Service Tax on renting of immovable property : No credit for denying Cenvat Credit – Jan 6, 2008

THE Ministry of Finance has issued a highly controversial Circular No 98/1/2008-ST on January 4, 2008. This circular meant to clarify issues related to renting of immovable property services and works contractor's services, has instead, managed to open up a pandora's box. In a blatant attempt to deny cenvat credit benefits to a service provider under "Renting of Immovable Property" service, the clarificatory Circular would seem to have raised a big question mark on the leviability of service tax on "Renting of Immovable Property".

Consider these……

1) The Circular makes a sweeping 'clarification' that 'Right to use immovable property is leviable to service tax under renting of immovable property service'

The words "right to use immovable property" has not been used anywhere in the Finance Act. As per Section 65 (90a) of the Finance Act, "Renting of Immovable Proeprty" includes renting, letting, leasing, licensing or other similar arrangements of immovable property for use in the course of or furtherance of business or commerce". From a purely legal point of view, there need not necessarily be a transfer of right to use immovable property, either actual or deemed, for rent to be received out of an immovable property. A typical example could involve certain sub-lease or sharing agreements when a first lessee could let out the leased premises to another sub lessee. It would be too simplistic to take a view that "Renting of Immovable Property" service can arise only on the "Right to use Immovable Property". What the Circular perhaps tries is to mean that "transfer of right to use immovable property" is taxable under "Renting of Immovable Property".

A rather poor usage of words such as these, is bound to create a lot of contentious issues. If the Government feels that it is the transfer of right of use immovable property that is taxable under "Renting of Immovable Property", what would happen to a case wherein a commercial property has been let out for a period of three years thro' a lease agreement prior to June 1, 2007? Since the right to use immovable property has already been transferred, does it mean that no service tax can be levied on the rentals arising out of such a lease agreement signed before June 1, 2007? After all, can't one take a view that 'right to use immovable property' cannot happen every month for the rentals to be brought into the service tax net?

1. We have all been under the impression that the Government has sought to levy service tax "renting of immovable property" as a service related to immovable property. As such, a number of petitions have already been admitted by the High Courts, challenging the constitutional validity of the levy of service tax on "renting of immovable property". The main line of argument that has been taken is that, no "service" gets rendered when a landlord or lessor lets out an immovable property for business or commerce and further that levy of service tax on "renting of immovable property" is nothing but a tax on immovable property by the Union Government, which is unconstitutional.

   The Government would seem to have made the life of the Courts easier by seemingly admitting that "renting of immovable property" is not a service. Look at the words that the Circular has used, which are reproduced below:

   "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".*

   It seems very clear that, in its attempt to deny cenvat credit benefits to service providers providing services under "Renting of Immovable Property", the Government could well run the risk of the very levy of service tax on "Renting of Immovable Property" being struck down by the Courts. Let's remember that the Government's views are binding on the Revenue and it is open for an assessee to say that when the Government itself feels that "Renting of Immovable Property" is a tax on immovable property, he is entitled to depend on that view.

1. Taking our discussion forward, let's try and see if there is any logic in the Department holding the view that the view that commercial or industrial construction service or works contract service used for construction of an immovable property,

cannot be treated as input service for the output service namely renting of immovable property service under the CENVAT Credit Rules, 2004?

"Input Service" is defined under Rule 2(l) of the Cenvat Credit Rules to mean any service used by a provider of taxable service for providing an output service. The nexus between the input service and the output taxable service could not have been more direct than in the case of the contractor's services and the "renting of the immovable property" services as both these services are linked to a common item, viz. the immovable property. How could somebody let out an immovable property without having taken services to build the property, is anybody's guess. It needs to be appreciated that the provisions dealing with "input service' are very wide and Courts have consistently held that even a remote or distant nexus is enough for cenvat credit being taken on an input service. In the instant case however, as aforesaid, the nexus is very direct. The Department's view is therefore very unlikely to stand a judicial interpretation.

4. The Circular makes a statement that 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. This view can hold good only if the service provider is providing one taxable service or manufacturing one "goods". In practical cases, service providers provide more than one taxable service and also provide exempted services and the cenvat credit utilization in these cases are governed by Rule 6 of the Cenvat Credit Rules, 2004. Under these rules, a service provider providing taxable services and exempted services can opt not to maintain separate accounts and go in for the benefit cenvat credit in terms of Rule 6(3) of the Cenvat Credit Rules, 2004. Here again, there is no denial of cenvat credit but only a restriction on the quantum of utilization of the credit, notwistanding the fact that a substantial portion of the overall cenvat credit could pertain to an exempted service. When there is a substantial law governing the utilization of cenvat credit, one does not appreciate the need for this kind of a clarification.

On a practical parlance, most of the landlords or lessors might be rendering other taxable services, eg. "Maintenance or Repair of Immovable Property Services", in respect of the same immovable property which has been let out for commercial or industrial purposes, and in these cases, the cenvat credit availability would be governed by the Cenvat Rules, 2004. There is absolutely no question of the applicability of the logic contained in the Circular, in such cases.

1. The TRU seems to have officially endorsed the view taken by several Commissioners that the benefit of the Composition Scheme is not available in respect of a subsisting or existing contract as of June 1, 2007. The Circular states that "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". One cannot understand the rationale of subjecting a single composite service to service tax, by vivisecting a composite service like construction service and levying service tax as of a particular date (September 10, 2004 for Commercial or Industrial Construction Services and June 16, 2005 for 'Construction of Complex' service) and taking a stand that such vivisection is not possible for extension of a substantive benefit given by law. Taking a differing stand when it comes to extending a substantive benefit will not go well with the Courts.

Writing in TIOL earlier, I had extensively argued that the benefit of Composition Scheme cannot be denied to service providers, in respect of on-going contracts.

6. The next question that arises is, whether a Department Circular can take away a substantive benefit, which is provided by law. The benefit of cenvat credit is available to a service provider under the Cenvat Credit Rules, 2004, which are well defined. The Supreme Court had held categorically that in *Commissioner of Customs, Calcutta & Others* v. *Indian Oil Corporation Limited & Another*, **2004-TIOL-23-SC-CUS**, which was reiterated in the recent case of Union of India v. Arviva Industries (I) Ltd **2007-TIOL-12-SC-CX** that a Board Circular is binding on the Department and the Revenue, but not on the assessee or the Court.

It is indeed unfortunate that the Department is getting into issues related to denial of substantive benefits conferee by law, which is legally, beyond its purview. The Department cannot and should not take the position of a judicial authority. It should ideally stop with issuing clarifications on procedural issues. We have been witnessing this dangerous and unfortunate trend of the Revenue trying to get into a judicial mode for some time now and the latest TRU Circular is a classic example.

7. Lastly, may I suggest that the Government officers who issue circulars such as this, which have wide ramifications on the industry, should drastically improve their skills in the wonderful English language. We have had major issues with many circulars issued by the Board, including an earlier clarification issued in August 2006, wherein the TRU had 'clarified' that Real Estate Developers are not liable for service tax. Most of the Commissioners did not accept this view and the result was nothing but chaos, which had prevailed thro' 2006 and 2007. While issuing the Master Circulars in August 2007, the TRU had repeated the wordings used in its earlier clarification issued in August 2006, in respect of the applicability of service tax on Real Estate Developers. Subsequent to the issuance of the Master Circulars, we have had cases of the local Commissioners issuing Circulars, 'clarifying' the clarifications issued by the TRU. For instance, we have had the case of the Bangalore Service Tax Commissioner taking a lot of pains to 'clarify' that the 'clarification' issued by the Board would not apply to most classes of Real Estate Developers. All of this confusion could be avoided, if the TRU takes enough care to use the right words in its Circulars

Perhaps, the CBEC needs to improve its understanding of the substantive provisions of the law, as much, as it needs to improve its language skills.