# White Paper-
# Service Tax on Educational Institutions

Ms. Radha Arun, Consultant to Udyog Software (India) Ltd.

*This paper contains a brief on Service Tax on Educational Institutions*

Udyog Software (India) Ltd.

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## Service Tax on Educational Institutions

The Customary post-Budget letter on service tax from the Joint Secretary (TRU) in the CBEC contained certain 'clarifications'. In paragraph 15.7 of the said F. No. 334/8/2016-TRU dated 29 February 2016, it 'clarified' that language teaching services provided to schools and colleges by an outside agency were not covered in the negative list or under any exemption and were therefore taxable. And thereby hangs a tale, to understand which we must look into the structure of service tax exemptions for education.

The overwhelming majority of educational institutions in India are operated as non-profit entities for reasons of accreditation, land use restrictions and other legal complexity, and enjoy the status of 'charitable organisations' in income tax. This status is often, and mistakenly, thought to exonerate the entity from payment of service tax. In this paper I look at developments in the impact of service tax on educational institutions and attempt to bring some clarity to the subject.

### 2003: Service tax on education delivered "commercially", except "recognised" education

Service tax was first levied in 2003 on education described as "commercial training or coaching" provided by a "commercial training or coaching centre" [- erstwhile section 65(26), (27) and (105) (zzc) of the Finance Act 1994]. Institutions that issued recognised qualifications were excluded from this at the outset.

### "Commercial"?

Litigation on this tax was centred on the word "commercial": the non-profit entities that ran institutions that did not issue recognised qualifications won the first round on the ground that they were not "commercial". Thereupon the law was amended in 2010 with retrospective effect, to say that taking a fee brought the institution into the ambit of "commercial".

### "Recognised"?

The other focus of litigation was on the issue of "recognised" qualifications. This has not reached finality. The CBEC clarified under its Circulars 107/1/2009-ST dated 28 January 2009 and 334/1/2010-TRU dated 26 February 2010 that recognition of universities and deemed universities by the UGC rendered their qualifications as recognised by law, and that recognition by professional councils like AICTE, the Medical Council of India or the Bar Council had the same effect. However there was ambiguity regarding programs like pilot training by aviation institutes that function under recognition by the Directorate General of Civil Aviation, and joint programs run by private institutes under MoU with recognised universities for issue of recognised qualifications by the universities. The case of the aviation institutes is before the Supreme Court at present, after a detailed order in favour of these institutes from the Delhi High Court in the case of Indian Institute of Aircraft Engineering [WP(C) no. 3513 of 2012, decided on 21 May 2013].

The meaning of "recognised under law" in relation to educational qualifications remains relevant, as the same wording is used even after the extensive changes in service tax law that were made with effect from July 2012.

### 2012: Tax on "Service", not in "Negative List", Not Exempted

From July 2012, the taxing entries for "commercial training or coaching" lost their relevance. Service tax is now levied under section 66B of the Finance Act 1994 on "service" other than services enumerated in the negative list. Further, even if an activity is inherently taxable by virtue of being a service and not being on the negative list, there could be an exemption issued by the central government in exercise of the powers given to it under section 93 of the Act. Thus only an activity that is a "service" as defined, and is not on the negative list, and is not covered under any exemption, will attract service tax. Below we take a closer look at these three ingredients of taxable service.

## "Service"

Service is an "activity carried out by a person for another for consideration" [-section 65B(44) of the Finance Act 1994].

The CBEC explained the meaning of 'activity for a consideration' as follows in paragraph 2.3 of its Education Guide:

> "The concept of 'activity for a consideration' involves an element of contractual relationship wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. An activity done without such a relationship would not be an 'activity for a consideration' even though such an activity may lead to accrual of gains to the person carrying out the activity."

To illustrate the point of activity resulting in monetary gain which is not 'activity for a consideration' the CBEC gives the example of an artist performing on a street. People may drop coins in his bowl, thus resulting in monetary gains for the artist. But contractual obligation is absent on both sides. He was not engaged to perform, and the spectators are not obliged to pay. This is not a service as defined in service tax law.

What is notable here is that mere receipt of money from another person for doing something may not make that something taxable as a service. The crucial ingredient is whether the activity is done for that specific person and the money is linked to doing it for that person.

## "Non-Service: Example of Research Grants"

In this context the CBEC gave a clarification in question-answer format in paragraph 2.2.7 of its Education Guide:

> Qs "Are research grant with counter obligation on researcher to provide IPR rights on outcome a research a consideration?"
>
> Ans. "In case research grant is given with counter obligation on the researcher to provide IPR rights on the outcome of research or activity undertaken with the help of such grants then the grant is a consideration for the provision of service of research. General grants for researches will not amount to a consideration."

Several research was well as teaching universities receive research grants. Academic institutions specialising in technological subjects typically have strong linkages with industry, and are funded by industry for various kinds of research. This research would, in the typical scenario, be carried out by the faculty and students of the institution and published as an academic paper. The industrial entity will benefit from this, and so will its competitors and anybody else who is able to use the information. Therefore, even if the research is in a narrow area of specialisation that potentially benefits the funder, it cannot be said that the outcome is for that specific entity. Only if the intellectual property in the outcome is vested with the funder, or if the university is restrained from publication, can it be said that the research was done for the funder.

Examples of other receipts that are non-taxable because of the lack of obligation to do anything for the funder are: endowments for a university, creation of a professorial Chair (which involves payment of the salary for that Chaired Professor), and paying for a student's travel to a conference abroad. (Institution of medals or prizes that bear the name of the funder could fall in the category of sponsorship, which is taxable in the hands of the funder on reverse charge basis and not in the hands of the university or institute.)

## Service in the negative list: Recognised Educational Courses

Some activities are clearly in the nature of service, in that there is a mutual obligation of activity and payment for it.

Provision of education to a student falls in this category. However, educational courses that lead to a qualification that is recognised under law are not taxable, because they are (as of now) covered by an entry in the negative list of services in section 66D of the Finance Act 1994.

This reads as follows: "66D(l) services by way of

> (i) Pre-school education and education upto higher secondary school or equivalent;
> (ii) Education as part of a curriculum for obtaining a qualification recognised by any law for the time being in force;
> (iii) Education as part of an approved vocational education course."

(This entry is slated to be deleted from the negative list with the enactment of the Finance Bill 2016 into an Act. However, recognised education will remain exempted under notification, as service by an educational institution to its students is already exempt. The change is discussed below.)

## Services that are exempted under notification

Notification 25/2012-ST (popularly known as the mega exemption) exempts various services from service tax, either fully and unconditionally or partially or conditionally. Services relating to education find mention at serial number 9 of the notification.

The entry covers:

> "9. Services provided, -
> (a) by an educational institution to its students, faculty and staff;
> (b)…"

For this purpose, "educational institution" is at present defined as an institution providing services specified in clause (l) of section 66D of the Finance Act 1994, which refers to the negative list entry.

## Shifting of the exemption for recognised education from negative list to exemption notification:

With the deletion of the negative list entry for recognized education, the definition of 'educational institution' in notification 25/2012-ST, which already exempts services provided by and educational institution to its students, is proposed to be changed to

"An institution providing services by way of

(i) Pre-school education and education up to higher secondary school or equivalent;
(ii) Education as part of a curriculum for obtaining a qualification recognized by any law for the time being in force;
(iii) Education as a part of an approved vocational education course."

Thus, an institution that provides education as part of a curriculum for obtaining recognized qualifications will not be required to pay service tax on any service, including teaching, provided to its students.

In effect, the exemption that was provided under the negative list has been shifted to an exemption notification. The reason for doing this has not been stated. One can suspect an intention to remove the exemption in future. Negative list entries are part of the statute, and only an amendment of the statute by Parliament can remove them; on the other hand, exemption notifications can be modified or withdrawn by the government at any time.

## Auxiliary Education Services: Reducing scope of Exemption

Above we considered the latest developments in entry number 9 of notification 25/2012-ST, which is for educational services. It is to be noted that this entry has mutated over the years and each change has reduced the scope of the exemption.

As it stood from 1 July 2012 to 31 March 2013, the entry read as follows:

> "9. Services provided to or by an educational institution in respect of education exempted from service tax, by way of
> (a) auxiliary educational services; or
> (b) renting of immovable property".

"Auxiliary educational services" were defined in clause (f) of the "Explanation" appended to the notification as "any services relating to imparting any skill, knowledge, education or development of course content or any other knowledge-enhancement activity, whether for the students or the faculty, or any other services which educational institutions ordinarily carry out themselves but may obtain as outsourced services from any other person, including services relating to admission to such institution, conduct of examination, catering for the students under any mid-day meals scheme sponsored by the Government, or transportation of students, faculty or staff of such institution."

The words "or by" were deleted w.e.f. 1 April 2013, so that the entry 9 of notification 25/2012-ST thereafter exempted services (including renting of immovable property) provided to an educational institution but not by it. Thus, from 1 July 2012 to 31 March 2013 renting out of property by an educational institution was exempted from service tax, but from 1 April 2013 it became liable to service tax. Similarly, auxiliary services like transport, courses that did not lead to recognised qualifications (offered by a recognised institution), and other non-core services provided by an educational institution became taxable from 1 April 2013. Some of these could be clubbed with the core education service by virtue of the concept of 'bundled service' under section 66F, but others were separately offered and subject to tax. For example, delegate fees for conferences, consultancy projects, courses conducted for others culminating in certificates that are not part of the recognised qualifications that it is notified to issue.

From 1 July 2014, another change was made and an exemption was brought in for services provided by an educational institution to its students, faculty and staff. At the same time, the exemption for auxiliary services provided to the institution was narrowed to specific items. The revised entry was as follows:

> "9. Services provided, -
> (a) by an educational institution to its students, faculty and staff;
> (b) to an educational institution, by way of, -
> (i) transportation of students, faculty and staff;
> (ii) catering, including any mid-day meals sponsored by the Government;
> (iii) security or cleaning or house-keeping services performed in such educational institutions;
> (iv) services relating to admission to, or conduct of examination by, such institution".

The amendment made with effect from July 2014 exposed many services to service tax. For example:

i. Language or skill courses conducted by outside agencies.
ii. Contracts for gardening and beautification, electrical works, guest house.
iii. Counselling services provided for students by external experts.

Now, in 2016, as seen above, it is proposed to delete the entry in the negative list which currently covers education as part of curriculum leading to recognised qualifications and shift the exemption to notification 25/2012-ST. While this will leave the institutions' teaching to their own students unaffected, the somewhat different wording of the entry in the notification ensures that guest faculty will have to charge service tax (if crossing the exemption threshold for small service providers). This is the case even if the guest faculty is supplementing the efforts of the regular faculty by providing specialised or expert inputs from a particular field to strengthen the students' understanding in a subject in the curriculum.

To confound the problem and take it back to a date prior to 2016, the CBEC has issued the clarification mentioned in the first paragraph of this article. Paragraph 15.7 of F. No. 334/8/2016-TRU dated 29 February 2016, on language teaching services provided to schools and colleges says as follows:

> "15.7 Services provided by institutes of language management
>
> 15.7.1 High Level Committee on Tax Laws in its IInd Half Yearly Report has observed that Institutes of Language Management (ILMs) are engaged by various schools / institutions to develop knowledge and language skills of students. Since the ILMs are providing coaching / teaching to the students in a school or college, as a part of a curriculum for obtaining a qualification recognized by any law for the time being in force it should be clarified that the services provided by ILMs are not liable to service tax.
>
> 15.7.2 The matter has been examined. The services provided by the ILMs are not covered by Section 66D (l) of the Finance Act, 1994 or Entry 9 of Notification 25/2012-ST as they are not providing pre-school education or education up to higher secondary school (or equivalent) or education for obtaining a qualification recognized by law. It is the schools / colleges / institutions (in which the students take admissions) which provide such education. The ILMs provides services to such educational institutions, which helps such educational institutions in providing services specified in the negative list. Thus, it is clarified that services provided by the Institutes of Language Management (ILMs) are not eligible for exemption under Section 66D(l) of the Finance Act, 1994 or under Sl no. 9 of Notification 25/2012-ST."

This "clarification" is of doubtful validity with regard to the negative list entry, as it is based on the fact that the contractual relationship is between the ILM and the institution. This fact is not relevant for the negative list entry, which is merely for "education as part of a curriculum for obtaining a qualification recognised by any law…". Who provides the education to whom is not an issue for the negative list entry? It is to be hoped that this clarification does not lead to service tax demands and more burden of litigation on educational institutions.

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Please connect with us at:

Web: www.udyogsoftware.com
Email: teammarketing@udyogsoftware.com