include the cleaning activity as one of the taxable services. Such services may be provided to any person by any person. Cleaning activity is defined to mean cleaning, including, specialised cleaning services such as disinfecting, exterminating or sterilising of objects or premises of

i) commercial or industrial buildings and premises thereof or

ii) factory, plant and machinery, tank or reservoir of such commercial or industrial buildings and premises thereof.

It is not uncommon in the industry to make independent bodies in the form of A.O.P.s which are officially called Resident welfare associations or by some other similar name, to undertake cleaning activities of the residential townships. It is also not uncommon to charge token amounts from the employees towards membership as well as recurring expenses to run such A.O.Ps though major expenses are ultimately borne by the enterprises itself. The definition of cleaning activity very clearly includes commercial or industrial buildings. What is meant by commercial building is not defined. As these townships are part of block of fixed assets for the purposes of depreciation, for all practical purposes townships though meant for residence of employees are commercial buildings and any amount recovered from the residents howsoever small it may be is liable to Service Tax.

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Maintenance or management of immovable property

It is often said that the Service Tax is unique tax wherein one service if not liable to tax under one head will come under the taxing clutches in another head. Finance Act, 2005 seeks to enlarge the meaning of words "maintenance or repair". For the purposes of this write up inclusions of words "maintenance or management of immovable property" is relevant.

What is meant by management of immovable property is not clear. Only time will tell what is likely to be covered. However considering other words used in the definition, only management which is akin or similar to maintenance should get covered.

As per *Webster's Ninth New Collegiate Dictionary* "maintenance means upkeep of a property or equipment." *Black's Law Dictionary* defines it as the act of maintaining, keeping up and supporting. 'Maintain' means acts of repair and other acts to prevent a decline, lapse or cessation from existing state of condition.

As discussed in foregoing paragraph under the heading "cleaning activity", the money recovered from the residents of townships shall be liable to tax if not under cleaning activity then under maintenance or management of immovable property.

Maintenance of company clubs

Generally company maintained townships have facility of recreational club or health centre. Finance Act, 2005 includes service provided "to its members, by any club or association in relation to provision of services, facilities or advantages for a subscription or any other amount". Club or association is defined to mean any persons or body of persons providing services, facilities or advantages, for a subscription or any other amount to its members. Even membership fees and any charges which are received from the members are subject to Service Tax.

Exclusions do not have any clause which excludes services provided by company managed clubs where beneficiaries are employees. However, company is a person, constituted under the law and should come under the exclusion clause reading as "any body established or constituted by or under any law for the time being in force." However, if the employer is constituted under some other arrangement say partnership shelter of this exclusion is not available.

The above interpretation about exclusions is not beyond litigation and frontline authorities shall take a view to include entrance fee/recurring membership fee to the taxation fold, and wordings will prevail over intention.

Cable TV

Though provision of Cable TVs in the company maintained townships is not a subject matter of Finance Bill 2005, yet it is relevant to discuss its applicability at this moment.

Services provided to any person, by a Cable operator are liable to Service Tax. Most of the State Governments levy Entertainment tax in one form or other on receiving and dismantling such Cable TV signals. Thus, in all the cases wherever even a token amount is recovered that becomes liable for Entertainment Tax and in turn for Service Tax. As per Circular F No. B.11/1/2002-TRU, dated 1.8.2002, Entertainment Tax collected and paid to the Government will not be includible in the value of taxable service, provided the Cable Operator clearly indicates the Entertainment Tax element in his bill to the customer.

How to avoid efforts and cost of compliance?

As has been explained in opening Paras taxing statutes do not go to the intention of levy of tax rather they go to what is written. Whether a particular payment/receipt is liable for tax or not shall be decided first by the frontline tax authorities who generally by their habit and practice act in favour of revenue leaving finer points of law to be discussed and decided by Appellate Authorities and Tribunals. The cost and time involved in litigation is high. These litigations can be avoided by better planning and documentation.

The subject matter of this write up is the services provided against levy of very nominal or token amount wherein basic intention is not to collect money but to keep the people involved.

Nowhere in the above write up it is suggested to stop welfare facilities/activities. However, the charge of tax, cost of compliance and litigation can be avoided by discontinuing nominal/token recoveries. It is well settled that liability of tax will arise only when something is being charged. This position has been accepted by the Department in MF/(DR) TRU Circular No. ST62/11/2003 (F.No. B3/7/2003-TRU) dated 21.08.2003. Recently, Delhi CESTAT has also upheld the same position after referring above circular dated 21.08.2003 in the case of Bharti Cellular Limited in Appeal No. ST/76/2004-NV (A) decided on October 15, 2004. As per charging section viz. section 66 of the Finance Act 1994, the tax is chargeable on the value of taxable service. If the value of service is zero the tax will also be zero even though the service is taxable.

When Service Tax was first introduced and till the end of 2003 the approach of administering was lenient and the focus was more on self-compliance without selecting the cases for verification, scrutiny, etc

Further, premises used for clubs etc., may be renamed as recreational center etc., and nowhere in the documents/correspondence the word "club" should be used.

Conclusion

Lots of hardship and litigation can be avoided if the things are pre-planned keeping finer language and interpretation used in the statue. If the purpose of recovering nominal or token amount is not generation of revenue, it is better, a practical approach is taken to discontinue recoveries against those services without going in to finer interpretations. Loss of revenue to the enterprise can be met by increasing the rent of the houses. This will reduce the perquisite value of houses as computed under Rule 3 of the Income Tax Rules and will lower the tax burden of the individual employees. ❐