

THE GOODS AND SERVICES TAX DIARY-VI

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(1) GST IN NEWS:

THE IT STRATEGY FOR GST

Please refer enclosed pdf file.

CENTRE COULD ALIGN RATES OF TAX ON GOODS WITH SERVICES BEFORE GST: RANGARAJAN

The Goods and Services Tax (GST) might take a while to take effect, but in the meantime, the Centre could make an effort, at its level, to “unify the rates of taxation of commodities with that of services,” said CRangarajan, chairman of the PM’s Economic Advisory Council. The Budget could be an opportunity to do this, he said. Rangarajan pointed out that the Cenvat credit remains unused in some cases where services are part of the production of a commodity. This is because there is no output service at the factory-gate level for the industry to claim the set-off. The lack of a facility for credit adjustment between central and state VATs (which is what the GST would essentially address) too adds to the cost of businesses. For big retail chains, service tax on rentals which account for 30-40% of the operating cost, cannot be offset as the only output tax they pay is state VAT. Similarly, for telcos, state VAT incurred turns out to be a lingering cost. PwC executive director R Muralidharan says, “Currently, excise and service taxes are levied by the Centre under different laws – the Central Excise Act and Finance Act. Although there is a common credit pool for both these in the Cenvat chain, it would be better if they are levied under single law, for better alignment.” Excise duty, the tax on manufacture, is levied on the ex-factory price – in the case of over 100 packaged commodities, the levy is on MRP, but even there, there is a system of abatement to offset the impact of the larger base (MRP tends to be 25-30% higher than ex-factory price for most items). At present, the excise on 95% of the commodities is 10%; a few items like medicines and paper attract a lower duty of 4% , while some food items like edible oil are exempt. At the state level, the VAT on sale price of goods is levied at a standard rate of 12.5% for most items (some states recently hiked this to 15%); a relatively smaller set of items – raw materials, capital goods, garments and IT hardware – are subjected to a 4-5% tax, and there are over 9,200 items including fruits and vegetables and specified items of local importance that are exempt. So, on a weighted average basis, the excise rate is 9-10%, and that of state VAT is 10-11% (including the incidence of VAT on excise but ignoring the different tax bases). So, the aggregate tax rate for goods is about 21% at present. This is not significantly different from the combined initial GST rate of 20% (10% +10%) which the Centre had proposed for most itrems. (The GST rate for most goods, as per the Centre's draft, would be reduced to

18% in the second year and further, to 16% in the third year). The concessional rate of tax for merit goods in the GST system is proposed at 12%. As against this, the service tax is now levied by the Centre on 117-odd services at 10%. "The tax regime right now is clearly biased towards services which attract a lower rate of tax," said Pratik Jain, executive director at KPMG. So, in case the GST faces further delays, which seems likely due to political squabbles, the Centre would have a window to raise the service tax rate in the interim. "Budget 2011 must keep in mind the need for the economy to grow at about 9%... That being the broad objective, it must also be ensured that the process of fiscal consolidation is well-placed, that the fiscal deficit is reduced from the previous year's level," Rangarajan said. Excise and service tax are major resources of revenue for the government, with the Budget estimates for the current fiscal pegged at Rs1.3 lakh crore and Rs 68,000 crore respectively. Although a relatively recent impost (introduced in 1994), service tax has been the fastest growing tax head in recent years. In the current year, however, excise grew much faster (33.7% during April-September) as compared to service tax (19.2%). This shows that the constraints in keeping the last few years' very high level of growth in service tax collection, with the current set of services. There is already a move to bring major areas like education and health under the service tax net. – www.financialexpress.com

CENTRE, STATES DEADLOCK ON GST LIKELY TO CONTINUE

The Centre's efforts to bring in a consensus on Goods and Services Tax (GST) before the Budget may face hurdles from the NDA-ruled states which feel that vital issue of states' autonomy has not been addressed in the new draft on the indirect tax reforms. Ahead of the crucial meeting of state finance ministers on February 11 here, Madhya Pradesh Finance Minister Raghavji told PTI over phone that "there is nothing new in the third draft on GST constitutional amendment bill." He further said there is no provision to address the issue of state autonomy. Sales tax has been a domain of state governments so why should the states allow the Centre to levy taxes on it. On February 11, the state finance ministers will also meet Union Finance Minister Pranab Mukherjee. Bihar Deputy Chief Minister and Finance Minister SushilModi said the new GST proposals may not impress the states as there is nothing on the Central Sales Tax (CST) compensation issue. "I do not want to speculate whether the meeting would yield results or not. However, the new draft is unlikely to impress the states as the CST compensation issue has not been resolved," Modi said. CST, a tax on movement of goods from one state to another, was reduced from 4 per cent to 3 per cent in 2007-08 and further to 2 per cent in 2008-09 after the introduction of VAT as it was considered distortionary. However, the states say they have not been adequately compensated on the loss in revenue. Taking into consideration the states' concern, the Finance Ministry has floated the third draft on GST constitution amendment bill recently. The new draft proposed to create a GST Council through an Act of Parliament, instead of presidential order, as proposed in the previous draft. Besides, the Centre has also dropped any reference to the Union finance minister heading the GST Council. – www.economicstimes.indiatimes.com

GOVT WATERS DOWN AMENDMENT FOR GST

Drops presidential order and FM's role to reach a consensus. In a last-ditch attempt to reach a consensus before the Budget session of Parliament, the Centre has sent the empowered committee of state finance ministers yet another draft constitutional amendment on the proposed goods & services tax (GST). The draft — the third in the last seven months — proposes the creation of a GST Council through an Act of Parliament, instead of presidential order, as proposed in the previous draft. The empowered committee will convene in New Delhi on February 11 to discuss the revised draft. Later in the day, its members will meet Union Finance Minister Pranab Mukherjee, who is expected to press for the introduction of GST without further delay. The meeting assumes significance, as the finance ministry is keen to align tax proposals for Budget 2011-12 with GST. Seeking to bring on board all the states — several of whom have expressed concerns about loss of autonomy under proposals in earlier constitutional amendment drafts — the Centre has dropped in the latest version any reference to the Union finance minister heading the GST Council. “Details of the council will be provided separately in legislation that can be passed by Parliament at a later date. This would help the finance ministry convince states about GST at this stage and move ahead. Issues about the composition and functioning of the GST Council can be sorted out later,” a person familiar with the developments told Business Standard. In the first draft, the Centre had proposed giving the Union finance minister veto power in the GST Council and said its decisions would be binding on both the central and state governments. After the states strongly opposed the proposals, the finance ministry came out with a somewhat watered down second draft, which stated that every decision of the Council would only be taken after members present at a meeting reached a consensus. The constitutional amendment draft will also address concerns of some Union territories such as Delhi, who have sought specific mention of their powers in the Constitution. Besides, the issue of central sales tax compensation to states also remains to be resolved. After missing the original April 2010 deadline for GST rollout, the government proposed to introduce it in April 2011. But finance ministry officials have already said this date would also be missed. Even though the Centre is working towards putting in place the information technology infrastructure for GST, there has not been much headway on discussions over the proposed constitutional amendments or GST structure since the last meeting of the empowered committee of state finance ministers on December 6, 2010. – www.business-standard.com

BRING ATF UNDER GST ACT: PVT AIRPORT OPERATORS TO GOVT

India's private airport operators want the government to bring aviation fuel under the Goods and Services Tax Act in the upcoming budget and also double dutyfree allowances for passengers coming from international destinations. In a list of suggestions sent to the Finance Ministry, the Association of Private Airport Operators (APAO) - comprising airport operators of Delhi, Mumbai, Bangalore, Hyderabad and Kochi - demanded that jet fuel be brought under the GST. The GST is intended to bring taxation of goods and services across various states under a unified tax structure. “Currently, the difference in tax structure and especially the tax rates, results in heavy cost for the tax payers. In case of ATF, the tax rates substantially vary from state to state and Indian aviation industry,

being very price- sensitive, is adversely affected due to vast difference in ATF taxation,” the APAO members said in their proposal. – www.economictimes.indiatimes.com

CONSTITUTIONAL AMENDMENT BILL FOR GST IN BUDGET SESSION

The finance ministry plans to table a Constitutional Amendment Bill for introducing the Goods and Services Tax (GST) in the coming Budget Session of Parliament. The proposed regime to replace many existing indirect taxes levied by the Centre and states, has already missed deadlines twice and may come into effect from April 2012. “The Centre and the states have now been engaged for almost four years in developing a roadmap for the rollout of GST... We have missed the timelines twice and it is my earnest request that we move expeditiously and introduce the Constitutional Amendment Bill in the forthcoming Budget Session,” Finance Minister Pranab Mukherjee said during his meeting with the Empowered Committee of State Finance Ministers today. Finance ministry officials told Business Standard the Bill would be tabled in Parliament towards the later part of the Budget session, which starts on February 21. It will then be referred to a standing committee for scrutiny. Once the committee gives its report, the government should be in a position to get it cleared in the Winter Session (in December). “After that it will have to be ratified by the legislatures of at least half of the states. So, the earliest date for GST introduction will not be before April 2012,” said a finance ministry official. Earlier in the day, the Empowered Committee met to discuss the third Constitutional Amendment draft for introduction of GST. The new draft has tried to address the concern of the Empowered Committee to provide powers to Union Territories without legislatures to levy GST. It also proposed to create a GST Council through an Act of Parliament, instead of a presidential order, as proposed in the previous draft. Of the 26 states present in today’s meeting, 16 supported the revised draft, while the remaining 10 opposed it. Some states felt the second draft was better than the third one because it clearly laid down the functioning and composition of the GST Council. The opposition to the Bill mainly came from BJP-ruled states. While Madhya Pradesh Finance Minister Raghavji said this would destroy the fiscal autonomy of the state, Gujarat Finance Minister Saurabh Patel said, “The new constitution amendment draft proposed by the government is retrograde in nature and completely against the fiscal federalism.” Haryana Finance Minister Ajay Singh Yadav pointed out, “We had lots of deliberation on GST constitution amendment. Now, the Bill should be introduced in the Budget Session of Parliament.” During the discussion with the committee, Mukherjee said concerns of the states could be heard by the Standing Committee, which comprises members from the ruling party as well as the Opposition. The finance minister said he would meet the states for a detailed discussion on their views on GST in the second leg of the Budget Session. Meanwhile, the Centre has agreed to fully compensate states for the losses they suffered due to reduction in the central sales tax, estimated at Rs 14,000 crore in 2010-11. – www.business-standard.com

CENTRE TO FULLY COMPENSATE STATES FOR CST LOSS: DASGUPTA

The Centre has agreed to fully compensate states for the losses they suffered due to reduction in Central Sales Tax (CST) estimated at Rs 14,000 crore in 2010-11, chairman of Empowered Committee of State Finance Ministers Asim Dasgupta said today. The

state finance ministers met Union Finance Minister Pranab Mukherjee here to discuss the GST rollout. "He (Mukherjee) said that he is willing to make full compensation for CST loss this fiscal. To begin with it would be an hoc relief to be followed by subsequent measures," Dasgupta told reporters after the meeting. Yesterday, the government had approved Rs 7,029 crore compensation to states for CST loss in 2010-11. Of this Rs 3,000 crore is likely to be released this fiscal. Once the proposed Goods and Services Tax (GST) is rolled out, other existing indirect taxes, including the CST, would be subsumed into it. CST, a tax on movement of goods from one state to another, was reduced from 4% to 3% in 2007-08 and further to 2% in 2008-09 after the introduction of VAT, as it was considered distortionary. – www.business-standard.com

(2) OTHER NEWS:

FREE MEDICAL SAMPLES TO DOCTORS LIABLE TO EXCISE DUTY

Free medical samples supplied to doctors by pharmaceutical companies are liable to excise duty, the Supreme Court has reiterated in a new appeal case involving Medley Pharmaceuticals Ltd. The new case followed the 2003 ruling of the court in the Ranbaxy case, which had accepted the view of the excise authorities. Explaining the reason further, the court stated: "The primary reason for distributing free samples appears to be only for the purpose of advertising the product and thus enhancing the sale in the open market. It has been shown by research that the market of a pharma company is enhanced substantially by distribution of free samples. It serves as a marketing tool." The court further emphasised that sale was not a necessary condition for charging excise duty, rejecting the company's argument that physicians' samples are prohibited from being sold under the Drugs and Cosmetics Act and rules under it. – www.business-standard.com

ADVISORY SERVICES MAY COME UNDER TAX AMBIT

Some advisory services are on a list of up to 12 services that may be brought into the tax net in Budget 2011-12. Their possible inclusion is part of the finance ministry's attempt to boost service tax collections without tinkering too much with tax rates. Service tax is currently levied on scientific, technical and legal consultancy services. Advisory services are provided in a whole range of areas such as corporate finance, accounting, auditing, taxation, management and technology. At present, the government levies a tax on 117 services. Only three services were taxed when the levy was introduced in 1994-95. "Some 10-12 services could be brought under the tax ambit in this Budget. We are seeing it as a transition towards the goods & services tax. The only way to bring down rates under GST is to include more services," a finance ministry official, who did not wish to be named, told Business Standard. Another official said the number of new services to be taxed could well be more than 12. He said the effort would be to gradually include all items listed in the United Nations Central Product Classification for goods and services. The CPC is intended as an international standard to organise and analyse data

on industrial production, national accounts, trade and other aspects. The CPC includes services in sectors like trading, hospitality, transport, communications, business, agriculture, mining & manufacturing, community and social. India does not use the classification, but it does levy tax on 60-70 per cent of these services. "We look at international practices when levying tax on new goods and services. Still, there are many services in the CPC that are not yet taxed in India. All those will be gradually taxed. To begin with, advisory services can be included in the service tax," said an official. Official sources said services in electricity transmission, education and health were some big-ticket areas, but the finance ministry was in two minds about including them in the tax net. Services contribute around 60 per cent to GDP, but they generate only 10 per cent to tax collections. The government's service tax receipts grew 19 per cent to Rs 44,081 crore in April-December this fiscal. The growth was meagre, compared with the 68.1 per cent and 33.7 per cent recorded by Customs and excise collections, respectively, in the same period. The finance ministry added eight more services in the tax net in the last Budget, while amendments were made with regard to some existing services. The proposal to levy a tax on some services was challenged in various courts and could result in some loss to the exchequer. The government needs to raise additional resources to bring down the fiscal deficit from a projected 5.5 per cent of GDP this fiscal to 4.8 per cent in 2011-12. While it may not be in a position to raise tax rates because of high inflation, broadening the tax net and greater compliance may help it meet its fiscal consolidation targets. – www.business-standard.com

GOVT TO END CONFUSION OVER SOFTWARE TAX THIS BUDGET

THE forthcoming budget may bring cheer to India's .10,000-crore information technology industry as the finance ministry is keen to resolve ambiguities over taxation of software. "We will try to clarify some aspects of software taxation," a government official familiar with the discussions on the issue told ET. Although, the finance ministry made several attempts in the past to clear the haze over software taxation, its moves have failed to satisfy the industry. Confusion largely stems from the fact that software is sometimes treated as a good when sold on a compact disc, while it is considered a service when supplied via electronic download. This peculiar nature of software sometimes leads to double taxation, causing hardships not just to the industry but also to consumers. Though, the panacea may lie in the Goods and Service Tax (GST), experts say interim measures are also needed. "It is expected that implementation of GST shall conclusively settle the confusion which prevails on taxation of software, but in the interim the Centre should decide whether to treat supply of software as goods or services," said Bipin Sapra, partner at Ernst & Young. In its latest attempt to streamline taxation of software, the finance ministry had exempted service tax on retail sale of packaged computer software to address the problem of double taxation on it. The 10% exemption on service tax is conditional to payment of excise on the retail price if the software has been manufactured or imported. But, this only partially addressed the software industry's problem. Experts say confusion still prevails. "This notification only addressed the problem partly," said Pratik Jain, partner at KPMG. The issue of double taxation of software -- imposition of service tax and countervailing duty -- still exists for software packages sold with licenses. The industry was allowed to split the license fee and cost of the CD for tax

purposes as the cost of packaged software for institutional customers depended on the number of users. The latest notification, however, removed the provision of splitting. Industry bodies, such as the Nasscom, have taken up the issue with the government. "We expect clarity on this soon," said Som Mittal, president of Nasscom. The official quoted earlier said the government could look at restoring this provision again as one of the options to address the problem. The 2008-09 Budget had made payment of service tax mandatory on packaged software by broadening the definition of software to include 'the acquisition of right to use packaged software'. However, sometimes even packaged software comes with a license that allows the buyer legal use of the software. So if this software is downloaded, the user is required to pay service tax at the rate of 10%, and if the license is delivered to him separately, he has to pay excise or countervailing duty when imported. Confusion over treatment of software as a good or service is not just limited to federal taxes. Some states have also contributed to it by imposing value added tax on the sale of software. – www.economictimes.indiatimes.com

ENTERTAINMENT SECTOR SEEKS FREEDOM FROM MULTIPLE TAXES

Representatives from the media and entertainment industry today met Finance Minister Pranab Mukherjee and suggested multiple taxation should not be levied on the sector to promote growth. The delegation, in association with the Federation of Indian Chambers of Commerce and Industry (Ficci) and led by Information and Broadcasting Minister Ambika Soni, met Mukherjee as part of pre-Budget consultations. After meeting Mukherjee, Ficci said it had demanded that entertainment taxes in case of multiplexes be included in the proposed Goods and Services Tax (GST) regime. However, "multiplex operators should be exempted from payment of duties on import of cinema equipment, till GST is introduced," it added. The delegates also recommended that necessary equipment and hardware for film production be allowed to be imported without the additional burden of the Customs duty. Ficci, in a report to the finance minister, said digitisation was vital for the growth of the industry. "There is a need for clear and well-defined roadmap for the transition from analog to the digital mode across the country. Digitisation should be supported through fiscal incentives," it said. Industry stakeholders recommended that Customs duty on set-top boxes be minimised to bridge the demand-supply gap in the industry. – www.business-standard.com

INPUT COST BALANCING MAY GET EXPORTERS REFUND OF SERVICE TAX

A new scheme to refund service tax to exporters is in the works as the government seeks to neutralise all input taxes to enhance competitiveness of the country's export sector. The finance ministry has set up an expert panel to work out the modalities of the scheme. "Refund of service tax has been a big irritant for exporters," a government official told ET. The new scheme is likely to be on the lines of the duty drawback scheme under which exporters are reimbursed taxes paid on inputs at a fixed rate decided by an expert panel every year depending on changes in the tax rates. If the scheme is finalised well in time, an announcement could be made in the forthcoming budget on February 28, the official said. The move follows recommendations by a committee

appointed by the department of commerce to look into transaction costs faced by the exporters. A task force also monetized transaction costs worth \$12-15 billion, which was 7-10% of exports valued at \$160-165 billion. The total merchandise exports from India stood at \$178.66 billion in 2009-10 and the government proposes to raise it to \$200 billion in the current fiscal. Exporters in South East Asia and China face transaction costs as low as 3-3.5% making their goods more competitive in developed markets compared with Indian exports. Currently, the finance ministry refunds tax paid on 17 services consumed in exports and two services are exempted. Services eligible for tax refund include banking and other financial services, port services, transport of goods by road and railways, general insurance, technical testing and analysis, storage and warehousing, business exhibition services and specialised cleaning services. Service tax on transport of goods by road and commission paid to foreign agents is exempted for exporters. But experts say there is always a delay in getting refunds. "The procedure is cumbersome and causes delay in the grant of the refund," said Anita Rastogi, associate director at PwC. Though the finance ministry has made several attempts to simplify procedures related with refund of service tax paid on input services used in exports, administrative costs are high with tens of crores locked in refunds. "For small exporters compliance cost is sometimes higher than the refund itself and there is huge pendency making matters worse," said Ajay Sahai, director general of the Federation of Indian Export Organisations (FIEO). The idea now is not only to ensure that exporters' cash does not stay locked with the government for an indefinite period, but also to save them the hassle of going through paperwork every time they want to claim an exemption, the official added. – www.economictimes.indiatimes.com

PMO WRITES TO FINMIN ON INDIRECT TAX REFORMS

Ahead of the budget, the prime minister's office has written to the finance ministry suggesting integration of excise duty and service tax framework with goods and services tax. "The PMO has forwarded a detailed note on what steps are needed to prepare the ground for integration of two central indirect taxes - excise duty and service tax framework with that of GST," a government privy to the matter told ET. This is a clear indication that the UPA government is keen to push forth at least some elements of this comprehensive reform of country's indirect taxes structure in this budget itself. The finance ministry has already initiated work on aligning various procedures with those proposed under the GST. Some of elements like aligning the turnover threshold limit of taxation for excise duty of Rs 1.5 crore with Rs 10 lakh proposed in the GST are expected this budget. GST, facing opposition from BJP -ruled states, was scheduled to roll out from April 1, 2011. But, with the centre and the states failing to reach a settlement on the structure and various other elements required for the implementation looks all set to miss the deadline. – www.economictimes.indiatimes.com

CENTRE CLEARS COMPENSATION FOR RS 7,029 CR CST LOSS TO STATES

The Government today approved Rs 7,029 crore compensation to states for the losses they suffered due to reduction in central sales tax (CST) rate in 2010-11. The Union Cabinet, chaired by the Prime Minister Dr Manmohan Singh, has approved a proposal for providing CST loss related compensation to states incurred in the current financial year, Information and Broadcasting Minister Ms Ambika Soni told reporters after the meeting. "The financial implication of this proposal is estimated at approximately Rs 7,029 crore," Ms Soni said adding that Rs 3,000 crore are likely to be released in 2010-11, while the balance of Rs 4,029 crore would be given in the next fiscal. "An additional requirement of Rs 3,000 crore for 2010-11 has already been included in the budgetary outlay..," she added. The Cabinet approved the "on account payment" of compensation to the states, pending finalisation of guidelines for revenue loss incurred by states in the current fiscal because of reduction in CST rates. CST, a tax on movement of goods from one state to another, was reduced from 4 per cent to 3 per cent in 2007-08 and further to 2 per cent in 2008-09 after the introduction of VAT, as it was considered distortionary. States have estimated the loss at Rs 20,000 crore this fiscal on this account and are demanding reimbursement for the same. – www.thehindubusinessline.com

PERMANENTLY FIXED FURNITURE TOO SUBJECT TO EXCISE

The SC ruled last week central excise duty can be levied on furniture permanently fixed to the walls or ground. It set aside the decision of the Customs, Excise and Service Tax Appellate Tribunal, Bangalore, which took a contrary view in the case, Commissioner vs Mehta & Co. This Mumbai company was engaged in interior decoration of luxury hotels. It entered into turn-key contracts with its clients and furniture was part of the work contract. When the revenue authorities demanded excise duty, it protested the woodwork was carried out in the premises of the hotels and they were permanent fixtures. They cannot be removed without causing damage to the goods or cannibalisation. When the contention was rejected, the firm moved the tribunal, which accepted its argument. The excise commissioner appealed to the SC. It quashed the tribunal's order. – www.business-standard.com

FINMIN MAY REVIEW SERVICE TAX ON AIR TRAVEL

The finance ministry is reviewing the levy of service tax on air travel. In the coming Budget, it may consider either doing away with the tax or removing the upper limit. In July last year, the ministry had put a cap on service tax in case of domestic flights at 10 per cent of the gross value of the ticket, or Rs 100 per travel, whichever is less, and on international travel by economy class at 10 per cent of the gross value of the ticket, or Rs 500, whichever is less. A finance ministry official said since the service tax was capped at Rs 100 for domestic and Rs 500 for international travel, in many cases, the credit of tax paid on inputs used to provide services was more than the service tax paid by the airline. "Input tax credit is not given when an item is exempted from service tax. But by paying a nominal amount as service tax, airlines can claim tax credit, which is sometimes huge. So, either the service tax should go or the cap removed," the official told Business Standard. Excise duty and service tax paid by a service provider on inputs

used to provide services are available to it as credit. This can be used to pay the service tax due to the government on the services provided. A service provider exempted from service tax on output services cannot claim credit on taxes incurred on the costs. Maintenance, airport landing, parking and security are some of the input services used by airlines. “When you pay service tax on a value basis (for example, 10 per cent of Rs10,000), you get credit for ATF, which is 30 per cent of the cost of an airline. But when you pay it on a fixed basis (Rs 100 or Rs 500), the input tax credit on excise duty is not given. The credit is paid only for the input service. Still, most airlines opted for the fixed option where they had to forgo the ATF credit. The sector has not yet recovered fully and the increase in ticket prices will have affected customers,” said Sujit Ghosh, partner, BMR Legal. The government had proposed in Budget 2010-11 that 10 per cent service tax be charged on air travel. The move was aimed at raising Rs 600 crore and Rs 1,000 crore annually from domestic and international operations, respectively. The aviation industry opposed it. The finance ministry later issued a notification and said service tax would be levied at 10 per cent of the ticket value or Rs 100 for passengers travelling in any class within India, and 10 per cent or Rs 500 per journey for those on an international journey in the economy class. – www.business-standard.com

(3) FROM THE GOVERNMENT:

Insurance Services - Clarification regarding service tax exemption for Janata Personal Accident Policy

CIRCULAR NO. 133/2/2011 - ST, DATED 18-1-2011

1. A clarification has been sought as to the scope and meaning of the description namely ‘Janata Personal Accident Policy (JPAP)’ appearing in the [Notification No. 3/1994-ST, dated 30-6-1994](#).
2. The issue has been examined. The representation seeking clarification arises in the context of customized group insurance policy schemes known as JPAP, floated by various insurance companies as specified by State Governments, to extend risk cover to certain specified target populations, under varying terms of insurance. Generally, a standard JPAP is an individual oriented policy with a fixed ‘sum assured’. The sum assured in these JPAP policies is often as low as Rs. 25,000, so that even people without regular income can afford to purchase a risk cover for themselves. For the insurers, JPAP offers a vehicle to fulfil the ‘rural or social sector’ obligation prescribed by the Insurance Regulatory Development Authority (IRDA). Since a description of JPAP Policy is not available in the relevant notification, it is clarified that customized group JPAP insurance schemes floated by various insurance companies as per the specifications of State Governments concerned, to extend risk cover to target populations, and to fulfil the prescribed ‘rural or social sector’ obligation, are covered by the subject service tax exemption.
3. Trade Notice/Public Notice may be issued to the field formations accordingly.

(4) CASE LAWS:

CLASSIFICATION OF GOODS

HIGH COURT OF ALLAHABAD

Himani Ltd. v. Commissioner of Commercial Taxes, UP, Lucknow.

SALES/TRADE TAX REVISION NOS. 93,95,96,98 TO 100,113 TO 117,128,132,145,151,169 AND 186 OF 2010

All these revisions both by the assessee dealers and the revenue are directed against the order of the Commercial Tax Tribunal Kanpur Bench -3 dated 29.12.2009.

The tribunal by the impugned order has classified Himani Boroplus Antiseptic Cream, Himani Gold Turmeric Cream and many other similar items as cosmetics whereas Himani Hair Oil and such other products as medicament and directed for levy of tax accordingly.

It may be worth noting that under the provisions of the U.P. Trade Tax Act items of medicament are taxable at a lower rate and cosmetics at a higher rate. It is for this reason the classification has acquired importance.

Learned counsel for the parties have advanced their submissions by taking revision no.99 of 2010 as the leading case. I, therefore, state in brief the facts of the aforesaid case only which may be sufficient for understanding the background leading to the passing of the impugned order in connection with all items involved.

In the above revision the tax liability of the assessee-dealer in respect of only two items, namely, Himani Boroplus Antiseptic Cream and Himani Gold Turmeric Cream for the assessment year 1994-95 is involved. The department by the assessment order dated 28.12.1995 subjected the above items to tax at the rate of 7.5% by classifying them as Ayurvedic medicament. Later on, proceedings under Section 21 of the Act were initiated by issuance of a show cause notice dated 6.2.1998 in view of a decision of this Court in the case of Balaji Agency Vs. Commissioner of Sales Tax, 1994 UPTC 184 and a reassessment order was passed on 19/21.9.1998 classifying the above two items as items of cosmetic taxable at the rate of 15%. The appeal of the assessee before the Deputy Commissioner was dismissed on 31.3.1999. However, further appeal to the tribunal was allowed vide order dated 21.10.1999 whereby the above products were held to be medicaments taxable at a lower rate. Aggrieved by the said order of the tribunal, revenue preferred T.T.R.No.400 of 2000 which was decided vide judgment and order dated 13.11.2007 and the matter was remanded to the tribunal for passing a fresh order after

applying the “twin test” as laid down in the case of Puma Ayurvedic Herbal (P) Ltd. Vs. Commissioner of Central Excise (2006) 3 SCC 266.

It is on remand that the impugned order has been passed by the tribunal upholding the orders of the two authorities below taxing the above goods on a higher rate as items of cosmetics.

I have heard with pleasure Sri Bharatji Agarwal, Senior Advocate ably assisted by Sri Ashok Kumar and Sri Narendra Sharma, counsel for the assessee-dealers and Sri B.K.Pandey, learned Standing Counsel for the revenue and with their consent proceed to decide the matter finally.

All these revisions raise a common question of law as to whether the above referred products are taxable as cosmetics or as medicaments.

The answer to the question as to whether the above referred goods are medicaments or cosmetics depends much upon the common meaning of the above two words.

The word medicament' has not been defined either in the concerned statute or anywhere else. However, according to the dictionary meaning 'medicament' means anything which is used for healing which in common parlance refers to a medicine.

Medical is a term used for the art of healing diseases and something intended to promote study of medicine i.e. science and art of mitigation, prevention, cure and alleviation of disease whereas medicine means anything applied for the cure or lessening of disease or pain whether single or compound (made up of more than one ingredient). Medicine as such is any substance liquid or solid that has the property of curing or mitigating disease or which is administered in a treatment of disease and it may be a combination of drugs in largely varying proportions. Anything related to medicine is medicinal and anything mixed with medicine is medicated. The process of such mixing of medicinal substances having the power to cure or to heal is medication.

The word cosmetic has been defined under Section 3(aaa) of the Drugs and Cosmetics Act, 1940 as under:

'Cosmetic' means any article intended to be rubbed, poured, sprinkled or sprayed on, or introduced into, or otherwise applied to, the human body or any part thereof for cleansing, beautifying, promoting attractiveness, or altering the appearance, and includes any article intended for use as a component of cosmetic.

Its dictionary meaning is, substances used for improving beauty especially that of the complexion or for beautifying skin and hair.

The Drugs and Cosmetics Act, 1940 also defines 'drug' under Section 3(b) of the Act to include:

“(i) all medicines for internal or external use of human beings or animals and all substances intended to be used for or in the diagnosis, treatment, mitigation or prevention of any disease or disorder in human beings or animals, including preparations applied on human body for the purpose of repelling insects like mosquitoes;

(ii) such substances (other than food) intended to affect the structure or any function of the human body or intended to be used for the destruction of vermin or insects which cause disease in human being or animals, as may be specified from time to time by the Central Government by notification in the Official Gazette;

(iii) all substances intended for use as components of a drug including empty gelatin capsules; and

(iv) such devices intended for internal or external use in the diagnosis, treatment, mitigation or prevention of disease or disorder in human beings or animals, as may be specified from time to time by the Central Government by notification in the Official Gazette, after consultation with the Board;”

Drugs may vary under different medical systems such as Ayurvedic, Siddha or Unani, Allopathy and Homoeopathy.

“Ayurvedic, Siddha or Unani drugs” has been defined in Section 3(a) of the Drugs and Cosmetics Act, 1940 as under:

“(a) “Ayurvedic, Siddha or Unani drug” includes all medicines intended for internal or external use for or in the diagnosis, treatment, mitigation or prevention of disease or disorder in human beings or animals, and manufactured exclusively in accordance with the formulae described in, the authoritative books of Ayurvedic, Siddha and Unani Tibb systems of medicine, specified in the First Schedule;”

Now from the above definition of 'cosmetic' as distinguished from 'drug' or 'medicament', it may be seen that cosmetics are meant to improve appearance of a person by enhancing beauty specially through treatment of skin and hair; whereas a medicinal product or a medicament is meant to treat, prevent, cure or reduce a disease or an ailment.

Many a times, a medicament may also contain properties of a cosmetic item and in curing or healing a disease may also ultimately result in enhancing the beauty of a person using it.

This can be illustrated by the following few illustrations.

Generally, a soap is used for cleansing and hygienic purposes only. It is commonly called a toilet soap but at times dermatologist may prescribe use of medicated soap for remedial or preventive purposes concerning skin related problems. Thus, a soap may, in a given case, be a medicament. Similarly, a toothpaste in common use may be recognised as a toilet product but when a special toothpaste with medicinal properties is prescribed by a dentist it is a medicament as distinguished from ordinary toilet toothpaste. In the same way, liquor is ordinarily used for intoxication but at times it may be used for medical purposes. A particular Ayurvedic product may be used for the treatment of baldness which is a hair related disease. The use of such Ayurvedic product may not only cure baldness to some extent but may enhance the general appearance of the person using it as with the cure of the disease hairs may grow.

In such cases and circumstances it becomes difficult to classify the product either strictly as medicament or cosmetics. In such a situation the primary role and the purpose of use of the product becomes the determining factor for its classification.

Law is well settled through various pronouncements of the Supreme Court that the burden/onus probandi to prove the classification of a particular product is upon the revenue.

In *Union of India and others vs Garware Nylons Ltd. etc.* AIR 1996 Supreme Court 3509, it has been held that the burden to prove that a particular item is taxable in the manner claimed is upon the taxing authorities and mere assertion that it falls under a particular clause alone is of no avail. This is particularly necessary when the claim of the assessee is supported by material and affidavits of the person dealing in those goods.

In *CCE vs. Sharma Chemical Works* 2003(5) SCC 60, it has been held that it is settled law that the onus or burden to show that a product falls within a particular tariff item is always on the revenue. The mere fact that a product is sold across the counters and not under the doctor's prescription, does not by itself lead to a conclusion that it is not a medicament.

In *Dabur India Ltd. Vs. CCE, Jamshedpur* (2005) 4 SCC 9 the three Judges of the Supreme Court following *Sharma Chemical Works* (supra) and (1996) 9 SCC 402 *Shree Baidyanath Ayurved Bhawan Ltd. Vs. CCE* reiterated and reaffirmed the above principle that the burden of proof that a product as classified under a particular tariff is on the revenue and must be discharged by proving that it is so understood by the consumer of the product or in common parlance.

In the instant case admittedly the products in question were earlier treated as medicaments and were subjected to tax accordingly. Later on, the revenue had started assessing them as cosmetics therefore, the burden to prove that they are taxable as cosmetics lies heavily upon the revenue only.

It is not in dispute that the assessee-dealers produced enormous evidence in the form of the affidavits of the persons dealing with almost all of the aforesaid products, namely dealers, consumers, doctors and research persons. Even authentic Ayurvedic texts recognised under the Drugs and Cosmetics Act 1940 were produced to establish that the aforesaid products have medicinal properties and value and are not actually used as pure cosmetics.

On the other hand it is admitted on record that the revenue had done nothing to discharge the aforesaid burden. It had not adduced any evidence whatsoever to establish that the aforesaid products are of cosmetic nature and cannot be classified as medicaments. None of the affidavits or the other evidence adduced by the assessee-dealers were rebutted either by filing counter to any of the said affidavits or by adducing contra evidence.

Now in the above background, I proceed to examine the nature of the above products for the purposes of their classification on the anvil of the twin test i.e. common parlance test and the use of ingredients based upon authoritative Ayurvedic text books.

In order to determine whether a product is an item of cosmetic or a medicament a twin test as aforesaid had always found favour with the courts. The Apex Court approved the application of the twin test for the first time probably in the case of CCE vs. Richardson Hindustan Ltd. (2004) 9 SCC 156 and held that the above two tests to be determinative for classifying the goods for taxation purposes. The above two twin tests, at the cost of repetition are (i) common parlance test i.e. to see and find out how the product in common parlance is understood and accepted; and (ii) whether the ingredients used for making the product find mentioned in the authoritative text books on Aayurved.

The aforesaid twin test finds the approval of the Supreme Court in the case of Pumma Ayurvedic Herbal (P) Ltd. vs. Commissioner, Central Excise Nagpur 2006 (3) SCC 266.

The assessee/dealers have adduced enough uncontrovered evidence in the form of affidavits of the following persons:

(i) Dr. Hari Shanker Sharma dt 21.7.1996;

(ii) Dr. (Smt.) Shashi Bundel dt. 6.8.1996;

(iii) Dr. Anand Rai dt. 17.8.1996;

(iv) Dr. S.K. Jaswasi dt. 6.8.1996;

(v) Dr. D.K. Jain dt. 26.8.1996;

(vi) Dr. D. Sohne dt. 6.8.1996;

(vii) Dr. Chitranjan Rai dt. 17.8.1996;

(viii) Dr. Kailash Singh Tomar dt. 19.8.1996;

(ix) Dr. Abhay Shanker Ojha dt. 19.8.1996;

(x) Dr. Mragank Mohan dt. 19.8.1996; and

(xi) Dr. P.K.Devnath dt. 16.8.1996

Apart from the above, certificates issued by (i) Dr. Sree Niwas Shastri (Aayurvedacharya) dated 20.10.90, (ii) Dr. Smita Pharsole dated 28.8.1989; and (iii) Dr Niranjan Prasad Sharma dated 8.10.1991 etc. were also brought on record.

All the above affidavits and the certificates apart from the other evidence such as prescriptions, certificates of the hospitals, certificates of medicine dealers and certificates of the consumers goes on the show that the aforesaid products are generally used as medicaments to treat minor cuts and wounds and that the results have been satisfactory.

The Tribunal by the impugned order brushed aside the aforesaid evidence even though there was no contra evidence on record. One of the reasons for ignoring the above evidence was that four of the affidavits namely that of Dr. Abhay Shankar Ojha, Dr Mrgang Mohan, Dr. Anand Rai and that of Dr. P.K. Devnath happened to be type written on one common machine and appeared to be more or less identical in language and therefore even if they have not been countered it does not make them admissible in evidence.

Similarly, three other affidavits of Dr. D. Sohne, Dr. Chitranjan Rai and Dr. Kailash Singh Tomar dated 6.6.96, 17.8.96 and 19.8.96 respectively were also discarded.

It was no ones case that the aforesaid affidavits were false or incorrect or that they do not reflect the true state-of-affairs. The fact that they were typed out on the same machine or were more or less identical in nature can not first of all be a relevant criteria to discard them in evidence when there veracity is not being disputed. Moreover, even if some of the aforesaid affidavits are ignored, sufficient other evidence in the form of other affidavits and certificates of the recognised authorities remain and there is no reason whatsoever to ignore them and to take a view that the products in question fail to qualify the twin test for classifying them as medicaments.

One of the affidavits of Dr. Hari Shanker Sharma who happen to be in medical profession for the last 45 years on the date of the affidavit i.e. 21.8.1996, clearly states that Himani Boroplus Antiseptic Cream is an Ayurvedic medicine which was prescribed by him to various patients suffering from skin diseases such as minor cuts, burns wounds, chopped skin, scratches etc. and the results were satisfactory and he is regularly prescribing it for

cure of skin diseases. To the same effect he has also filed affidavit dated 14.10.1996 in respect of Himani Gold Turmeric Cream. The above affidavits and similar other affidavits of qualified medical practitioners have neither been controverted nor have otherwise been discarded by the tribunal.

Besides the above evidence, Drug Licences, authorised texts of Ayurvedic books and labels used on the products were also produced.

All the aforesaid evidence actually proves that they satisfy the twin test laid down for classifying the goods. The said evidence sufficiently proves that people in general use the above products for curing and treating burns, minor cuts and wounds and not for improving their general appearance. In common parlance these products are treated as medicaments. Above all, they are made of ingredients which found reference in Ayurvedic text books as prescribed under the Drugs and Cosmetics Act, 1940.

The other ground on which the Tribunal non suited the assessee dealers is that though the above products have been manufactured from the ingredients which are mentioned in the authoritative Ayurvedic text, nonetheless as their use in the said products is nominal, they cannot be classified as medicaments.

In *Sharma Chemical Works (supra)* the Supreme Court held that where all the ingredients used for manufacturing a product were found in Ayurvedic text, merely because the percentage of medicaments is less does not mean that the product is not a medicament. Generally, the percentage/dosage of the medicament will be such as can be absorbed by human body and the use of medicament would necessarily be covered by fillers/vehicles in order to make the product usable.

In the case of *Amritanjan Ltd. vs. CCE 1996 (9) SCC 413* it has been held that the mere use of the ingredients or that they are purified or added with some preservative does not alter their character so long as the ingredients used therein were known to both Ayurvedic and Western Sciences.

In *Richardson Hindustan Ltd. (supra)* Vicks Vaporub was held to be Medicament by the Supreme Court even though it contained only 2% menthol and 98% was paraffin wax.

In *Puma Ayurvedic Herbal (P) Ltd. (supra)*, the Supreme Court explained and laid down that the extent or the quantity of the medicament used in a particular product is not a relevant factor for its classification. The extent of use of medicinal ingredients in a product is sometime very low because excess or large use of them may be harmful for human body and as such they are required to be mixed up with what is in trade parlance called fillers and vehicles in order to make the medicament useful. It was illustrated by an example of vicks vapourub which has been referred to above. Thus, it was held the fact that use of medicinal elements in a product was minimal does not detract it from being

classified as a medicament. It was also held that in order to be a medicinal preparation or a medicament it is not necessary that the item must be sold under a doctor's prescription and it makes no difference if it is available across the counter in shops.

It is common knowledge that paraffin wax is a filler or a vehicle in which Ayurvedic contents are mixed for making a medicine. Therefore, non-mention of paraffin wax in any Ayurvedic text makes no difference and the tribunal manifestly erred in returning a finding that as paraffin wax is not an Ayurvedic material the product made by using it can not be a medicament.

In *Union of India and others Vs. G.D. Pharmaceuticals Ltd. and another* (2001) 9 SCC 759 Boroline antiseptic cream containing boric acid and zinc oxide was held to be a medicament. However, this authority of the Supreme Court has been distinguished by the Tribunal on the ground that Boroline comprises of certain IP (Indian Pharmacopoeia) drugs whereas in the products in question there are no such drugs. The distinction made is not tenable in view of the admitted position that the ingredients used for their preparation have medicinal properties and are contained in the authoritative Ayurvedic texts notwithstanding the fillers used not being Ayurvedic products.

In *Muller and Phipps (India) Ltd. Vs. CCE* (2004) 4 SCC 787 the apex court treated Johnson prickly heat powder to be a medicament and not an ordinary talcum powder as it is known for curing problem of prickly head. Similarly, in the cases of medicated shampoo meant to treat dandruff, a disease of hair, the Supreme Court held the shampoo to be a medicament vide 1995 Supp. (3) SCC 1 *BPL Pharmaceuticals Ltd. Vs. CCE*.

Apart from the above, the assessee-dealers had produced respective licences for the manufacture, sale and distribution of drugs which have not been denied. According to the plain reading of the definition of 'drug' given under Section 3(b) of the Drugs and Cosmetics Act, 1940 it includes within its fold all medicines for internal and external use of humans/animals. Items of cosmetics are not covered within the definition of 'drugs'. It may be noted that separate licences for dealing in drugs and in cosmetics are to be taken out under the Drugs and Cosmetics Rules, 1945 framed under the Act. Now when the licensing authority under the above Act has granted the assessee dealers licenses either for the manufacture, sale or distribution of drugs and not for cosmetics, it means they can not deal with cosmetics unless a separate license to that effect is produced. In the absence of evidence that the assessee dealers are also dealing in cosmetics the presumption is that they are only dealing in drugs i.e. medicines and the products manufactured or sold or distributed by them fall in the same category.

The above discussion leads me to an inevitable conclusion that the products in question of the assessee dealers do satisfy the twin criteria laid down for the classification to prove them to be medicaments and at the same time the revenue has utterly failed to prove that

they ought to be classified as cosmetics for the purposes of taxation. Accordingly, the tribunal and the other subordinate taxing authorities committed a gross error in classifying them as cosmetics and in levying tax accordingly.

There are some revisions of the revenue clubbed with this bunch of revisions of the assessee-dealers. All the revisions of the revenue are beyond time. The delay is not much and its condonation is not being seriously opposed. Sufficient explanation for the delay in filing the revisions also exists. Therefore, I treat the revision to be within time.

Learned Standing Counsel in support of the revisions preferred by the revenue, all of which pertain to classification of Himani Navratan Oil contended that the tribunal has erred in treating the aforesaid product as an Ayurvedic medicine without applying the twin test and despite the fact that it contains 67% liquid paraffin.

The submission of learned Standing Counsel is totally misplaced and devoid of any substance. As earlier stated, the burden to prove the classification of any product is upon the revenue. The revenue in connection with Himani Navratan Oil has not produced any evidence to show that it is not an Ayurvedic medicine but an ordinary oil with no medicinal value. On the contrary, again evidence adduced by the assessee-dealers proved that in common parlance people take the above oil for its medicinal value and that it is made out of ingredients mentioned in the authoritative Ayurvedic texts as laid down under the Drugs and Cosmetics Act. Thus, the twin test as laid down in Puma Ayurvedic Herbal (P) Ltd. (supra) stands satisfied.

The tribunal in holding Himani Navratan Oil to be an Ayurvedic medicament recorded that the liquid paraffin used for making it is also an Ayurvedic ingredient which finds mention in the Ayurvedic book “Bhav Prakash” and, as such, all the ingredients of the oil are Ayurvedic substances. Moreover, even otherwise the use of liquid paraffin as a filler or vehicle would not have effect of altering the character or the nature of the product.

In the end before parting a reference may also be made to the report no.626 dated 3.3.2009 of the trade tax department which has been accepted by the Commissioner to the effect that on a survey conducted the products Boroplus Antiseptic Cream and Himani Navratan Oil are understood by the public to be Ayurvedic products in the general and, as such, fulfils the common parlance test. The said survey itself prove that the common parlance test stands duly satisfied in respect of the above items.

Accordingly, the revisions preferred by the revenue are devoid of merit and are dismissed and those of the assessee-dealers are allowed and the impugned order dated 29.12.2009 passed by the Commercial Tax Tribunal, Kanpur is set aside to the extent it classifies the products in question as items of cosmetics and directs for levying tax accordingly.

Parties are directed to bear their own costs.