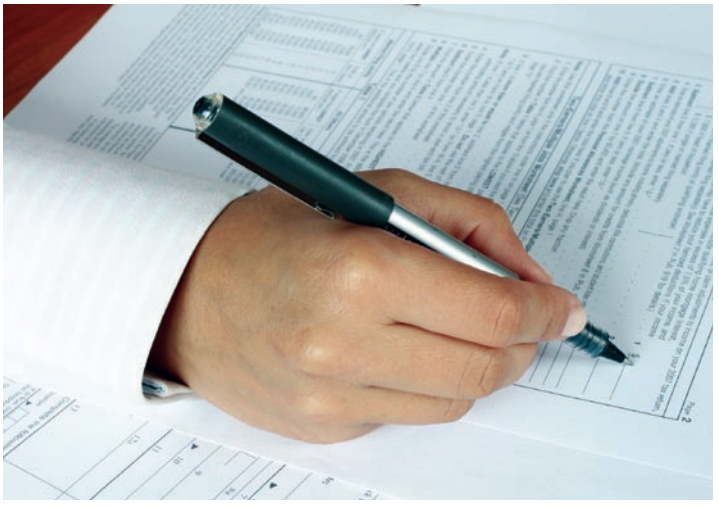
Exemptions and Negative List under New Service Tax Regime



The Finance Act, 2012 has completely revamped the service tax regime by replacing the present method of taxing individual services by taxing all services with a Negative List of services not liable to tax. Under the new service tax regime, all services will be liable to tax except those which are specifically mentioned in the exemption notification and the Negative List. Here, the author has attempted to explain the basic concepts and principles of interpretation of exemption provisions and notifications, while discussing some of the specific issues arising out of the Negative List and the mega exemption notification. The author has discussed few items of general importance from the Negative List and the exemption notification in the present article. Read on…

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Introduction

The Finance Act, 2012 which received the assent of the President on 28-5-2012 has completely revamped the service tax regime. It has replaced the present method of taxing the individual services by taxing all services with a Negative List of services not liable to tax, and also a mega exemption list. Under the new service tax regime, all services will be liable to tax except those which are specifically mentioned in the exemption notification and the Negative List. Besides the basic concepts and principles of interpretation of exemption provisions and notifications, some of the specific issues arising out of Negative List and the mega exemption notification have also been discussed.

General Principles of Interpreting Exemption Provision

It is now well settled that an exemption provision/notification being an exception to taxation has to be construed strictly. Eligibility criteria mentioned in the notification/provision should be interpreted strictly and an exemption will be

granted only if an assessee fulfills the eligibility criteria. The Supreme Court of India in *CCE Vs Hari Chand Shri Gopal and others 2010 (260) ELT 3 held: An exemption notification has to be interpreted in the light of the words employed by it and not on any other basis. A person who claims exemption or concession must establish clearly that he is covered by the provisions concerned, and in case of doubt or ambiguity the benefit of it must go to the State.*

Further, the Supreme Court in *Associated Cement Companies Ltd Vs State of Bihar and others 2004 (7) SCC 642* held that once the exemption became applicable, no rule or principle required that to be construed strictly. It was held that liberal and strict construction of an exemption provision was to be invoked at different stages of interpreting it.

It could be seen that in many cases, the exemption notification stipulates the conditions to be fulfilled by an assessee. The question whether such conditions are mandatory or directory has been the subject matter of litigation. The courts held that the substantive conditions were to be held as mandatory and the procedural conditions should be treated as directory. Though at an abstract level, the above description is easy to understand, the practical application of the principle is fraught with difficulties. What are the tests to be applied to find out whether a condition is substantive or procedural, have not been clearly laid down in the judgments? In most of the cases, it is decided on the perception of the court rather than on application of any well-settled criterion for differentiating substantive and procedural conditions. In practice, this could cause a serious difficulty. Therefore, assessees must endeavor their best to fulfill all conditions so that their exemption claim will not be denied on some hyper technical grounds.

It may so happen that it may be impossible for assessees to fulfill certain conditions mentioned in the notification. In such cases, the principle of interpretation that is adopted is that those conditions are not applicable to those particular assessees. *In Commissioner of Customs Vs Malwa Industries Ltd (235) ELT 214*, the Supreme Court held that the requirement of use in the same factory by the manufacturer would not apply to the claim for exemption of CVD in case of imports. As per the notification no. 4/2006. CE, excise duty was exempt if the item manufactured is used in the same factory in which inputs are used. In the case of an importer, the department denied the exemption on the ground that the imported item was manufactured in a factory abroad which is different from the factory of use in India. The Supreme Court negatived this contention and held that such a condition could not be applied to the importers, and that a notification was to be interpreted in a reasonable manner.

Operation of Exemption (*whether prospective or retrospective*)

Most of the time, the exemption notification itself would specifically state the date from which it becomes effective. But sometimes, a question may arise whether the exemption notification can be said to be clarificatory in nature. It is well settled that if an exemption notification is held to be clarificatory, it operates retrospectively. The Courts have laid down the following tests to find out whether a notification is clarificatory:

a. When there was any ambiguity in the earlier notification and the subsequent notification has been issued to remove that ambiguity.
b. When one notification is withdrawn and it is replaced by another notification on almost all identical items within a short interval, the notification can said to be clarificatory [*W.P.I.L. Ltd Vs CCE 2005 (181) ELT 359 (SC)*].

Simultaneous Existence of Two Notifications

Sometimes it might happen that the Government issues two notifications, both of which may be applicable to assessees. The question that would arise for consideration is, which one of the notifications is to be applied. Of course, there is no doubt that assessees cannot claim the benefit of both the notifications. This issue was resolved by the Supreme Court in *Collector of Central Excise Vs Indian Petro Chemicals (92) ELT 13 and H.C.L Ltd Vs Collector of Customs (130) ELT 405* by holding that assessees have an option to claim the benefit of the notification which is more beneficial to them. The department cannot force the assessees to opt for a notification of department's choice.

Equality

Sometimes, an argument is advanced that another person has been given the exemption and on that ground the assessee

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also should be given the exemption even though he may not be eligible on a strict interpretation of the notification. The Supreme Court in *Faridabad CT Scan Center v D.G Health services 95 ELT 161 and Collector of Customs Vs Maestro Motors Ltd 174 ELT 289* held that merely because in some other cases exemption has been granted, that itself cannot be a ground for allowing the benefit of notification in a case where exemption is not available. It is important to note that a wrong interpretation of notification cannot create a vested right in favour of third party. It is well settled that two wrongs do not make one right. It is also to be noted that the issue is one of the interpretation of exemption notification where strict rules of interpretation should be applied.

Addition of Conditions

It is a well-settled principle that a notification has to be interpreted on its own wordings. Neither the exemption can be given nor can it be denied on the supposed intention of the Government in issuing the notification. The only relevant criterion is whether the conditions mentioned in the notification are satisfied or not. The exemption is often being denied on the ground that the intention of the Government is not to exempt under particular circumstances even though the notification does not contain any such riders. The Supreme Court in *Gujarat State Fertilizers Company Vs CCE (91) ELT 3* held that the department cannot add a condition to the notification.

Taxes Covered in Notification

Exemption of taxes that are not specifically mentioned in the notification cannot be claimed on the principles of analogy. The Supreme Court in *Modi Industries Ltd Vs Union of India (25) ELT 849* held that an exemption given to basic custom duty could not be extended to special and auxiliary custom duty. It is also to be noted that the exemption notification covers only present taxes that are levied and not the future taxes. For instance, an exemption notification exempting all taxes levied under a particular sales tax enactment cannot be construed to include turnover tax that was levied later.

Benefit of Doubt

As a natural corollary to the principles of strict construction, the benefit of doubt should go to the revenue and not to the assessee. This principle has been laid down by Supreme Court in *Harichand Shri Gopal's case (260) ELT 3*.

Specific Inclusion and Exclusion

When the notification specifically includes or excludes a particular item, there would not be any difficulty in finding out whether the exemption is available or not. But when the item is not specifically mentioned either for inclusion or exclusion a doubt always arises. One of the contentions that are normally canvassed before the Court is that if a particular item is not expressly excluded, it is deemed to be included. The question would arise in interpreting the notification which uses certain expression wherein it is not clear from a plain reading whether a particular item is included and, at the same time, notification specifically excludes certain other items. Under such circumstances, a person may contend that since the items are not specifically excluded, it is deemed to be included and, hence, the exemption should be granted. This contention was negatived by Supreme Court in *Collector of Customs Vs Perfect Machine Tools Co Ltd (96) ELT 214*.

Summary of Principles of Interpretation of Exemption Notification

- The substantial conditions have to be construed strictly and the procedural conditions have to be construed liberally.
- Assessees have an option to choose a notification which is more beneficial to them when there are two or more notifications applicable to them.
- The department cannot add any condition on presumed legislative intent or intent of the Government.
- Notifications apply only to the taxes specifically mentioned and not to other taxes and future taxes. In case of doubt, it should be resolved in favour of the revenue.
- Notifications removing ambiguity or restoring the exemption within a short interval are generally clarificatory in nature and therefore, retrospective in operation.
- That an item is specifically not covered in exclusion clause does not necessarily mean that it is included.
- The benefit of notification cannot be claimed on the basis of equality and prevention of hostile discrimination.

Negative List

Whether the principles stated above would apply to a Negative List mentioned in Section 66D of the Finance Act, 1994 is a matter of debate. Negative List is a new concept and, therefore, there are no precedents dealing with the interpretation of Negative List. One view would be that there is no essential difference between the exemption and a Negative List. Therefore, the principles of interpretation of exemption notification would apply with equal force even to the Negative List. The other view

would be that the Negative List is an exception to charge itself and it cannot be equated with exemptions. Therefore, the Negative List has to be interpreted keeping the above factor in view. Being an exception to the charge, it has to be interpreted in the same manner as that of the charging section, and one should lean toward an interpretation which is in favour of the assessee. In other words, the Negative List is to be interpreted in such a way that the exclusions provided therein are effectuated and not whittled down by an unduly narrow and strict construction. It is a matter of debate and the Courts have to evolve a new principle of interpretation regarding the Negative List.

Negative List under Finance Act, 1994

Section 66D of the Finance Act, 1994 sets out the various services that are not liable to be taxed in the sense that they do not fall under the charging Section 66B. Section 66B of the Act levies a tax on all services other than those services specified in the Negative List. Therefore, the charge under Section 66D of the Act is not attracted at all to the services specified in the Negative List. Here, we present only those services mentioned in the Negative List that have an impact on business. Readers may go through Section 66D of the Act for the services that are specified therein.

The services rendered by the Government are generally not liable to service tax. But the services of speed post, express parcel post, life insurance and agency services provided to any person other than the Government, services in relation to aircraft or the vessel inside or outside the precincts of a port or an airport, transportation of goods or passengers and support services provided to business entity are liable to service tax. These services are excluded in the Negative List. It may be stated here that, as per notification no. 30/2012 ST dated 20-6-12, which would come into force with effect from 1-7-2012, the service recipient is liable to pay service tax in respect of services provided by way of support services by government or local authority. It has been made clear in the notification that renting of immovable property and services mentioned in Section 66D (i) to (iii) will not be covered by reverse charge mechanism. Hence, this notification does not cover the taxable services rendered by government other than the support services. Therefore, in respect of any other taxable services rendered by the government, the liability would be on the government department itself and not on the service recipient.

One of the services listed in the Negative List is renting or leasing an agro machinery or vacant land with or without a structure incidental to its use, if such services relate to agriculture or agricultural produce. The expressions *Agro Machinery* has not been defined in the Act. Therefore, one has to apply the commercial parlance test to find out whether the machinery is *agro machinery* or not. It should be noted that the list includes services relating to agricultural or agricultural produce. The expression *relating* to is very wide in its connotation. Therefore, any machinery which would satisfy the test of being *agro machinery* if it is used even indirectly with reference to agriculture or agricultural produce, would not be leviable to service tax. Normally, any machinery which is used for, cultivating, harvesting can be categorised as agricultural machinery.

One of the services listed in the Negative List is trading of goods. Trading normally means buying and selling of goods. In the present electronic age when many goods can be downloaded electronically, whether the down loading of various goods through an intermediary would be trading of goods is an interesting issue. For instance, "A" may be producer of recorded music. He may grant a right to "B" to distribute such recorded music to various customers through internet. In such a case the question is whether "B" is trading in goods or providing services. One way of resolving such issues would be to see whether a person carrying out a particular activity is paying VAT/CST or duties of customs on such activities and if the answer is yes, it can be said that he is a trader in goods. It is very likely that a number of litigations may crop up on the interpretation of expression "trading of goods".

Another service that is listed in the Negative List is service by way of renting of residential dwelling for use of residents. It is to be noted that what is included is renting of residential dwelling. As per the decided case laws, dwelling means a place of living for an indefinite period. It does not include any place of living for a short and limited period. Therefore, the hotels and motels which provide short term residential accommodation cannot claim that their premises are used for dwelling for residence. But in many large cities, the rooms are given on monthly rent. These buildings are popularly known as *lodges*. Persons stay in such lodges for a fairly long time and it is possible to contend that renting of rooms in such lodges would fall under the expressions renting of *residential dwelling for the use as residents*. Anyhow, renting of rooms in lodges is likely to be exempt under serial no. 18 of Notification no. 25/2012.

Another such service from the Negative List is that of extending deposits, loans and advances. As per the Section 66(D)(n) services by way of extending deposits, loans or advances in so far as the consideration is represented by the way of interest or discount are included in the Negative List. Interest or discount is not defined. In today's world of finance, there are many financial products where the interest is not given directly but through other mechanism. For instance, a debenture may be issued at par and redeemed at

a premium. Of course, premium is likely to be calculated on the basis of the current interest rates. In such a case, whether the premium is interest or not is to be decided. In the opinion of the author, the expression *interest* should not be given an unduly restricted meaning. Any compensation for time value of money should be treated as interest for the purpose of Section 66D(n). Section 66D(p) includes services by way of transportation of goods by road except the services of goods transportation agency or courier agency, in the Negative List.

It is interesting to note that Section 65(26) of the Act defines *goods transport agency* and not *goods transportation agency*. This is perhaps an un-intended error. In any case, the difference in phraseology may not have much significance. Section 65B(26) defines a goods transport agency to mean any person providing services in relation to transportation of goods by road and issues consignment note by whatever name called. It may be noted that before 1-7-2012, the services of carrying goods by road by a goods carriage as defined in the Motor Vehicle Act alone are liable to tax. The goods carriage as defined in Section 65(50a) before its amendment stated that goods carriage has the meaning assigned to it in Section 2(14) of Motor Vehicle Act, 1988. Section 2(14) read with Section 2(28) of Motor Vehicle Act, 1988 excluded vehicles having less than four wheel fitted with engine capacity of not exceeding 25cc. Chapter V of Finance Act, 1994 does not define goods carriage. Section 65(50a) which defines goods carriage is not operational from 1-7-2012. Therefore, a doubt arises as to whether the carriage of goods by three wheelers is liable to service tax. One view of the matter could be that in the absence of a definition of a goods carriage, any vehicle carrying goods would be a goods carriage and services rendered by such vehicle owner would be liable and as per notification no. 15/2012, the service recipient is liable to pay service tax. The other view is that the expression "goods carriage" is a legal and technical expression used in Motor Vehicle Act, 1988 and the same meaning should be given for the purpose of service tax also. No doubt Rule 2(c1a) of Service Tax Rules defines a goods carriage and as per that Rule it has the same meaning assigned to it in Section 2(14) of Motors Vehicle Act. But, it must be noted that the definition given in the Rule is only for the purpose of Rule and not for any other purpose. In my opinion, the definition of goods carriage in Service Tax Rules, 1994 is relevant only for Rule 2(b), Rule 4B and the meaning given in the Rules cannot be imported into Act. Similarly, notification no. 25/2012 defines goods carriage in an identical manner. Here also, it should be noted that the definition in the notification is only for the purpose of notification. Hence, it is very doubtful whether the definitions given in the Rule and notification no. 25/2012 can be extended to the Act. There is no clarity on the issue. Perhaps it can be said that the Government never had the intention to levy service tax on the owners of tempos and other three wheelers carrying goods as such owners are operating in a very highly un-organised manner. But this can be a very weak argument because there is nothing in the Finance Act or any other provision dealing with service tax which brings out the clear intention of the Government not to levy service tax on carrying of goods by tempos and other three wheelers.

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Exemption under Notification No. 25/2012 dated 20-6-12

The Central Government has issued a mega exemption notification no. 25/2012. As stated in the Budget 2012, the basis of levying service tax is changed from service-specific *levy to levying tax on all services* except services specified in Negative List and the exemption notification. The exemption notification becomes operative with effect from 1-7-2012. Here, a few exemption issues have been discussed out of 39 services that have been exempted.

One of the services that have been exempted is the healthcare services rendered by a clinical establishment or an authorised medical practioner or a paramedic. The clinical establishment has been defined to include hospitals, nursing homes, clinics or any institution that offers services or facilities regarding diagnosis, treatment, care for illness, etc. Therefore, the entire medical health care services are exempt. The expression "paramedic" has not been defined and it has to be understood in its normal sense. A paramedic is a person who is not qualified as a medical practioner but has qualification and training to assist the medical practioners, injured and other persons who are ill. It includes nurses, ambulance attenders, etc.

The services by a charitable institution registered under Section 12AA of Income-tax Act, 1961 are exempt. Similarly, services received by a charitable institution registered under Section 12AA from non-taxable territory will not be taxed under reverse charge mechanism. There is a lacuna in the way the exemption has been drafted.

Reference to Section 12AA restricts the scope of institutions covered under the exemption notification. It is well known that the charitable institutions are not only registered under Section 12AA but also under Section 12A, 10(23C), etc. Therefore, notification requires to be amended to cover all charitable institutions which are registered under 12A, 12AA, 10(23C).

Notification no. 25/2012 defines a charitable activity which means the following activities:
Public health activities:

a. Advancement of religion or spirituality
b. Advancement of educational programmes or skill development relating to certain specified categories like abandoned or orphaned children, physically or mentally abused persons, persons or person over the age of 65 years residing in rural area
c. Preservation of environment including watershed or wild life
d. Advancement of any other object of general public utility upto a value of ₹25 lakh in a financial year provided the total value of such activity had not exceeded 25 lakhs in the preceeding financial year (For the FY 2012-13, the limit is ₹18.5 lakh)

It is to be noted that other charitable activities will not be exempt unless they fall under any other specific exemption or services listed in the Negative List. For instance, preschool and high school education and awarding of a degree recognised by the law are not liable to service tax because they are included in the Negative List. A charitable institution rendering such services will be exempt from payment of service tax not under entry no. 4 of notification no. 25/2012, but by virtue of provisions contained in the Negative List. The question that arises for consideration would be whether in computing the value of activity, the following amounts received should be included or not:

a. Voluntary contribution
b. Interest income
c. Other income not related to the carrying on activity.

In other words, the question is whether only the consideration received for rendering the service should be taken into account or the entire receipts of the charitable institutions should be considered. In my view, only the consideration received for an activity falling under the definition of "taxable service" is to be taken into account. It should not be forgotten that the charge is on the taxable services and therefore, only the consideration received for taxable service should be taken into account in determining the aggregate value of ₹25 lakh. It cannot be said that the donations, interest etc are to be treated as consideration for activity. One more issue that could arise is whether the expression "objects of general public utility" would include medical relief, poor relief, etc. In my opinion it should include all such charitable activities also.

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The services provided by an individual or a firm of advocates to any person other than a business entity is exempt. Initially, the notification no. 12/2012 granted exemption only to individual advocates. Now, the exemption has been extended to a firm of advocates also. Notification no. 30/2012 which requires the recipient of service to pay service tax under reverse charge mechanism has specifically included in its scope the legal services received either from an individual advocate or a firm of advocates by a business entity. Therefore, an individual advocate or firms of advocates rendering legal services are out of the clutches of service tax. They need not register themselves, collect and remit the tax.

If an individual lawyer can be relieved of facing the procedural hassles, it is not clear as to why other professionals like chartered accountants, cost accountants, company secretaries should also be not exempt.

Services by way of training or coaching in recreational activities relating to art, culture or sports are also exempt. The use of expression "recreational" creates a problem. If any training or coaching is given to a person to enable him to become a professional in arts, culture or sports, it cannot be said that it is recreational in nature. The practical application of tests to decide whether a particular training or coaching is recreational or professional can create serious disputes between the assessee and the department.

Item No. 14(b) of notification no. 25/2012 exempts single residential unit otherwise as a part of residential complex. Prior to 1-7-2012, the residential complex had been defined to mean a building consisting of more than 12 residential units. This definition has been given a go-by. The notification no. 25/2012 itself defines a residential complex to mean any complex comprising of building or buildings having more than one single residential unit. Therefore, it is to be noted that construction of two or more residential units in a building would be a taxable service indeed.

One issue that arises for consideration is whether the construction of individual houses in a colony or in a gated community would fall under entry no. 14(b) of notification no. 25/2012. An analysis of the definition of a residential complex would show that in order to be a residential complex the following must be satisfied:

a. It must comprise of building or buildings
b. It should have more than one single residential unit.

A reasonable interpretation of the definition of "residential complex" would be that the residential unit should be situated in the building itself. In other words, if an apartment complex has more than one residential unit, it would become a residential complex. In the opinion of the author, individual houses built in a colony would not fall under the definition of residential complex. In this connection, the following decisions may kindly be taken note of:

- *In re* Harekrishna Developers 10 STR 357 (Authority for Advance Ruling)
- Macro *Marvel Projects v CCE* 12 STR 603 (Tribunal)

In Harekrishna Developers' case, it was held that if there were more than 12 individual houses in a residential colony, it would satisfy the definition of a residential complex. In Macro Marvel's case, it was held otherwise. This conflict of judicial opinion may kindly be kept in mind.

Many individuals construct a house consisting of two or more floors. It is possible that each floor may be capable of living independently. The construction of such houses was not liable to service tax till 30-6-2012. With the change in the definition of residential complex with effect from 1-7-2012, construction of such houses would be taxable service and the contractor would be liable to pay service tax.

Entry no. 15 of notification no. 25/2012 exempts temporary transfer or permitting the use or enjoyment of a copyright covered under Section 13(1) (a) or (b) of the Copyright Act. Prior to 1-7-2012, Copyright services falling under Section 13(1)(a) of the Copyright Act was not liable to service tax whether it was a temporarily transfer or otherwise. Now, the exemption is restricted to the temporary transfers of such right and not to the permanent transfer thereof. Therefore, with effect from 1-7-2012, the permanent transfer of rights specified in Section 13(1)(a) or (b) of Copyright Act would be liable to service tax.

Item no. 17 of the notification exempts the services by way of collecting or providing news by independent journalists or Press Trust of India or United News Services of India. The services rendered by other organisations would be liable to tax.

Item no. 28 of the notification exempts certain services rendered by un-incorporated body or an entity registered as a society. One of the services that are specified in item no. 28 reads:

(c) Upto an amount of ₹5,000/- per month per member for sourcing of goods or services from a third person for the common use of its members in a housing society or a residential complex.

The notification no. 8/2007 dated 1-3-2007 which is in force till 30-6-2012 exempts such services if the total consideration received from an individual member by the said association for providing the said services does not exceed ₹3,000/ per month. As per notification no. 8/2007, if the amount collected per month exceeds ₹3,000/- the entire amount collected would be liable to tax. Under notification no. 25/2012, a more liberal approach is adopted. The government has given a basic exemption of ₹5,000/- per month per member and only excess collected over and above the sum of ₹5,000/- would be liable to pay service tax. This should come as a great relief to many housing societies.

Item no. 33 exempts services by way of slaughtering of bovine animals. The meaning of bovine is given in Random House Dictionary as *of the ox family*. Normally, cattle are referred to as bovine. It is not clear as to why the government has not exempted slaughter of other animals and restricted it only to bovine animals.

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Conclusion

It is very likely that many issues would crop up in practical application of the Negative List and the exemption notification. But one must welcome the policy of the Government in taxing all services and exempting the services specified in Negative List and notification no. 25/2012. The readers are advised to go through the Negative List in Section 66D of the Act and list of exemptions in notification no. 25/2012. As stated earlier, full Negative List and the exemption list have not been reproduced in this article due to space constraint. ■