THE TUGHLAQ DURBAR

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A close pal of ours, who is an expert archeologist, once said that the present location of the CBEC is exactly the erstwhile courtroom of the most famous Sultan Mohammed – Bin – Tughlaq, who is known for his ingenuous blunders. We dismissed it as joke but now, the recent Circular No. 98/1/2008 ST Dated 04.01.2008, make us believe that there could be a definite possibility!

The levy of service tax on various construction related services (commercial / industrial construction service, residential construction service, etc.) is always beset with lot of practical complications, due to the unique nature of this industry and the nuances of this new levy, compounded by half baked instructions issued by the CBEC, in the guise of "clarifying". And the recent attempt of the CBEC to "clarify" is would beat all its siblings, in terms of its utter disregard to the legal provisions and portrayal of lack of, even elementary, knowledge of the subject.

Service tax has been imposed on "renting of immovable property service" with effect from 01.06.2007. Though the legality of this levy itself is now before various corridors of the Courts of law, the levy is in place, as of now. Obviously, the service provider under this category of service would also be entitled to the benefit of Cenvat credit in respect of the inputs, capital goods and input services, in terms of the provisions of Cenvat Credit Rules, 2004. Though, the scope of availing such Cenvat credit on inputs and capital goods is very much limited, there is enormous scope for availing Cenvat credit on various input services, such as "commercial / industrial construction services, insurance services, repairs and maintenance services, architects' services, interior decoration services, etc."

The present clarification has laid down that a service provider under the category of "renting of immovable property" service would not be entitled to avail Cenvat credit in respect of the commercial / industrial construction service availed by him. The clarification reads as under.

> *Right to use immovable property is leviable to service tax under renting of immovable property service.*
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> *Commercial or industrial construction service or works contract service is an input service for the output namely immovable property. Immovable property is neither subjected to central excise duty nor to service tax.*
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> *Input credit of service tax can be taken only if the output is a 'service' liable to service tax or a 'goods' liable to excise duty. Since immovable property is neither 'service' or 'goods' as referred to above, input credit cannot be taken.*

At the outset, describing the "building" as an output, if not idiotic, is quixotic.

It is a basic fact that if a property has to be let out, first of all, it has to be built, by availing the services of a construction service provider. If this could not qualify as an input service, what else would qualify? The circular goes on to say that since the said "immovable property" i.e the building, is neither "goods" attracting excise duty nor a "service" attracting service tax, Cenvat credit of service tax paid on the above input services cannot be availed. For example, in the context of Central Excise, Cenvat credit of inputs used in the manufacture of capital goods, which are meant for captive use, would be admissible in terms of Explanation 2 under Rule 2 (k) ibid, notwithstanding the fact that no duty of excise would be paid on such capital goods, in view of Notification 67/95. The reasoning behind such provision is that, ultimately, the goods manufactured out of such capital goods would be subjected to duty of excise and the proverbial Cenvat chain should not be broken, in the spirit of the Cenvat scheme. Unfortunately, the present clarification has thrown into wind the rationale of the Cenvat scheme itself.

The clarification is also in blatant violation of the statutory provisions. The definition of the term "input service" as per Rule 2 (l) of the CCR, 2004 refer to ***"services used in relation to setting up, modernization, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises"***. In other words, if a manufacturer builds a factory (which is nothing but an immovable property), and avails the above input services, he is entitled to take Cenvat credit of the service tax paid on such input services, notwithstanding the fact that no excise duty is paid on the "factory" as such. Similarly, if any other service provider builds his premises, he is very much entitled for taking Cenvat credit of these input services, notwithstanding the fact that his premises is neither "goods" nor "services". The present clarification has been drafted, in total disregard to the above statutory provision.

If the logic propounded in the clarification is further extended, the following comic, nay, tragic situations may emerge.

- Credit of service tax charged by a Charted Accountant would not be available, as the "output" is only a "piece of paper" containing his report, on which neither any duty of excise nor any service tax is payable.
- Credit of service tax charged by an insurance company on the premium would not be available, as the "output" in this case is only an "Insurance Policy" on which neither any duty of excise nor any service tax is payable.
- Credit of service tax charged by Telecom service provider would not be available, as the "output" of this service is only a "call" on which neither any duty of excise nor any service tax is payable.
- Credit of service tax charged by an Advertising Agent would not be available, as the "output" of this service is only an "advertisement" on which neither any duty of excise nor any service tax is payable.
- And what not!!!!

Another clarification is in the context of introduction of "works contract service" with effect from 01.06.2007, which reads as below:

> *Prior to 01.06.07, service provider classified the taxable service under erection, commissioning or installation service [section 65(105)(zzd)], commercial or industrial construction service [section 65(105)(zzq)] or construction of complex service [section 65(105)(zzzh)], as the case may be, and paid service tax accordingly. The contract for the service was a single composite contract. Part of service tax liability corresponding to payment received was discharged and the balance amount of service tax is required to be paid on or after 01.06.07 depending upon receipt of payment.*
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> *Classification of a taxable service is determined based on the nature of service provided whereas liability to pay service tax is related to receipt of consideration. Vivisecting a single composite service and classifying the same under two different taxable services depending upon the time of receipt of the consideration is not legally sustainable.*
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> *In view of the above, a service provider who paid service tax prior to 01.06.07 for the taxable service, namely, erection, commissioning or installation service, commercial or industrial construction service or construction of complex service, as the case may be, is not entitled to change the classification of the single composite service for the purpose of payment of service tax on or after 01.06.07 and hence, is not entitled to avail the Composition Scheme.*

It may be recalled that the services of commercial / industrial construction services, erection / commissioning / installation services and construction of residential complex services, which were already taxable under respective categories have been grouped under the new "Works Contract Service". The new classification would come into play if the above activities are in the nature of works contracts. A composition method of payment of service tax, @ 2 % of the gross amount has also been made applicable for this new service. A doubt arose as to whether the activities, which were subjected to service tax under the respective categories prior to 01.06.2007 and were continuing even after 01.06.2007 can be reclassified into "Works Contract Service" with effect from 01.06.2007 and whether service tax can be paid under the composition scheme.

While answering in the negative, the reasoning (!) given in the present clarification is, since the service has been classified under a category, the classification cannot be changed subsequently and the composite service cannot be "vivisected" (courtesy : Daelim). It is further observed that classification of service is done based on the nature of service provided whereas liability to pay service tax is related to receipt of consideration and vivisecting a single composite service and classifying the same under two different taxable services **depending upon the time of receipt of the consideration** is not legally sustainable.

In order to better appreciate the issue, the situation can be compared with the situation under Central Excise. The taxable event for the levy of duty of excise is "manufacture" and the point of its collection is the "Time of removal". While paying duty of excise, the goods have to be properly classified and the appropriate rate of duty has to be applied. Let us assume that the tariff heading of a particular commodity has been amended with effect from a given date. If the goods which were manufactured prior to such amendment were cleared after such amendment, while paying duty of excise at the time of their removal, the goods have to be classified only under the new heading and not under the heading, which was in force on the date of manufacture of such goods. In service tax, while rendering of service can be equated to manufacture, realization can be equated to time of removal. Service tax is payable, upon realization of consideration. At the time of paying service tax upon realization, the service has to be classified accordingly. Accordingly, classification of taxable service is a continuous process and has to be done at each and every time of payment of service tax, i.e upon every receipt of consideration. If a more specific category of taxable service is introduced subsequently, the services rendered after such new levy shall be classified only under the new category of taxable service, whenever service tax is payable on the said service, in respect of the payments received after the introduction of the new levy.

Before parting...

On the contrary, if the Works Contracts levy had come with a higher rate than the construction services, tell us, whether the department is going to allow the on going service to continue under construction services under the old head or would insist that it be necessarily reclassified under the Works Contracts???