Chapter 4
Classification of Services

Under the system of indirect taxation, classification always plays an important role. The importance, however, is somewhat diluted if the rate of taxation is uniform for all the categories. So is the case with taxable services because the effective rate of service tax is uniformly pegged at 10.30% (inclusive of education cess and secondary and higher education cess). Earlier also when the rate was 5% or 8% or 10% or 12%, it was uniform for all the taxable services leading to lesser disputes over the issue of classification. Still, the accurate classification of taxable services has its own importance and the uniform rate should not be taken to suggest that there is no need for classification.

1. Importance of Classification

There are certain services which appear to fall under two or more categories simultaneously. Some instances where such problems have arisen relate to Management Consultants v. Manpower Recruitment Services, Mandap Keepers v. Convention Services, Rent-a-Cab Scheme v. Tour Operators, Cargo Handling Services v. Storage and Warehousing Services, Architect v. Interior Decorator, Scientific and Technical Consulting Services v. Consulting Engineer, Practicing Chartered Accountants v. Management Consultants, etc.

Before levying service tax, it is essential to determine under which category a particular service falls. Further, in case of supply of multiple services, each service has to be classified separately and taxed accordingly. A similar issue has been dealt with by the CBEC Letter (F. No. B1/6/2005-TRU), dated 27-07-2005 which states that: “At present exemption from the gross amount charged (abatement) has been prescribed for certain taxable services such as construction and transport of goods by road. However, abatement scheme is not applicable to other than specified taxable services. A point has been raised about application of abatement scheme in case of single provision of service which consists of both category of taxable services, in such cases, what portion of the gross contract would get the benefit of abatement. In all such cases, it is required to take a view as to whether the taxable service provided is a single service or multiple supply of services and thereafter classify the service provided as per the provisions of Section 65A of the Finance Act, 1994 which lays down principles for classification of services. The benefit for abatement would be extended only if the taxable service is classifiable under the category for which abatement scheme is applicable.”

Following are some of the reasons which necessitate classification of services:

A taxable service, if not classified properly may be denied the benefit of an exemption notification. Thus, a service if classified under a particular category may be taxable but if classified under the other category, which in fact is the proper classification, may not be taxable because of some exemption notification.

Due to wrong classification one may pay tax for non-taxable service. At present, not all the services are taxable. Thus, due to wrong classification, a service may appear to fall under a
taxable service whereas this may not be so because that particular service is not taxable at all since it is not specified as a taxable service under the service tax provisions.

*Due to wrong classification one may not pay tax for a taxable service.* Improper classification may lead to conclusion that a particular service is not taxable whereas in actuality it is taxable because the same finds mention in the clause defining taxable services. This may particularly happen in case of ‘Business Auxiliary Services’.

*Due to wrong classification one may not take the available benefit of CENVAT credit or may take wrong benefit of CENVAT credit.* Under Rule 6(5) of CENVAT Credit Rules, 16 services are specified for which 100% input credit is available even if such services are used both for taxable and exempt output services. In case of incorrect classification of input service, such benefit may not be appropriately taken.

In this context, the Department has examined the CENVAT claim of Taj GVK for the services received from IHCL, which were treated as management consultancy services by Taj GVK and 100% credit was claimed though the services were used both for taxable and exempt services. The Department in its Instruction Letter (C.No.06-Zone 14-S.Tax-2009), dated 05-03-2009, states that such services were classifiable under business support/business auxiliary services and therefore not eligible for 100% credit being not in the list of Rule 6(5) services.

### 2. How to Classify the Services

Initially the Department vide CBEC Circular No. 51/13/2002-ST, dated 07-01-2003 provided that the guiding principle of classification is that a service should be categorised under that category which is more specific. However, a need was felt for the more detailed guidelines, and therefore, Section 65A was inserted by the Finance Act, 2003, w.e.f. 14-05-2003 to provide a set of statutory guidelines for classification of services.

Interpretative rules of classification given by Section 65A of the Act are explained below:

**Rule 1:** Section 65A(1): In the first instance, classification of taxable services shall be determined according to the terms of the sub-clauses of clause (105) of Section 65 of the Finance Act, 1994. Clause (105) of Section 65 defines all the taxable services separately. If a service clearly belongs to a particular sub-clause and there is no ambiguity about its classification, the service shall be classified as such.

**Rule 2:** Section 65A(2): If, for any reason, a taxable service cannot be classified as per Rule 1 but is, prima facie, classifiable under two or more sub-clauses of clause (105) of Section 65, classification shall be done as per the following criteria:

(a) **Classification in case of Services having Specific Description:** In case of a service if any sub-clause of Section 65(105) provides the most specific description, it shall be preferred to sub-clauses providing a more general description. Thus, in respect of any service most specific classification shall be preferred than the general one. For example, in relation to a hotel, the services may fall either under “Convention services” or “Mandap keeper services”. Where the hotel has rented out its conference hall for the purpose of holding general meeting of a company (an official function), the service will be classified under the category of convention service because this is more specific as compared to mandap keeper services. This is so because convention service covers conventions only, which is like an official function whereas mandap keeper services include official, social and business functions.

In case where a service is classified under a specific description and later on some other taxable category overlaps in description, such service can be taxed only under one head of service irrespective of overlapping of different taxable heads. In *Coal Handlers (P) Ltd. v. CCE*¹, it has been held that since Insurance Services and Clearing and Forwarding Services are more specific description and were also subjected to service tax prior to imposition of tax on Business Auxiliary Service, the insurance agents and clearing and forwarding agents working on commission basis would fall under those respective categories.

Further, if a service is covered under a specific entry and exempt therefrom, it cannot be classified under general category for the purpose of levying tax such service. In *Dr. Lal Path\(^1\)*

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Lab (P) Ltd. v. CCE, Ludhiana\(^2\), it was observed by the tribunal that, “It is well settled that once there is a specific entry for an item in the tax code, the same cannot be taken out of that specific entry and taxed under any other entry. In the present case revenue is seeking to discard the specific entry and to bring the appellant’s services under a very general entry, only because under the specific entry no tax is payable. This approach is contrary to the scheme of legislation. What is specifically kept out of a levy by the legislature cannot be subjected to tax by the revenue administration under another entry.”

It is relevant to note here that in a recent Advance Ruling in case of Harekrishna Developers\(^3\), the Authority held that the works contract of residential complex construction would be covered under residential complex construction services more appropriately though it can also get covered under works contract services. A related fact is that the works contract services also specifically include works contracts of residential complex construction and the CBEC in its circular has stated that such services should be categorised under works contract services.

It may be noted that a dispute regarding classification of a service does not vitiate its taxability. As per DGST Order (F. No. V/DGST/21-30/Legal04/2004), dated 13-12-2005, in case of dispute regarding classification of a service, its taxability does not get vitiated. The assessee may pay tax under any of the contending categories. Though this circular now stands withdrawn, however, the intent expressed in the circular is in line with the spirit of the law.

**Classification in case of Composite Services:** In case of a composite service which consists of a combination of different services and therefore, cannot be classified in the manner specified in clause \((a)\) above, it shall be classified as if it consisted of a service which gives it its essential character.

For example, a manpower recruitment agency may also be providing management consultancy services. Thus, after giving some valuable advices regarding management of personnel, the agency recruits manpower for an organisation. In this case of composite service, the manpower recruitment service provides the essential character and therefore, the classification should be done as manpower recruitment agency’s services.

In this regard, CBEC Instruction Letter (F. No. 334/4/2006-TRU), dated 28-02-2006 states that: “Often services provided consist of more than one service. In such cases, it is important to decide, for the purpose of classification of services, whether each element of the transaction should be treated separately or as a single composite transaction, albeit, made up of two or more separate services. A composite service, even if it consists of more than one service, should be treated as a single service based on the main or principal service and accordingly classified. The decision is to be made on question of facts and law. It will not make a difference if the tax rates of the components are the same as that of the principal service. The problem may arise when some elements are taxable and others are exempt. While taking a view, both the form and substance of the transaction are to be taken into account. The guiding principle is to identify the essential features of the transaction. The method of charging does not in itself determine whether the service provided is a single service or multiple services.”

CBEC Instruction Letter (F. No. 334/1/2008-TRU), dated 29-02-2008 has further reiterated this principle by putting it a little differently. The letter states that: “For the purpose of classification of a service covering number of separate services, a view has to be taken as to whether an individual service is merely a component of the overall supply or is itself a distinct and independent supply i.e., whether the component is merely ancillary to the principal supply or the component can be considered as separate taxable service in its own right. A service, which does not constitute for a customer an aim in itself but a means of better enjoying the principal supply, is considered as a supply ancillary to the principal supply. Section 65A states the principles for classification of taxable services. Classification of a composite service is based on that component of the service which gives the essential character. There is a need to determine whether a given transaction is the one containing major and ancillary elements or the one containing multiple and separate major elements. In the case of a transaction containing a major and ancillary element, classification is to be determined based on the essential features or the


\(^3\) 2008-TIOL-03-ARA-ST.
dominant element of the transaction. A supply which comprises a single supply from an economic point of view should not be artificially split. The method of charging or invoicing does not in itself determine whether the service provided is a single service or multiple services. Single price normally suggests a single supply though not decisive. The real nature and substance of the transaction and not merely the form of the transaction should be the guiding factor for deciding the classification.

The above view is also supported by the judgment in the case of Gujarat Chemical Port Terminal Co. Ltd. v. CCE & C\(^4\), wherein it was held that the activity of storing and warehousing of goods, incidental to port services, is taxable under the category of port services and is not taxable under the category of storage and warehousing services. The court commented that taking an example from common life, if a person is rendering a paying guest accommodation and also provides food to the resident, can that person be held to be providing the services of a restaurant, when such food providing is only restricted to the paying guest and not to any independent person, who can come at any point of time and enjoy the food facility. Similarly, if a hotel provides services of washing and ironing of clothes to its resident guests, can it be called as a laundry or a dry-cleaning service provider? The answer to both the above propositions would be an emphatic “NO”. Applying the above analogy to the fact of the present case, it has to be held that the appellant is a minor port which was leviable to tax w.e.f. 01-07-2003 and any incidental services of storing the goods in terms of legal obligations of Rule 42 of the Major Port Trust Act, cannot be separately made liable to tax as storing and warehousing services.

In the above context, it is also relevant to note the judgment in the case of Card Protection Plan Ltd. v. CCE\(^5\), wherein the House of Lords had to determine as to whether the services provided along with the insurance service will be treated separately and would be liable to VAT or will it form a part of insurance service provided by the Card Protection Plan Ltd. The House of Lords held that the service which comprises a single service from an economic point of view should not be artificially split up. The court held that service must be regarded as ancillary to the principle service if it does not constitute for customer an aim in itself, but a means of better enjoying the principle services provided. The extract of the relevant part of the judgment is as under:

“28. The court further held that in deciding whether a transaction which comprises several elements is to be regarded as a single supply or as two or more distinct supplies to be assessed separately, regard must first be had to all the circumstances in which that transaction takes place, taking into account:

“29. . . first, that it follows from Article 2(1) of the Sixth Directive that every supply of service must normally be regarded as distinct and independent and, secondly, that a supply which comprises a single service from an economic point of view should not be artificially split, so as not to distort the functioning of the VAT system, the essential features of the transaction must be ascertained in order to determine whether the taxable person is supplying the customer, being a typical consumer, with several distinct principal services or with a single service.

“30. There is a single supply in particular in cases where one or more elements are to be regarded as constituting the principal service, whilst one or more elements are to be regarded, by contrast, as ancillary services which share the tax treatment of the principal service. A service must be regarded as ancillary to a principal service if it does not constitute for customers an aim in itself, but a means of better enjoying the principal service supplied.”

The law laid down in this case followed the judgment of the House of Lords in case of College of Estate Management v. Her Majesty’s Commissioners of Customs and Excise\(^6\), wherein House of Lords held that the supply of books is ancillary to the education services being provided to the students. Therefore, the supply of the books will not be treated as an independent activity rather it is ancillary to the principle service of education.

(c) Classification in case Services are not classifiable as per clause (a) or clause (b): When a service cannot be classified in the manner specified in clause (i) or clause (ii) above, it shall be

\(^{4}\) (2007) TIOL 1898.
\(^{5}\) Reported in 2001 UKHL 4.
\(^{6}\) Reported in 2005 UKHL 62.
classified under that sub-clause of clause (105) of Section 65 which occurs first among the sub-
clauses which equally merit consideration.

Under Section 65(105), the taxable services have been placed in the order of their coming into
the tax net i.e. the service which was brought into the service tax net first, has been placed above
that service which was taxed subsequently. For example, a particular service may either be
classified as Consulting Engineers’ Service (made taxable w.e.f. 07-07-1997) or Scientific or
Technical Consultancy Service (made taxable w.e.f. 16-07-2001). Since it is presumed that the
service in question equally merits consideration under both the categories, it shall be classified as
consulting engineers’ service since it came first under service tax net and therefore, occurs first
under Section 65(105).

3. No Double Taxation

The Department has emphasised in its Instruction Letter (F. No. B2/8/2004-TRU), dated 10-09-
2004 that while the classification of a taxable service would be in terms of Section 65A of the
Finance Act, 1994, it should be ensured that there is no double taxation and a service is taxed
only once under appropriate category. This position was clarified by the Department earlier also.
CBEC Circular No. 51/13/2002-ST, dated 07-01-2003 stated that: “any service (transaction)
can be taxed only once, even if it appears to fall under two or more categories. It should be kept
in mind that service tax is a tax on the service provided and is recovered from the service
provider (in some cases even from the service recipient). The position is akin to Central Excise
duty which is charged on manufactured goods. Just as Central Excise duty cannot be charged
twice on the same goods under two separate chapters/heading/sub-headings of the Central
Excise Tariff, so also Service tax cannot be charged twice on the same service (transactions).”