PASSENGERS EMBARKING FOR INTERNATIONAL JOURNEY BY AIR OR DOMESTIC TRAVEL BY AIR IN ECONOMY CLASS-

SECTION 65(105)(zzzo) OF THE FINANCE ACT, 1994}.

Recent Amendments

The position of law after the issuance of notification 24 to 33/2010 service tax are as follows:-

i) The Service Tax on economy class is effective from July 01, 2010 though tickets may have been issued prior to that.

ii) Effective Rate is Rs.500 plus cess (i.e. Rs515/-) or 10% plus cess of the gross value of the ticket for international journey and Rs.100 plus cess (i.e. Rs103/-) or 10% plus cess of the gross value of the ticket for domestic journey .

iii) No change as yet in the Cenvat credit rules for availing the cenvat credit relatable to taxable services.

iv) Cenvat Credit relating to economy class cannot be claimed incase exemption of paying Rs.500/-/ 100 on economy class is availed.

Brief History

1) In February 2010, the Finance Budget for Fiscal Year 2010 was presented, wherein it was proposed to levy service tax not only on embarking for International journey in class other than economy class but also on economy class as well on domestic travel as well. Accordingly changes were proposed in the Finance Bill 2010. The budget was passed, however the date for the levy of service tax was not notified and the earlier section 105(65)(zzzo) was proposed to be substituted as under:-

"(zzzo) to any passenger, by an aircraft operator, in relation to scheduled or non-scheduled air transport of such passenger embarking in India for domestic journey or international journey;";

On 22nd June 2010, the effective date of the Finance Act 2010 has been notified to be 1st July 2010 vide notification No. 24/2010 and furtherance thereof notification No.25/2010 & 26/2010 and 27/2010 amongst others have been issued.

Current scenario after the issuance of the new notifications

1. In accordance with the notification, it may be seen that service tax on economy class for International Journey has also now been included under the ambit of service tax. However, as per the notification No. 26/2010, the airline has been given the option to collect service tax @ Rs. 500/- or 10% of the gross value of the ticket whichever is lower thereby meaning that the flat rate of 500/- plus Cess per ticket in the economy class can be charged instead of the normal 10% of the gross value.

2. It is to be noticed that the education cess of 3 % would be over and above the above Rs. 500 or 10% of gross fair.

   It would also be pertinent to mention that the rate/amount specified in the notification No.26/2010 is for the service tax payable under section 66 of the Act. The said amount/rate is to be increased by the Education Cess of 2% and Higher Education Cess of 1% .

3. Since the notification is effective w.e.f. 1st July 2010.Following issues require attention:-

A) Service Tax on ticket issued prior to 1st July 2010 and traveled after 1st July 2010?

B) In case the airline opts to charge service tax @10% then what would be the gross value on which service tax would be chargeable?

In our opinion, the Service Tax Authorities are sure to raise demand of service tax on all tickets issued prior to 1st July but travelled subsequently. The airline should charge service tax on all tickets, which are intended for travel subsequent to 1st July although, may have been issued prior to 1st July 2010.

The date of issue of the notification no 26 is irrelevant in this regards and the service tax authorities will surly ask the service tax on all tickets issued before this notification.

In case the airlines opt to charge service tax @10% of the gross value of the tickets the valuation would be disputable since the airlines would not be charging service tax on taxes, PSF, etc.

Allow ability of Cenvat Credit in the new scenario

Brief History

Initially, CENVAT credit was available upto 20% of input credit available. However w.e.f. 1st April 2008, a notification amending the CENVAT Credit Rules 2004 was issued amending the Rule 6 of CENVAT Credit Rules, 2004, wherein cenvat credit relatable to taxable service only was allowed. Since the airline are rendering both taxable and non taxable services i.e. the economy class and non economy class the CENVAT Credit is allowed only to the extent, the same is relatable to the non economy.

Subsequently in the Finance Act, 2010, Service Tax was introduced on economy class.

In respect to the cenvat credit the notification 26/2010 service tax reads as under

"Provided that this exemption shall not apply in case where the credit of duty paid on inputs used for providing such taxable services has been taken under the provisions of CENVAT Credit Rules, 2004"

From the above provision, it is clear that if the option of paying Rs. 500 per tickets on economy class is availed, the CENVAT Credit in respect of economy class will not be available.

Brief Summary

i) If the Airline start charging Service Tax @10% on the economy class tickets then they shall be allowed to take a credit of full cenvat credit relatable to both Buisness class an economy class.

ii) The other option is not to charge Service Tax on the full value and charge only Rs. 500/- on economy class. In this case Cenvat credit on the inputs relating to Economy class will not be available.

It will be purely a commercial call which the Airline has to take whether to avail the exemption and pay 500 per ticket and be more competitive in the market since their tickets would be cheaper and forgo the CENVAT credit relatable to Economy class.

Or avail of 100% credit and charge 10% on the full value of the ticket.