CHAPTER III
EXEMPTIONS

Under section 93 of the Finance Act, 1994, the Government is empowered to exempt services attracting service tax from the whole or any part of the tax leviable thereon, either generally or subject to conditions, as may be specified in the notifications granting these exemptions. A few illustrative cases of incorrect availing of exemptions involving short levy of service tax of Rs. 24.93 crore are mentioned in the following paragraphs. These observations were communicated to the Ministry through 10 draft audit paragraphs. The Ministry/department has accepted (till January 2010) the audit observations in four draft audit paragraphs with tax implication of Rs. 2.27 crore of which Rs. 1.11 crore has been recovered. In another draft paragraph, though the department has not accepted the audit observation, the assessee has paid the tax of Rs. 1.91 crore.

3.1 Exemption availed of violating the prescribed conditions

3.1.1 By a notification dated 1 March 2006 as amended on 23 May 2006, construction services as well as erection, commissioning or installation services under a contract involving supply of machinery, equipment or structures, are exempt from the levy of service tax to the extent of 67 per cent of the value of taxable service subject to the conditions that (i) cenvat credit on inputs, input services and capital goods is not availed of; (ii) the benefit of exemption of the cost of material under notification dated 20 June 2003 is not availed of and (iii) the gross amount charged from customers in respect of erection contracts involving structures, includes the value of structures, parts or any other material sold during the course of providing such service.

3.1.1.1 M/s Tata Projects Ltd., in Hyderabad II commissionerate, entered into two types of contracts with M/s Power Grid Corporation of India Ltd., M/s BHEL, M/s GAIL and several State Power Generation Corporations. In the first set of contracts involving erection of transmission line towers in civil foundations, the assessee supplied towers, tower extensions, bolts and nuts/accessories against separate supply orders and paid service tax on 33 per cent value of the contracts representing labour charges and cost of construction material like cement, sand etc., used in foundations of erection work. In the second set of contracts, involving supply of material as well as execution of projects on turn key basis, the assessee billed the customers for the total amount including the cost of equipment as well as labour charges and availed abatement of 67 per cent under the aforesaid notification. The exemption availed of, in both the cases was not correct as the assessee had availed of cenvat credit of service tax on several input services. Moreover, in the first set of contracts, the assessee also derived the benefit of exclusion of the cost of the material viz., towers and tower parts for the purpose of service tax by bifurcating the contracts into supply contracts and erection works and reckoning only the latter for payment of tax. During the period from March 2006 to March 2007, the assessee availed of abatement on a turnover of Rs. 107.67 crore (being 67 per cent of the contract value of Rs. 160.70 crore

on erection works and turn key projects) on which exemption of service tax of Rs. 13.14 crore availed of was incorrect.

On the matter being pointed out (December 2007), the department admitted the audit observation on the erection contracts and intimated (September 2008) recovery of service tax of Rs 45.84 lakh and interest of Rs. 12.41 lakh.

In the case of turn key construction contracts, the department stated (September 2008/March 2009) that the assessee had utilised credit only on certain common input services in its head office but not on any service which was project specific and the assessee had reversed pro-rata credit of Rs. 2.34 lakh alongwith interest of Rs 0.46 lakh attributable to such input services utilised in turnkey projects valued at Rs. 167.81 crore. It further stated that since the assessee had already foregone the input service credit, the abatement availed of on turn key projects was in accordance with the provisions of the exemption notification and also in line with the Supreme Court's decision in the case of M/s Chandrapur Magnet Wires (P) Ltd {1996 (81) ELT 3 (SC)}.

The reply of the department is not tenable as the reversal of pro-rata credit in lieu of the payment of service tax on 100 per cent value of contracts is not covered by the cenvat credit rules or the relevant notification. Further, the Supreme Court's decision quoted by the department is not relevant since non-availing of input service credit itself is a requisite condition for availing of exemption in the present case whereas Supreme Court decision was in the context of availing of modvat credit on fully exempted goods covered by an unconditional exemption.

The reply of the Ministry has not been received (January 2010).

3.1.1.2 M/s Larsen & Toubro Ltd., (ECC Division), Chennai, in Chennai service tax commissionerate, engaged in providing erection, commissioning or installation service, availed of abatement of Rs. 15.74 crore being 67 per cent of the gross amount of Rs. 23.49 crore charged for the construction of port facility at Karaikal in the month of March 2006 under the aforesaid notification dated 1 March 2006. Audit observed that the assessee had availed of cenvat credit of Rs. 26.47 lakh during March 2006. The benefit of exemption was, therefore, not admissible. Service tax of Rs. 1.61 crore on the abated amount was required to be collected along with interest.

On the matter being pointed out (April 2009), the department stated (July 2009) that the assessee had utilised accumulated credit on input services for payment received after 1 March 2006 for the services rendered prior to March 2006 and had stopped taking cenvat credit from 1 March 2006.

The reply of the department is not tenable as the relevant service tax return indicated that the assessee had no accumulated credit at the end of February 2006 and that the credit of Rs. 26.47 lakh was taken afresh during March 2006 and utilised in the same month.

The reply of the Ministry has not been received (January 2010).

3.1.2 A notification dated 20 June 2003 provides for exemption from service tax on the value of goods and material sold by the service provider to the recipient of the maintenance and repair services (MRS), subject to the condition that no credit of duty paid on such goods and material sold has been

taken under the provisions of the cenvat credit rules or where such credit has been taken by the service provider on goods and material, the service provider has to pay the amount equal to such credit availed of, before the sale of such goods and material.

M/s Hewlett Packard India Sales Pvt., Ltd., and M/s Sun Micro Systems India Pvt., Ltd., in Bangalore commissionerate of service tax, engaged in providing maintenance and repair services, availed credit of countervailing duty paid on the inputs/spares received for MRS covered under annual maintenance contract during the period from 2004-05 to 2006-07. The assessees sold the goods and material to the service recipients on separate invoices without charging service tax. The assessees also claimed exemption under the aforesaid notification without paying an amount equal to the cenvat credit availed of, before the sale of those goods and material. Availing of exemption of service tax of Rs. 3.30 crore was accordingly not correct.

On this being pointed out (December 2007/December 2008), M/s Hewlett Packard India Sales Pvt. Ltd. paid the entire amount of Rs. 1.91 crore (December 2007). However, the department stated (December 2007) that the above assessee would be benefited as cenvat credit availed of was 16 per cent of the value of input whereas service tax paid on the value of input was 12 per cent. The reply in the second case has not been received (January 2010).

The reply of the department is not tenable as the assessee had taken double benefit by availing of cenvat credit as well as exemption of service tax simultaneously while the benefit of exemption was available only on reversal of cenvat credit before the sale of such goods/material, which was not done by the assessee.

The reply of the Ministry has not been received (January 2010).

3.2 Benefit availed on non-specified services

3.2.1 A notification dated 30 June 1994 exempts the service tax leviable on departmentally run public telephones for local calls and guaranteed public telephone operating only for local calls. The term local calls has been defined in rule 2(X) of the Indian Telephone Rules which means a call from a subscriber's line to another line on any exchange within the same exchange system.

M/s Bharti Airtel Ltd. in Bhopal commissionerate, issued coin collection boxes (CCBs) to the various subscribers in the shape of local PCO connections in urban area after executing agreement/receipt of security deposit. The assessee collected call charges of Rs. 33.05 crore from the said subscribers through bills for the period April 2005 to March 2006 but service tax of Rs. 3.37 crore leviable thereon was not paid claiming exemption under the aforesaid notification dated 30 June 1994. Since CCBs were installed with STD facility, these were not exempt from service tax under the category of "guaranteed public telephone operating only for local calls" covered under the notification. The exemption availed was incorrect and tax of Rs. 3.37 crore was recoverable with interest.

On this being pointed out (June 2007), the department stated (January 2008) that the assessee had provided CCBs to subscribers for local calls only.

The reply of the department is not tenable as it could not produce evidence to support its contention despite persistent follow up by audit. The department, however, intimated (June 2008) that a show cause notice was being issued.

The reply of the Ministry has not been received (January 2010).

3.2.2 A notification dated 20 June 2003 exempts the business auxiliary service provided by a commission agent who causes sale or purchase of goods on behalf of another person for a consideration which is based on the quantum of such sale or purchase, from payment of service tax.

M/s Hindustan Unilever Ltd., in Chennai service tax commissionerate, engaged in providing business auxiliary service, beautician and GTA services etc., rendered services for the sale and distribution of edible oil and fat of M/s Bunge Agribusiness India Pvt. Ltd., through its own distribution network for which it was entitled to a commission at 2.5 per cent of the net proceeds of sale. M/s Bunge consigned the products to M/s Hindustan Unilever Ltd. i.e. the assessee on consignment transfer basis to various depots designated by the assessee and after distribution of the products, the sale proceeds collected by the assessee excluding commission was passed on to M/s Bunge's account. Since the assessee not only booked sales order for M/s Bunge but also received, stored and distributed the goods, the service provided by the assessee fell under 'clearing and forwarding agent's service'. The assessee did not pay service tax up to 8 July 2004 by availing of exemption under the aforesaid notification and started paying service tax under BAS from 9 July 2004. The exemption of Rs. 34.01 lakh availed of, for the period from April 2003 to June 2004 was not correct as the said notification exempted services of commission agent and not services of consignment agent.

On the matter being pointed out (May and December 2008), the department reported (October 2008 and January 2009) that show cause notice for Rs. 34.01 lakh was issued (October 2008) in accordance with the findings of the internal audit group which visited the unit during July 2008. It was further reported that the audit observation stated to have been sent on 29 May 2008 had also not been received by them.

The reply of the department is not tenable as the observation had already been discussed and a copy thereof handed over to the jurisdictional assistant commissioner during discussion on 28 May 2008 for further action by the department whereas the internal audit visited the unit only in July 2008 and the show cause notice was issued in October 2008. Thus, the departmental action to examine and safeguard revenue was subsequent to the audit finding.

The reply of the Ministry has not been received (January 2010).

3.3 Exemption availed of, in violation of the Board's instructions

By a notification dated 3 December 2004, 75 percent value of the taxable service provided by a goods transport agency (GTA) to a customer is exempt from the levy of service tax subject to the condition that credit of the duty paid on inputs or capital goods used for providing such taxable service is not taken

and exemption under notification dated 20 June 2003 is not availed of, by the goods transport agency.

The Board issued instructions (27 July 2005) that the abatement is permissible only if the GTA issued consignment note declaring that neither has the credit been taken on inputs or capital goods used for provision of service nor has the benefit of notification dated 20 June 2003 taken. Rule 4B of the Service Tax Rules, 1994 stipulates the issue of consignment note by the goods transport agency to the customers. The Board again examined the issue in consultation with the Ministry of Law and issued (12 March 2007) an order under section 37B reiterating that the earlier instructions of 27 July 2005 must be followed.

M/s Kross Manufacturers (I) Pvt. Ltd. in Jamshedpur commissionerate, engaged in the manufacture of various excisable goods, availed of the services of GTA and paid service tax after availing of exemption of seventy five per cent on the gross taxable freight charges paid to GTA during the period April 2006 to March 2008. The declaration as required under the Board's instructions was not obtained in any of the consignment notes issued by the GTA. Exemption of service tax amounting to Rs. 20.26 lakh availed of, by the assessee was, therefore, incorrect.

On the matter being pointed out (September 2008), the department stated (May 2009) that show cause notice for Rs. 20.26 lakh for the period April 2006 to March 2008 had been issued.

The reply of the Ministry has not been received (January 2010).

3.4 Exemption availed of without exemption notification in vogue

Service in relation to maintenance or repair of computers or computer system was exempt from payment of service tax vide a notification dated 21 August 2003. However, the aforesaid notification was rescinded by another notification issued on 9 July 2004. Accordingly, service tax on maintenance or repair of computers or computer system or computer software was leviable from 9 July 2004.

M/s Microsoft Corporation (India) Private Ltd., Gurgaon, in Delhi commissionerate of service tax, provided services under the category of business auxiliary services, manpower recruitment agency and maintenance and repair services. The assessee paid service tax on income on account of "service fees - product support services in relation to software" covered under maintenance or repair of software services from 7 October 2005. However, service tax was not paid on similar charges of Rs. 12.55 crore obtained during the period from 9 July 2004 to 6 October 2005 treating the service as exempt under the aforesaid notification. Since the notification providing exemption was rescinded from 9 July 2004, service tax of Rs. 1.28 crore was recoverable with interest and penalty.

On the matter being pointed out (January 2008), the department issued a show cause notice in April 2008 for the recovery of service tax of Rs. 1.28 crore.

The reply of the Ministry has not been received (January 2010).

3.5 Exemption on services provided to SEZ unit/developer

Under a notification dated 31 March 2004, all taxable services provided by a person to a developer of Special Economic Zone (SEZ) or a unit located in SEZ are exempt from levy of service tax if such services are consumed within SEZ, subject to fulfillment of certain specified conditions. The Ministry clarified on 28 June 2007 that since the exemption was intended to cover services meant for consumption in SEZ, taxable services provided and consumed within SEZ are only exempt from service tax and service provided outside SEZ do not qualify for exemption under the aforementioned notification.

M/s IVRCL Infrastructure and Projects Ltd. in Hyderabad II commissionerate, entered into an agreement with the Public Health Engineering Department (PHED), Jaipur for execution of work relating to the transmission of clear water from an industrial area (Sanganer) to the SEZ boundary on turnkey contract basis for a consideration of Rs. 9.77 crore. The assessee received the consideration of Rs. 8.46 crore during the period from December 2007 to March 2008 but did not discharge the service tax liability on the ground that they were eligible for exemption under the notification dated 31 March 2004. The services rendered by the assessee do not qualify for exemption as the services were provided to PHED but not to a unit of SEZ or developer of SEZ. Further, the execution of work was from industrial area to SEZ boundary and services were consumed outside SEZ. The exemption availed of, amounting to Rs. 1.05 crore was not correct.

On the matter being pointed out (May 2008), the Ministry accepted the audit observation and reported (January 2010) issue of show cause notice for Rs. 1.32 crore covering the period from December 2007 to September 2008.

3.6 Other cases

In two other cases of exemption involving tax of Rs. 64.04 lakh, the department has accepted the audit observations and reported (January 2010) recovery of Rs. 53.15 lakh.