

Budget 2010-11- Levying tax on Medical Services - The Case of Delivering a Deformed Baby

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Introduction

- 1.0 In order to evaluate applicability of the provision of a statute levying tax, one is required to look at the nature of the transaction and, at times, the type of tax payer. In general course, the statute is supposed to provide in a simple language the transaction which is proposed to be subject to tax. It means the tax provision covers all the individuals irrespective of their caste, creed or colour. However, the life of a draftsman becomes pitiable when he is required to draft a statute taxing particular set of persons and for restricted qualified transaction without naming them. However, the draftsmen at Ministry of Law in India are smart enough to accomplish such tasks. But, in the process of relieving their burden, they make the life of tax payers miserable. Look at the proposal to levy service tax on medical services as proposed in the Budget 2010-11 which reads as follow:

- 1.1 Services rendered; -

(zzzzo) by any hospital, nursing home or multi-specialty clinic, –

(i) to an employee of any business entity, in relation to health check-up or preventive care, where the payment for such check-up or preventive care is made by such business entity directly to such hospital, nursing home or multi-specialty clinic; or

(ii) to a person covered by health insurance scheme, for any health check-up or treatment, where the payment for such health check-up or treatment is made by the insurance company directly to such hospital, nursing home or multi-specialty clinic;

- 1.2 It refers to business entity [BE]. A new section which is proposed to be inserted, defines it as follow:

(19b) "business entity" includes an association of persons, body of individuals, company or firm but does not include an individual;

Analysing the Proposal

- 1.3 A plain reading of the proposed clause (zzzzo) may give one an impression that entire medical services provided by all types of entities have been covered within the net of service tax. No. The authorities are well aware of consequences of such a move as it will be committing a grave blunder, the one which Abhimanyu committed 5,000 year ago and lost his life. The Government is fully aware that it will be neigh impossible to enter the labyrinth and do so at a single stroke. Therefore, in order to test the water, certain selective medical services provided by selected entities in

respect of which payment has been received in a selected manner have been made subject to tax.

- 2.1 Before analyzing it in detail, let us see how the Government is looking at these provisions.

Annexure- A to JS (TRU-II) D.O. letter dt. 26-2-2010 by Joint Secretary, TRU-II explains as follow:

2. Health services undertaken by hospitals or medical establishments for the employees of business organizations and health services provided under health insurance schemes offered by insurance companies.

2.1 With the change in the style of functioning of the business organizations, health check up is a routine facility provided by the employers to their employees. The main purpose is to ensure that the productivity of the organization is not adversely affected due to ill health of its employees. Such activities, commonly known as corporate health check up schemes, are undertaken by designated hospitals in order to detect any medical indicator or to ensure timely diagnosis of any disease so that prophylactic measures can be taken. In such cases, the hospital providing these services charge the employer i.e. the business organization and it constitutes expenditure for the latter. In certain cases (for example, in case of flight crew) pre-flight check ups are conducted not only to test the fitness levels but also to rule out the possibility of the flying crew being under intoxication. Such health check up schemes is being brought within the ambit of service tax under the new service.

2.2 A large number of health insurance schemes are being offered by the insurance companies under which charges for hospitalization, surgery, post-surgical nursing etc. are generally paid by the insurance company. Such insurance policies, which fall under the category of general insurance service, are already taxable. Under general insurance service, an insurance company is a service provider to its clients. Under the proposed new service, tax is also being imposed on the medical charges paid by the insurance companies to the hospitals on behalf of a business entity for its employees. As such, the insurance company would be the service receiver and the tax paid by the hospital would be available to the insurance companies as credit.

2.3 The tax on the above mentioned health services would be payable only if and to the extent the payment for such medical check up or treatment etc. is made directly by the business entity or the insurance company to the hospital or medical establishment. Any additional amount paid by the individual (i.e. the employee or the insured, as the case may be) to the hospital would not be subjected to service tax. This is to ensure that an individual is not required to pay a tax for which he cannot take credit.

- 2.2 When read with the proposed provisions, it will be clear that it goes far more beyond than what is stated above. In the first stage, it is stated that the tax is proposed on “health services” undertaken for the employees of business organisations. However, para 2.1 repeatedly refers to “health check-up” services. As we know “health services” is a much wider term than “health check-up”. In fact sub-clause (i) refers to “health check-up” and “preventive care” only. Thus, as per the proposed provision, its scope is restricted to “health check-up” or “preventive care” only and not the entire range of health services as one is lead to believe while reading the title of the explanatory note.
- 2.3 Secondly, the letter is silent about non-coverage of various other services viz. hospitalization, surgery etc. rendered by the hospitals. Reading the proposed provision, it is clear that the same are not covered. However, the letter is conspicuous by its silence on this aspect.
- 2.4 Thirdly, by putting two clauses together under a single taxable service, an impression is created that the cases of payment made by the business entity and health insurance companies are covered. However, a closer reading will reveal that in the case of payment made by health insurance companies (HIC), the tax is proposed to be levied not only on “health check-up” but also “health treatment”. Read the clause (i) again and it will be clear that payments by business entity for health “treatment” are not subject to tax. This is for the reason that the word “treatment” is missing in clause (i). However, the explanatory letter is silent about this.
- 2.5 And lastly, while justifying non-levy of the tax in other cases the letter, says *“This is to ensure that an individual is not required to pay a tax for which he cannot take credit.”* Is this the principle to be followed in all the cases? Will the same principle be followed in future as well? Justification for excluding certain cases on this line is not convincing. As we know, there are large numbers of cases wherein the recipient of service is required to pay the tax in spite of the fact that the service recipient is not in a position to take credit. In fact, the principle followed while levying the ST is that it is a destination based tax, meaning thereby the tax is to be borne by the recipient of service. This is an innovative argument for excluding certain class of recipient of services.

Esoteric of ST

- 3.0 Before understanding the complexities of the proposed provision, let us understand certain terminology and entities involved in taxation of ST. They are:
- 1) Nature of services rendered
 - 2) Type of Service Provider (SP)
 - 3) Type of Service Recipient (SR)
 - 4) Place of the provision of services
 - 5) Mode of payment for services received
 - 6) Value of services
 - 7) Methods applied for rendering of Services

3.1 In a simple case, tax has to be levied for the services rendered covering all the types of recipient and providers. However, when the objective is to cover only a select type of service recipients, some other parameters have to be factored in. Therefore, the best course of action is to bring as many factors as possible and qualify them so that the target is hit at the desired point without naming it. This is what has been proposed in the above clause. Let us analyse the taxation of proposed health services from various angles:

1) Nature of services rendered

Clause (i) covers “Health check-up”, “Preventive Care”. Other than these medical services, if any, are not covered. Clause (ii) covers “health check-up” and “treatment”. As we shall see, the term “health treatment” is wide enough and, therefore, will cover all the types of medical services.

2) Type of Service Provider (SP)

The proposed section is silent about it. It means it covers all the types of SP viz. any hospital/nursing home/multi-specialty clinic run by an individual, partnership firm, private or public limited company, Association of Persons, public charitable trusts, State and Central Government, local authorities etc. One may be lead to believe that only service providers defined as “business entity” are covered. However, the proposed section is silent about the form of service providers. Hence, it covers all the types of service providers.

3) Type of Service Recipient (SR)

The proposed section covers two types of service recipient viz. an employee of any business entity and health services to a person covered by health insurance scheme. It should be noted that under the clause (i), only the “employees” of “business entity” are covered, meaning thereby, in the case of service recipient, employees of other entities viz., Central and State Government, local authorities are not covered even though payment for the same might have been made by such authorities.

4) Place of the provision of services

The proposed section is applicable to hospital, nursing home or multi-specialty clinic only. Any other types of place where these three types of services are provided are not covered.

5) Mode of payment for services received

Generally, mode of payment of tax is not of much significance in a taxing statute. However, as per the proposed provision even if a transaction satisfies all the conditions, it will be subject to tax only if the payment for the services has been made by a business entity or a HIC.

6) Value of Services

Service Tax is levied on the value of services rendered. Generally, value of goods involved in rendering service is marginal and, therefore, it does not pose any problem. However, when the services rendered involve substantial value of goods, the question of reducing the value of service by the value of goods involved, as charged in the bill, arises. In many cases, provisions for abatement for value of goods are made. In such cases, due to certain standardization it is possible to quantify the value of goods involved in the services rendered. Secondly, in such cases the SP is also required to pay Value Added Tax (VAT) on the value of goods involved. Thus, abatement provisions help in avoiding double taxation in the value of goods involved.

Levying ST on health services will pose a serious problem. In the first stage, there are varying kinds of services many of which may not be involving consumption of goods. However, in many cases value of goods run into substantial amount and, perhaps in some of the cases, far more than the value of services rendered by the hospital. Generally, there is no practice to identify value of such goods in the bill raised. The amount charged covers both viz. value of goods used and various other services rendered. In view of this, as a result of the proposed provision, value of goods will also be subject to ST indirectly. However, it is true that the hospitals do not pay VAT on such goods as it is considered as part of services rendered and not sale of goods. So far, the hospitals did not have any problem as they were not liable to VAT and ST as well. However, with the proposed ST, value of goods used will get taxed indirectly. An interesting development herein will be that VAT paid on purchase of such goods cannot be utilised as input credit as the tax is not being paid under local VAT laws. Of course, this is a transitory problem, as with the introduction of Goods and Service Tax (GST) input credit will be available for the tax amount involved.

In view of this, for the time being, the burden of ST @ 10.30% on total amount of bill for medical treatment will look high. With the introduction of GST w.e.f. 1st April, 2011 all the hospitals and nursing homes will have to redesign the fees structure.

7) Methods applied for rendering of Services

Various methods are applied for rendering health care and treatment services. Most prevalent methods being viz. Allopathic, Ayurvedic, Homeopathy etc. Both the clauses are silent about taxability of the same, meaning thereby that methods adopted for rendering health services are not important for determining the taxability of services. As long as health services are rendered they will be subject to tax irrespective of the methods applied.

Defining the Medical Services

- 4.0 The term medical service is a general term as it covers varieties of services relating to health. Clause (i) and (ii) uses three terms viz. "health check-up", "preventive care" and "health care". What is "Health Check-up"? What is "Preventive Care"? What is

“health treatment”? Let us understand these terms with what we are familiar with and, thereafter, we shall examine it from the legal perspective.

- 4.1 Broadly speaking health care services can be classified into three parts. They are (a) Preventive Care (b) Curative and (c) Palliative.

Preventive Care

- 4.2 Preventive care refers to measures taken to prevent diseases rather than curing them. It includes services that can help people prevent disease. Preventive care is rendered in times of good health to ward off or prevent ill health from happening. In such cases the focus is on early diagnosis of disease counseling, and other necessary intervention to avert a health problem.
- 4.3 Health check-up services are designed for the prevention and/or reduction of illnesses by providing such services in the early stage. This care is in opposition to curative care, which goes into effect only after the occurrence of an illness. Generally healthcare is equated with illness care. However, specifying the most effective activities falling under each category is not easy. If we look at from various levels, prevention is generally classified in two categories viz. (a) primary (b) secondary and (c) tertiary levels. If the idea is to keep new problems from developing, it is called primary. The objective of secondary level is early disease detection, thereby increasing opportunities for interventions to prevent progression of the disease and emergence of symptoms. Secondary prevention covers early detection of a disease particularly when it is in early stage so that it does not become acute. In fact, at this stage, at times, the line between treatment and prevention blurs. The objective of Tertiary prevention is to reduce the negative impact of an already established disease by restoring function and reducing disease-related complications.
- 4.4 For medical science it may not be of much significance as the objective is to render service to human beings. However, when it comes to levy of tax on such services, a thin line is required to be drawn. In view of this, under clause (i), since the term used is “health check-up” and “preventive care”, coverage of services for taxation herein will be limited. However, as it happens in all the cases, legal issues will arise as to which type of treatment is to be considered for levy of tax. Use of general terms will give rise to the problems relating to classification of services.

Curative Treatment

- 5.0 Clause (ii) uses the term “treatment”. As we know, it is much wider term and includes all types of medical services rendered. There is no Central statute defining this term. As per the proposal for amendment in Bombay Nursing Home Registration Act, following definition for the term “medical treatment” proposed:

Medical Treatment:

“systematic diagnosis and treatment for prevention or cure of any disease, or to improve the condition of health of any person through allopathic or any other recognized systems of medicine such as Ayurveda, Unani, Homeopathy, Yoga, Naturopathy and Siddha; and includes Acupuncture and Acupressure treatments”.

- 5.1 It appears that here the focus is on all the aspects viz. preventive, curative and palliative. One would have expected a specific reference to these issues.

Palliative Treatment

- 6.0 It is a form of medical care that concentrates on reducing the severity of disease symptoms, rather than striving to halt, delay or providing a cure. The objective here is to prevent and relieve suffering and to improve quality of life. Once again, in the absence of any definition, it is not clear whether the term “treatment” will cover palliative treatment or not.
- 6.1 One would have expected the draftsman to be more particular in this area so as to avoid legal issues arising.

Defining the places of Health Treatment

- 7.0 The proposed section takes in its ambit three different places where health services are provided viz. hospital, nursing home or multi-specialty clinic. What is hospital? Which place has to be called nursing home? Are all these terms defined in any statute? Is there any legal regulatory authority which defines the norm for such places in India? No. More recently a bill called The Clinical Establishments (Registration and Regulation) Bill has been placed before the Parliament in February, 2010. It proposes to streamline the functioning and provision of services by clinical establishments. It is proposed to regulate not just allopathic facilities, but also clinical establishments that provide services in a range of Indian systems of medicine. Although, the said Bill does not define the terms “hospital”, “nursing home” etc. it defines “*clinical establishment*” as follow:

(i) a hospital, maternity home, nursing home, dispensary, clinic, sanatorium or an institution by whatever name called that offers services, facilities with beds requiring diagnosis, treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicine established and administered or maintained by any person or body of persons, whether incorporated or not; or

(ii) a place established as an independent entity or part of an establishment referred to in sub-clause (i), in connection with the diagnosis or treatment of diseases where pathological, bacteriological, genetic, radiological, chemical, biological investigations or other diagnostic or investigative services with the aid of laboratory or other medical equipment, are usually carried on, established and administered or maintained by any person or body of persons, whether incorporated or not, and includes clinical establishments owned, controlled or managed by the Government, a Trust, a Corporation, a local authority and a single doctor establishment, but does not include the clinical establishments owned, controlled or managed by the Armed Forces. [(Section 2[c])

- 7.1 As can be seen, the draftsman has not taken cognisance of the term “clinical establishment” as per the proposed definition. However, some of the State Governments have tried to regulate medical services through local laws. Notable among the same being is Bombay Nursing Homes Registration Act. Some of the terms referred to under the proposal find definition therein. They are as follow:

Nursing Home:

S. 2(8): Nursing Home means “a place where patients are treated as inpatients with facilities for admission as inpatients for treatment of illness without or with surgery or conduct of delivery and also includes other gynecological operations where women are received or accommodated for the purpose of sterilisation, hysterectomy, or medical termination of pregnancy etc. with or without overnight inpatient facilities”.

A proposal was moved for extending the above definition as follow:

Nursing Home would include “any inpatient medical clinic, nursing home, Maternity home, hospital, old age homes, day care centers (any intervention which would require observation and on-going care/ monitoring).

Hospital:

As per the proposal the hospital has been defined as “a place where patients are treated as inpatients with facilities for admission as inpatients for treatment of illness without or with surgery or conduct of delivery and also includes other gynecological operations where women are received or accommodated for the purpose of sterilisation, hysterectomy, or medical termination of pregnancy etc. with or without inpatient facilities”.

To what extent these definitions will help in interpreting the provisions of ST is a point to be seen.

Issues arising for Service Providers

- 8.0 The SP will have the tough task of identifying taxable transactions. As we have seen, at the first level, the SP will have to identify the payee for the services rendered. In the second step, it will have to be ascertained whether the services rendered are within the defined category. Accounting for all these will have to be carried out at an early stage so that bills can be raised with ST accordingly.
- 8.1 In case of health insurance, two modes of payments are prevailing. Under the first mode, the patient makes the payment to the hospital and seeks, thereafter, reimbursement from the insurance company. In this case, since the payment is being made by the patient to the SP, the services will not be taxable. In the second method, as per the prior arrangement between the HIC and hospital, payment is made directly by the insurance company to the SP. In this instance, the service will be taxable.

Issues arising for the Employers

- 9.0 As can be seen from clause (i), the focus for determining the applicability of the taxing provision is type of the payee for services rendered. In the case of large corporate houses, arrangement exists between the employer and the hospitals for the

direct payment to the SP. However, even in such cases, applicability of the provision will be restricted to the category of “health check-up” and “preventive care”. Naturally, therefore, the payment for “health care” or other medical services like surgery etc. will not be covered. This is for the reason that wordings for sub-clause (i) and (ii) are different. In fact, the above said letter by TRU refers to the arrangement for “health check-up” and “preventive care”. Therefore, it appears that the idea for keeping the coverage restricted is a conscious decision.

- 9.1 Here, once again it may so happen that the employer may reimburse the expenses incurred by the employees for health services. In such cases, since the payment is being made by the patient directly to the hospital, it will be out of tax-net. Considering the amount of tax involved, many of the employers may switch-over to such an arrangement.

Bonanza for Health Insurance Companies (HIC)?

- 10.0 Since the Government has levied the tax, it has to be recovered from the user of services. Therefore, HIC will have an excuse, and soon may be a reality in near future, for raising the rate of Medclaim Insurance policies. Although, it can be justified from the perspective of HIC, the most important aspect that should not be lost sight of is entitlement of CENVAT credit to HIC. HIC will be entitled for the credit of tax paid to hospitals which can be adjusted against the tax liability arising in their own case i.e. ST collected from policyholders of Medclaim. Since, the amount involved in respect of hospitalization expenses are small part of the total premium collected, HIC will have substantial amount of CENVAT credit for adjustment against tax liability arising for insurance services rendered. Therefore, any increase in the rate of insurance premium in the guise of new tax on health services will be a bonanza for HIC.

Impact on Patients

- 11.0 Sub-clause (i) and (ii) differentiates between two types of patients viz. employees receiving the services and HIC. As far as employees of the companies are concerned there may not be any impact as the employer will bear the additional burden of tax arising. In majority of the cases, it may be possible to claim CENVAT credit by the employers. This is, of course once again subject to the dispute regarding the classical legal battle “in relation to” as referred to in Explanation 2(1)(ii) of S. 2(k) of CENVAT Rules.
- 11.1 In certain cases, the employer may switch over to a system of reimbursement to the employees and keeping itself out of picture. In such cases, the patient will have to make the payment in the first stage and lodge the claim for reimbursement from the employer.

Graphical Portrait of Labyrinth

- 12.0 Despite having attempted to make it as simple as possible, any one is bound to be confused. Let us try to draw the labyrinth and see how it will look like.

Matrix showing applicability of the proposed Service Tax provisions on health care services							
Health services rendered by --→		Central and State Government, Local Authorities, Charitable Trusts, Corporate bodies, Partnership Firm, Individuals, Association of Persons and Body of Individual					
Services rendered at -----→		hospital, nursing home or multi-specialty clinic			Other places		
Payment for services by -----→		BE	HIC	Others	BE	HIC	Others
<i>Payment for Employee of</i>	Type of services covered						
AoP	Health Care	Yes	Yes	NA	NA	NA	NA
	Preventive Care	Yes	No	NA	NA	NA	NA
	Treatment	No	Yes	NA	NA	NA	NA
BoI	Health Care	Yes	Yes	NA	NA	NA	NA
	Preventive Care	Yes	No	NA	NA	NA	NA
	Treatment	No	Yes	NA	NA	NA	NA
Company	Health Care	Yes	Yes	NA	NA	NA	NA
	Preventive Care	Yes	No	NA	NA	NA	NA
	Treatment	No	Yes	NA	NA	NA	NA
Firm	Health Care	Yes	Yes	NA	NA	NA	NA
	Preventive Care	Yes	No	NA	NA	NA	NA
	Treatment	No	Yes	NA	NA	NA	NA
Central / State Government, Local Authorities	Health Care Preventive Care Treatment	NA	NA	NA	NA	NA	NA
Person covered by HI scheme	Health Care	NA	Yes	NA	NA	NA	NA
	Preventive Care	NA	No	NA	NA	NA	NA
	Treatment	NA	Yes	NA	NA	NA	NA

From the aesthetic perspective, the portrait is certainly not the one in its natural eye soothing format. It looks more like a tailor-made deformed baby.

Conclusion:

- 13.0 In Mahabharat, Abhimanyu got entangled in labyrinth as he did not have the knowledge of getting-out of it. As we know, levying tax on medical services will be resisted strongly by various sections of the society. Unlike Abhimanyu, the Government has taken a cautious approach by entering the first layer of the labyrinth and testing (or “tasting”) the challenge. Let us see whether the proposed section meets the fate of Abhimanyu or survives it.