



Udyog Whitepaper



MARCH 2014

Bundled Services

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Introduction

The concept of 'negative list' for the taxation of services came in July 2012 with the hope of simplification: no more taxability or rate of tax issues, we thought – everything is taxable. The reality turned out to be very different.

Need to determine classification

It remains important, in many contexts, to determine the correct description of a service. Issues of taxability and the rate of tax applicable hinge upon this. Thus, placing a service in the correct category / description is important to answer the following questions, which in turn have a bearing on whether and how much service tax is payable:

- Whether the service is covered in any entry in the negative list;
- Whether the service is exempted under the mega exemption notification 25/2012-ST (which exempts services of the descriptions specified therein) or under some other exemption notification;
- Whether the service is one of the specified services that are eligible for abatement of taxable value under notification 26/2012-ST;
- Whether tax is payable on reverse charge basis on the service? (Reverse charge applies to specified services.)
- What is the place of provision of the service? (The criteria for determining this vary for different kinds of services.) This has a bearing on import and export of service.
- Is Cenvat credit admissible, or is the service one of those that are excluded from the definition of input service?

Multiple / composite supply of service: classification difficulties

The difficulty of correct classification of a service is exacerbated in a situation of a multiple or composite supply of services. Are these to be separately evaluated for determining the rate of tax or taxability? Or is the whole to be treated as a single service, and if so, which service? Examples will make this plainer:

- 'X' provides children's parties, in which a hall, entertainment, and catering of food are arranged. An abatement of taxable value is available for catering, but not for the other two services.
- 'Y' provides parking service at the airport, along with transport arrangement to the terminal. Transport of passengers is exempted, but parking is taxable.
- A goods transporter also provides warehousing and loading / unloading service. Transportation of goods by road carries an abatement of taxable value, but this is not available for warehousing or loading / unloading.

Multiple / composite supply of service: provisions of law

Prior to July 2012, classification of taxable services was governed by section 65A of the Finance Act 1994. Under this, the rule for composite services consisting of a combination of different services was that the services should be fitted under the most specific description, if this was possible; or, failing this, composite services must be classified as if they consisted of a service which gives them their essential character. As section 65A applied only for the classification of taxable services, it did not address the problem of classification of a composite service in which some services were taxable and some were not taxable. Further, the issue of how to determine what gives a service its "essential character" remained open to interpretation.

From July 2012, section 65A ceased to be operational except for the past period, and classification of services is governed by section 66F of the Finance Act 1994. The new section is titled, "**Principles of interpretation of specified descriptions of services or bundled services**". It reads as follows:

- 1) Unless otherwise specified, reference to a service (herein referred to as main service) shall not include reference to a service which is used for providing main service.
- 2) 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.
- 3) 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.

Explanation:- For the purposes of sub-section (3), the expression "bundled service" means a bundle of provision of various services wherein an element of provision of one service is combined with an element or elements of provision of any other service or services.



Thus, section 66F lays down the following principles as regards multiple / composite or 'bundles' services:

- If the different elements of the bundle are normally bundled in the ordinary course of business, the service will be treated as provision of the single service that gives the bundle its essential character.
- If the different elements are not normally bundled in the ordinary course of business, the service will be treated as provision of the single service which results in the highest liability of service tax.

Interpretations on classification of composite service

The CBEC had issued guidelines to its field formations in the context as follows, in CBEC Circular 334/1/2008-TRU dated 29 February 2008 in the context of section 65B:

- For the purpose of classification of a service covering number of separate services, a view has to be taken as to whether an individual service is merely a component of the overall supply or is itself a distinct and independent supply i.e. whether the component is merely ancillary to the principal supply or the component can be considered as separate taxable service in its own right. A service, which does not constitute for a customer an aim in itself but a means of better, enjoying the principal supply, is considered as a supply ancillary to the principal supply.
- Section 65A states the principles for classification of taxable services. Classification of a composite service is based on that component of the service which gives the essential character. There is a need to determine whether a given transaction is the one containing major and ancillary elements or the one containing multiple and separate major elements. In the case of a transaction containing major and ancillary elements, classification is to be determined based on the essential features or the dominant element in the transaction. A supply which comprises a single supply from an economic point of view should not be artificially split. The method of charging or invoicing does not in itself determine whether the service provided is a single service or multiple services. Single price normally suggests a single supply though not decisive. The real nature and substance of the transaction and not merely the form of the transaction should be the guiding factor for deciding the classification.

This circular gives us an important clue on classification of a composite service, namely, whether it is a “single supply from the economic point of view”. In fact the circular follows the landmark European case on the subject, which is the European Court of Justice ruling in the case of Card Protection Plan Limited v Commissioners of Customs & Excise, in terms of which the House of Lords gave its decision as reported in 2001 UKHL 4. The British revenue authorities, acknowledging that this case is the “lead case” on the subject, summarised the principles laid down by the ECJ in the Card Protection Plan case as under: <http://www.hmrc.gov.uk/manuals/vatscmanual/vatsc82000.htm>

- Since it is not possible to give guidance that would cover all cases of single/multiple supplies, when you are considering a transaction that consists of a number of components regard must be given to all the circumstances in which that transaction takes place.
- Each supply of a service must normally be regarded as distinct and independent.
- A supply that comprises a single service from an economic point of view should not be artificially split - the essential features of the transaction must be ascertained to decide if the supply to a typical customer comprises several distinct principal services or a single service.
- There is a single supply in cases where one or elements are to be regarded as ancillary services. An ancillary service is defined as something that does not constitute for customers an aim in itself but is a means of better enjoying the principal service supplied.
- The fact that a single price is charged is not decisive. If the circumstances indicate that customers intend to purchase two or more distinct services a single price will not prevent these being treated as separate supplies with different liabilities applying, if appropriate, to those services.

In deciding the case of Card Protection Plan, the House of Lords applied the principles laid down by the ECJ as follows. The issue was whether the services of registration of card, maintaining of database of cards, and provision of various facilities upon loss of a card, which were the outcome of a block policy taken with the insurers by Card Protection Plan, were to be classified as insurance service, which was not taxable, or whether each was to be analyzed and taxed separately. The House of Lords observed that the purpose of registration of the card by the card-holder was to get an insurance against the loss of cards, and that all the other services only facilitated this. It was not possible to say that some elements of the services were ‘economically dissociable’ from the others. Hence it ordered that the entire transaction was to be treated as exempted insurance supply.

Section 66F: “Bundled in the ordinary course of business”

The CBEC circular discussed above was issued in the context of section 65B, which is no longer operative. However section 66F, which is now extant, retains the concept of “essential character” of a bundled service, for determination of its classification, if it is normally commercially offered as a bundle. If the different elements are “naturally bundled in the ordinary course of business”, we must identify the single service that gives the bundle its essential character, and classify the whole as if it is that service. For what is to be considered “naturally bundled in the ordinary course of business”, the CBEC’s Education Guide offers the following example in paragraph 9.2.1:

“A hotel provides 4 nights 3 day package with breakfast free. This is a natural bundling of services, to which the service of hotel accommodation gives the essential character”

The British case law offers a clarificatory concept of “economic dissociability”, which helps in deciding whether the elements of a service are “naturally bundled”. We can understand this to mean that if one element is removed, the customer may not be interested in the others. For example, in the Card Protection Plan case, if no insurance was provided, the registration of card and concomitant facilities were either meaningless or greatly reduced in their value to the customer.

The CBEC applied the same principle, though with different terminology, in its circular 104/7/2008-ST dated 16 August 2008, to the issue of loading / unloading, packing / unpacking, transshipment, and temporary warehousing provided by a goods transporter (GTA). The CBEC identified these as intermediate and ancillary services, which are provided in the course of transportation by road. It observed that these are provided as the means for successful provision of the service of transportation of goods by road and the classification should therefore be based on the essential character of the service by identifying the essential features of the transaction.

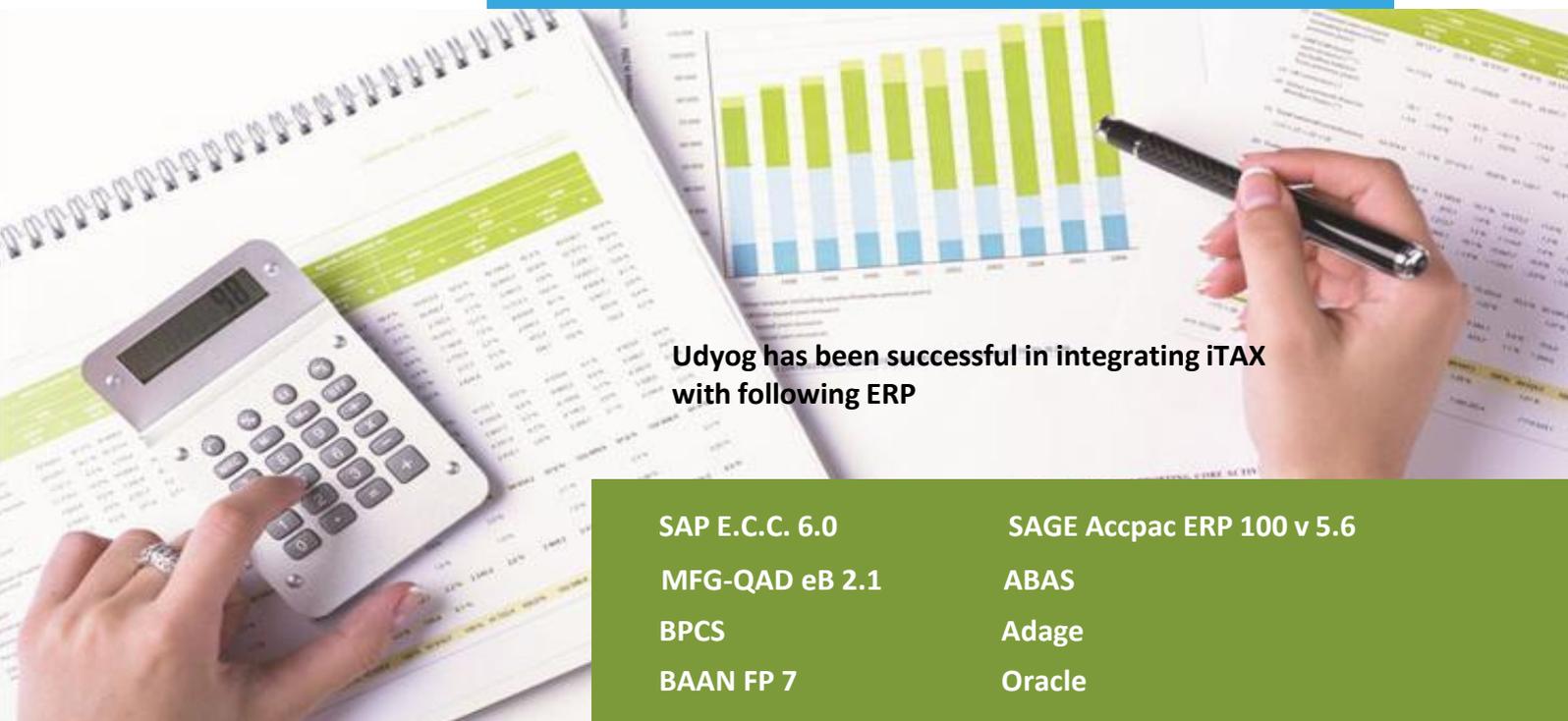
Summary of principles of classification of a multiple service supply

To recapitulate the above, the law requires that we must first determine whether the various activities are normally bundled in the ordinary course of business, and then we must determine the essential character of the bundle, if any. If different activities are not normally bundled, they have to be taxed separately. Further, if normally bundled, and if there is no single service that gives the bundle its essential character, the bundle will be taxed at the highest rate applicable to any of the services.

Possible conflict zones

We can expect disputes around the following issues:

- Where there is no single service that gives a composite service its essential character, we would expect the department to argue that it is a natural commercial bundle, to as to tax the whole at the highest rate applicable. On the other hand, the service provider would argue that the services are merely combined and not naturally bundled in the normal course of business. Case law has yet to develop on “normal course of business”.
- What is the essential character of the service will remain a grey area, because it is a matter of perception. In the example given at the outset, does a person who parks his car at the airport and takes a bus to the terminal value either of these services over the other?



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