Exclusion Clause under 'Input Services' would create large-scale litigation – JULY 1, 2011

THE existing definition of "Input Service", as contained in Rule 2(l) has been replaced with a new definition, with effect from April 1, 2011 which reads as follows:
(l) "input service" means any service, -

(i) used by a provider of taxable service for providing an output service; or

(ii) used by a manufacturer, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal, and includes services used in relation to modernisation, renovation or repairs of a factory, premises of provider of output service or an office relating to such factory or premises, advertisement or sales promotion, market research, storage upto the place of removal, procurement of inputs, accounting, auditing, financing, recruitment and quality control, coaching and training, computer networking, credit rating, share registry, security, business exhibition, legal services, inward transportation of inputs or capital goods and outward transportation upto the place of removal;

but excludes services,-
(A) specified in sub-clauses (p), (zn), (zzl), (zzm), (zzq), (zzzh) and (zzzza) of clause (105) of section 65 of the Finance Act (hereinafter referred as specified services), in so far as they are used for-

(a) construction of a building or a civil structure or a part thereof; or

(b) laying of foundation or making of structures for support of capital goods, except for the provision of one or more of the specified services; or

(B) specified in sub-clauses (d), (o), (zo) and (zzzzj) of clause (105) of section 65 of the Finance Act, in so far as they relate to a motor vehicle except when used for the provision of taxable services for which the credit on motor vehicle is available as capital goods; or

(C) such as those provided in relation to outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession, when such services are used primarily for personal use or consumption of any employee;

I would restrict this piece to the exclusion clause provided in the new definition, as per which, services such as outdoor catering, beauty treatment, health services, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefits extended to employees on vacation such as Leave or Home Travel Concession would not be treated as input services, when such services are used primarily for personal use or consumption of any employee

The words that strike one most are 'primarily' and' personal'. *Per se*, it looks like, when the input service is used primarily for personal use or consumption of any employee, it would not be treated as an 'input service' for purposes of availment of cenvat credit.
In terms of P Ramanatha Iyer's Advanced Tax Lexicon 3 rd Edition, the word 'primary' means that, which is first in order, rank or importance; anything from which something else arises or is derived (Section 62 of the Indian Evidence Act, 1872)..

The intent behind bringing this exclusion clause seems to be to deny credit, when the input service is used mainly for the personal use or consumption of the employees. Para 1.9 of the TRU Circular dated 28-2-2011, reproduced below, makes this clear:

1.9 On the same lines, a service meant primarily for the personal use or consumption of employees will not constitute an input service. A list of specific services has also been given by way of example in the definition. Most of these services constitute a part of the cost-to-company package of the employee and are provided either free of charge or on concessional basis to company employees.

When one reads the statutory provisions along with the TRU Circular dated February 28, 2011, the view that one gets is that, whatever input service, which the employees can use as a matter of right, forming part of the Cost to Company compensation, cannot confer the benefit of cenvat credit on the employer. By contrast, whatever services that the employer provides to the employees, on a voluntary basis, which do not form part of the CTC, would constitute input services, for cenvat credit purposes. Thus, mediclaim insurance costs, personal accident costs, life insurance costs, etc., which are not treated as part of the CTC, will qualify as input services, in my view, if these are not treated as part of the CTC package. Even, canteen services provided to the employees, would qualify as input services, if the employer does not recover the costs from the employees, in which case, it would not form part of the CTC remuneration.

The new definition of 'input services', in terms of the TRU Circular would seem to determine the cenvat credit availablity on the basis of whether the cost of the input services would form part of the CTC of the employees. Cost to Compensation ('CTC') is one of the most misunderstood concepts, especially, in the IT industry.

CTC is a concept, which is widely used in the IT Industry and most remuneration packages are decided on the basis of the CTC. While some Companies include most of the direct and indirect costs incurred for and on behalf of the employees in the CTC sheet, many others and especially, the MNCs, don't. The concept of CTC is to be distinguished from the gross salary concept and this brings in a lot of confusion as to what elements would constitute CTC and what would constitute gross salary. One would wonder as to how the Department would compute the CTC, for determining which input service would form part of the CTC.

Can an employer avail of cenvat credit, of the service tax paid on a fitness centre, which his employees are allowed to take benefit of? In my strong view, credit is available, so long as the employees are not entitled to this benefit, as a part of their employment contract, which is the situation in most companies, at least, in Bangalore, that I am aware of.

Taking this discussion forward, can an employer who is statutorily required to use cab services, to drop his employees beyond the office hours, entitled to avail of credit? My response is a strong 'Yes', as it cannot be said that, this facility is for the 'personal' use of the employees. Rather, this is for the 'official' use of the employees, necessitated by a statutory requirement. Further, many companies have barred women employees from using their own vehicles, working on night shifts, in Bangalore, Here again, it cannot be said that, these services are for the personal use of the employees.

By bringing in the concept of the personal use of the input services by the employees, the Government would seem to have opened up a pandora's box. Many IT companies allow consultants, business associates, vendors, customers, etc., to use their canteens, fitness centers, etc. While the employees are normally exempted from paying for using these services, others are normally required to pay for these services. Can it be said, in these cases, that these services are not meant, primarily, for the personal use or consumption of the employees?

Before parting…

The new definition for 'input services' is bound to bring in a lot of subjectivity to the cenvat credit law. How can the employer prove that the input services received by him are not 'primarily' used for the personal use of the

employees? Or, for that matter, how will the Department prove that the canteen was used primarily by the employees, for their personal use? Is the employer required to keep a log book containing details of the people who have eaten food in the canteen, on a day to day basis? Is there a possibility of cenvat credit being denied on a proportionate basis, to an extent that the input service is attributable to the personal use by the employees?

In a IT industry driven city like Bangalore, most employees prefer to classify themselves as 'Consultants' for a variety of reasons, including, income tax related ones. From the employer/assessee's point of view, there is hardly any distinction between employees and consultants, in terms of the work involved. Moreover, many companies have also employed outsourced agencies and the employees of these outsourced companies would be treated as Consultants and not as employees. Surely, there is no scope to deny credit in respect of input services used by the Consultants and the other non-employees.

Though the TRU Circular links the availability of cenvat credit, in respect of the services covered under the exclusion clause, to the CTC concept, the definition only talks of the input service being primarily meant for the personal use or consumption of the employees. It does seems that, an input service which is meant for the official use or consumption of the employees will still permit cenvat credit availment. It is for the more intellectually trained, to distinguish between personal use and official use, by the employees.

The new definition of 'input services' has been brought about by Notification No. 3/2011-Central Excise (N.T.) dated March 1, 2011, which has been issued under Section 94 of the Finance Act, 1994. It does not seem that the Government has the power to restrict the cenvat credit by bringing in an exclusion clause, by issuing a Notification under Section 94, as the power to restrict cenvat credit does not seem to fall within the powers given by Section 94.

One does not understand the need to statutorily restrict the availability of cenvat credit, at a time when the Governments says, it is serious about the implementation of GST. This move, which would strike at the very heart of the concept of indirect taxes, is clearly aimed at getting over the innumerable decisions of the Courts and Tribunals including the Apex Court, which have taken a very broad view of what would constitute an 'input service'.

There is little doubt that the new definition of 'input services' would result in large scale litigation, for sure.