

December 31, 2012

Shri P. Chidambaram
Finance Minister
Central Board of Excise and Customs,
Ministry of Finance,
New Delhi

Respected Sir,

Subject: Representation to the Ministry of Finance to zero rate Service tax on reimbursement of electricity charges by the landlords/lessors from the member retailers occupying the premises on rent

Please find attached herewith a Representation drawing the urgent attention of your Honour on the applicability of Service tax on the electricity charges collected by the landlords/ lessors as reimbursements from our members. The applicability of Service tax on reimbursement of electricity charges comes as an unforeseen and sunk cost to the Retail sector and will have adverse impact on the business fundamentals of member retailers given the fact that this sector is already one of the heavily taxed in India with multifarious taxes without any robust credit mechanism.

It is submitted that the issue set-out in this Representation has a significant impact on the entire Retail sector particularly members of Retailers Association of India and therefore, requires MoF's urgent attention. In the background of the rationale as set-out in the Representation, it is prayed that the exemption from the applicability of Service tax on electricity charges recovered by the landlords/lessors from the member retailers should be granted at the earliest.

We also request you to grant us an opportunity of a personal meeting to enable us explain the matter in detail.

Should you need any further information/clarification on this, we shall be glad to provide the same.

Thanking you,

Yours truly,
For **Retailers Association of India**



(Authorized Signatory)

Enclosure: As above

Copy to:

1. Smt. Praveen Mahajan, Chairperson CBEC
2. Shri V.K Garg, Joint Secretary (TRU-II)
3. Smt. Sheila Sangwan, Member (Budget) & Service tax (Additional Charge)

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1. EXECUTIVE SUMMARY

Introduction

- 1.1 **This Representation is filed by Retailers Association of India (“RAI”) seeking to draw your urgent attention to applicability of Service tax on the electricity charges collected as a reimbursement by the landlords/lessors from the retailers association members, who are tenants / lessees in the premises, across India under the Negative list approach to taxation introduced w.e.f. 1st July 2012.**
- 1.2 **The Retail sector is amongst the most heavily taxed within India, despite being acknowledged as one of the major resource in satisfying the daily basic needs of the consumers in India.**
- Multifarious (Central and State)
 - Heavy
 - Without any robust credit mechanism
- 1.3 **The Central Board of Excise and Customs (“CBEC”) has while formulating the Negative list offered a tax benefit for retailers by declaring trading as a Negative list service seeking to alleviate the burden of Service tax for the industry. The sunk cost of Service tax however still remains on various fronts – most specifically for electricity recovered by landlords/lessors. The incongruity of this issue needs to be appreciated from the position that-**
- a. The wide definition of “service” and the wide language of the charging section carries some unintended consequences qua electricity while certain activities are under the Negative list for certain entities; there is a heavy downstream qua the same activity. In the present case, while the primary activity of distribution/transmission of electricity is exempt from levy of Service tax however, when mere reimbursement for its use is collected by the landlord from the lessee, there is a liability to Service tax.**
 - b. The activity of the lessor is only to seek reimbursement of the charges and is not really a rendition of service in normal commercial parlance.**

Issue

- 1.4 **The issue raised in the representation has arisen in the background of :**
- (i) The introduction of Negative list approach to taxation which marks a transitional shift from selective basis of taxation to a very comprehensive taxation of all service transactions except those figuring in the Negative list under Section 66D of the Finance Act, 1994 (“the Act”) or the Notification No. 25/2012-ST, dated June 20, 2012 (“Mega Exemption Notification”).**
 - (ii) Given the wide expanse of the definition of Service under Section 66(44) of the Act in the new regime, the electricity charges recovered/collected by the landlords/lessors for the usage of electricity (from the member retailers) qualifies as service and stands subjected to Service tax.**

(iii) The exemption from the levy of Service tax under the new tax regime is if at all, restricted to the transmission or distribution of electricity by an “electricity transmission or distribution utility” specified under Section 66D (Negative list of services).

- 1.5 Having in dispute and under several litigations over the years, the issue of trading qualifying as a service or not, has been clarified by the Government w.e.f 1 April 2011 by concluding the same as “exempted service” not liable to Service tax, addressing the concerns of high multifarious taxation faced by the Retail sector. In continuation of the same, the CBEC has withheld the levy of Service tax on trading under the Negative list regime by declaring as Negative list service. To fully address the impact of Service tax, it is critical to zero rate Service tax in the context of this industry which is liable to a State levy of VAT. As part of this effort the impact of Service tax on electricity should be neutralized at the very earliest.
- 1.6 It needs to be mentioned here that the levy of Service tax on reimbursements of electricity charges would defeat the very intention of the Central Government to not subject trading to any levy of Service tax. In fact, the applicability of Service tax on electricity charges comes as an unforeseen cost will have a severe adverse impact on the business fundamentals of retailers who are a critical link in the process of ensuring the exhibition of films to the public at large across segments.
- 1.7 Electricity is acknowledged to be one of the biggest costs after rent and salary in the retail business. An additional burden of Service tax on electricity charges without any option to recoup will prove disastrous for the industry which already operates at a very competitive margin which is already very heavily taxed by multifarious indirect taxes without a robust credit mechanism as trading (output service) is exempt from Service tax but is subjected to Value Added Taxes by the States – effectively leaving no option to off-set Service tax paid on input services including the one charged on reimbursement of electricity charges. Not to discount the high cost of power which in recent times have been consistently revised upwards.
- 1.8 This issue equally needs to be appreciated in light of the fact that the Governments (Central as well as States) having recognized electricity as one of the basic necessity and have not levied any Excise duty or Value Added Tax (“VAT”) on generation, transmission and distribution of electricity. Levy of Service tax will go against this basic philosophy of treating electricity as basic necessity which ought not be subjected to any levy, Central or State as the case may be.
- 1.9 It is submitted that this issue needs to be addressed expeditiously to alleviate more fully the burdened/ sunk cost on account of Service tax on reimbursements collected towards electricity charges. The most appropriate option would be a zero rating mechanism qua Service tax for the Retail industry.

Relief Sought

- 1.10 Within the background set out above, this representation is being filed seeking:
- (i) Exemption from the applicability of Service tax on electricity charges recovered by the landlords/lessors from the member retailers who are lessees in their premises,
or

- (ii) Specific clarification that such reimbursements of electricity charges made by the member retailers to their landlords/lessors do not attract Service tax.

2. BACKGROUND

About Retailers Association of India

- 2.1. The RAI is the unified voice of Indian retailers. RAI works with all the stakeholders for creating the right environment for the growth of the modern retail industry in India. The members of RAI, collectively constitute the majority of the organized retail sector in India.
- 2.2. The members of RAI operate various retail stores across India, and, play a significant role in supplying goods of all types, including essential goods such as food, clothing etc. The reach of such stores extends even to the remotest parts of the country.

About the Indian Retail Industry

- 2.3. The Indian retail industry has experienced high growth over the last decade with a noticeable shift towards organized retailing formats. The industry is moving towards a modern concept of retailing. The size of India's retail market was estimated at US\$ 435 billion in 2010. Of this, US\$ 414 billion (95% of the market) was traditional retail and US\$ 21 billion (5% of the market) was organized retail. India's retail market is expected to grow at 7% over the next 10 years, reaching a size of US\$ 850 billion by 2020. Traditional retail is expected to grow at 5% and reach a size of US\$ 650 billion (76%), while organized retail is expected to grow at 25% and reach a size of US\$ 200 billion by 2020.
- 2.4. The US-based global management consulting firm, A T Kearney, in its Global Retail Development Index (GRDI) 2011, has ranked India as the fourth most attractive nation for retail investment, among 30 emerging markets.
- 2.5. As India's retail industry is aggressively expanding itself, greater demand for real estate is being created. The cumulative retail demand for real estate across India is expected to reach 43 million square feet by 2013. Around 46 per cent of the total estimated demand between 2009 and 2013 will be from Tier-1 cities¹.
- 2.6. The growth of the retail sector fuels other commercial activities such as the development of organized markets, encourages price parity and eliminates excessive middle men, thereby supporting farmers to sell their agricultural produce at a higher price. Further, the organized retail sector also helps curtail the parallel economy.

¹ FICCI Sector profile of the Retail Industry – accessed from http://www.ficci.com/sector/33/Project_docs/Sector-prof.pdf

Recent changes in Service tax law

- 2.7. With the introduction of the Negative list (effective 01.07.2012), all services, except those services which are specified in the Negative list or specifically exempted, are liable to Service tax at the rate of 12.36% (inclusive of cesses thereon). The term “service” is defined under Section 65B(44) of the Act, as amended by the Finance Act, 2012 (“2012 Act”).
- 2.8. It is for the first time the term “service” has been defined under the Service tax Law. As it stands under the Negative list regime of taxation, the term “service” means any activity for a consideration carried out by one person for another and includes a declared service.
- 2.9. Hence, the coverage of term “service” is wide enough to include within its ambit any activity rendered for a consideration by one person for another. The Taxation of Services - An Education Guide (“Education Guide”) issued by CBEC on 20.6.2012, while clarifying the scope of term “service” provides for the meaning of term activity and consideration. The relevant paras of Education Guide are reproduced hereunder:

“2.1.1 What does the word 'activity' signify?”

'Activity' has not been defined in the Act. In terms of the common understanding of the word activity would include an act done, a work done, a deed done, an operation carried out, execution of an act, provision of a facility etc. It is a term with very wide connotation. Activity could be active or passive and would also include forbearance to act. Agreeing to an obligation to refrain from an act or to tolerate an act or a situation has been specifically listed as a declared service under section 66E of the Act.

2.2.1 The phrase 'consideration' has not been defined in the Act. What is therefore, the meaning of 'consideration'?

As per Explanation (a) to section 67 of the Act "consideration" includes any amount that is payable for the taxable services provided or to be provided.....

In simple terms, 'consideration' means everything received or recoverable in return for a provision of service which includes monetary payment and any consideration of non-monetary nature or deferred consideration as well as recharges between establishments located in a non-taxable territory on one hand and taxable territory on the other hand.”

- 2.10. Thus, any act done or a facility provided in exchange of a payment in monetary or a non-monetary nature would qualify as a service. Owing to the wide coverage of the term “service” which also includes provision of a facility, the electricity charges which are collected by the landlords/lessors from the member retailers occupying their premises seems to be covered within this wide definition of service. Despite being reimbursements of the electricity charges, either paid or payable or subsequently payable by the landlords/lessors, under the new regime, the entire amount stands exposed to Service tax.
- 2.11. What have been covered under the Negative list of services is the activities of transmission or distribution of electricity provided by an “electricity transmission or distribution utility”. The term “electricity transmission or distribution utility” has been defined² to cover the Central Electricity Authority; a State Electricity Board; the Central Transmission Utility or a State Transmission Utility notified under the Electricity Act, 2003; (36 of 2003.) or a distribution or transmission licensee under the said Act, or any other entity entrusted with such function by the Central Government or, as the case may be, the State Government - thereby, restricting the benefit of exemption to entities involved in transmission/distribution.
- 2.12. While the intention would have been to clearly not subject electricity (being basic necessity and growth commodity) to any levy of Service tax at the stage of transmission and/or distribution, however, owing to the wide definition of service and the limited coverage of the Negative list entry, reimbursements of electricity charges seems to be subjected to Service tax. This interpretation poses a huge burden and ultimately leads to subjecting the end consumer (member retailers) to Service tax – thereby defeating the very intent and purpose of granting exemption to the activity of transmission and distribution.

3. RATIONALE FOR GRANTING RELIEF

3.1. Amongst the heavily taxed sectors, levy of Service tax on reimbursements towards electricity charges would substantially add to the lists of sunk costs which already burdens the Retail sector

- 3.1.1. Undisputedly, the Retail sector figures amongst the heavily taxed industry within India. The sector is subjected to multifarious taxes – at high rates without any robust credit mechanism. The Retail sector including the member retailers who are engaged in trading of goods are not subject to Service tax on their output viz. trading. The direct consequence is the denial of credit of Service tax paid on input services such as renting, reimbursement of electricity charges. Instead, trading revenues (output) are subjected to VAT which cannot be off-set against Service tax.
- 3.1.2. While the exemption from Service tax is a significant effort on part of the Government to address the concerns of high multifarious taxation faced by the Retail sector, the fact remains that the industry is yet to achieve the desired tax parity (with most of other industries) as there has also been a lack of robust credit mechanism for the sector.

² Section 66B (23) of the Act

Despite the Government's efforts to not to subject trading to Service tax, this (unintended) levy of Service tax on reimbursements of electricity charges comes unforeseen and would result in huge sunk cost for the Retail sector particularly the member retailers.

3.1.3. This sunk cost of Service tax on reimbursements is also to be seen in context of the challenges faced by the member retailers on account of costs Service tax on renting, VAT which in itself is substantial and not to mention the high cost of electricity. The impact of these have been set out in brief below:

(a) **Service tax on renting:** Renting has always been amongst the highest operating cost in the retail business. With the introduction of Service tax on "renting of immovable property", this adds to the further costs. More so because, member retailers do not have any "output service" so to recoup this Service tax cost by way of credit.

(b) **Salary Cost:** The Retail sector recognizes salary as another one of the highest operating cost of member retailers since this sector predominantly employs almost 8% of India's employable population³. The strength of personnel employed under this sector can be easily anticipated by number of personnel engaged in any shopping mall dealing with the customers interested in their products.

(c) **Electricity:** Electricity is the main source for the member retailers while carrying out activities of trading. In India, a sharp rise in the prices of electricity has been witnessed in the past. As per the Annual Report 2011-12 on the working of State Power Utilities & Electricity Departments⁴, the all India Average Power Tariffs for Industry has increased from Rs.4.16/kwh to Rs.4.97/kwh over the last five years. Evidently, electricity which itself commanded a high cost with an upward swing in the tariff each year, now, with this levy of Service tax on reimbursements of electricity charges will severally impacts the very fundamentals of retail business.

3.1.4. The burden of these costs on the retail business has to be also appreciated in light of the fact that the companies in the retail business generally operate on the low margin model wherein the scope of profit margins depends only upon the volume of sale.

3.1.5. Survey⁵ conducted by Dun & Bradstreet (August 2009) reveals that 52% of the retailers operate in the low margin business model. The supermarkets and discount stores that provide daily usage products to consumers at a discounted price come under this category. This can be depicted from the graphical representation below:

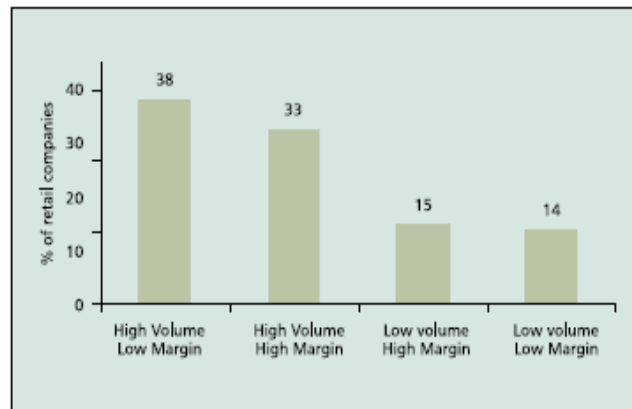
³ International Journal of Research in Finance & Marketing Volume 2, Issue 2 (February 2012) (ISSN 2231-5985)

⁴ Planning Commission, Data Table, "Power, Energy and Irrigation Related"; Available at www.planningcommission.nic.in

⁵ "Indian Retail Industry: Challenges, Opportunities and Outlook", Dun & Bradstreet August, 2009

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Business model of the Indian retailers



3.1.6. With Service tax on renting already a huge cost, this levy of Service tax on reimbursement of electricity charges stands in direct conflict with the intention/ policy of the Government of India to not subject the activity of trading to Service tax. The other possible way to understand why this levy of Service tax will hurt the member retailers most is the fact that under the Negative list regime, there is no levy of Service tax on the output service of trading provided by member retailers.

3.1.7. If not addressed expeditiously, this sunk cost of Service tax (on reimbursements of electricity charges) will lead to irreparable damage to the efficiency of the retail business which already operates at a very competitive margin and would in the long run threaten the survival of member retailers.

3.2. Service tax on reimbursements of electricity charges will be an impediment to the growth of retail sector and will deter future investments in this sector

3.2.1. The Indian retail sector is one of the fastest growing service sectors and is expected to grow rapidly over the next 15 years, driven by the increasing urbanization and the demand for quality and standard products/ services.

3.2.2. India's retail sector is estimated to touch US\$ 833 billion by 2013 and US\$ 1.3 trillion by 2018, with a compound annual growth rate ("CAGR") of 10%⁶. This will not only generate greater revenue for the Government but will also generate millions of employment opportunities. As on today, retailing as a whole contributes almost 10% of India's GDP being the second largest contributor to GDP after agriculture and employs almost 8% of India's employable population⁷.

3.2.3. With such high growth potential, on account of revenue as well as employment generation, the retail sector needs support from the Government more so given the global down turn which has also affected the Indian markets including the retail sector.

⁶ "India Energy Outlook: End Use Demand in India to 2020" by Ernest Orlando Lawrence Berkeley National Laboratory, January 2009 and International Journal of Research in Finance & Marketing Volume 2, Issue 2 (February 2012) (ISSN 2231-5985)

⁷ International Journal of Research in Finance & Marketing Volume 2, Issue 2 (February 2012) (ISSN 2231-5985)

While the Government has always looked favorably towards the concerns of the retail sector, during these difficult times, an additional cost on account of reimbursement towards electricity charges with no option to recoup them may hamper the growth of retail industry. Particularly affected will be the mid-size and small retailers. The effect will not only be on the business opportunities of the sector but will also impact the employment opportunities within the sector. Therefore, urgent attention should be accorded to this issue of Service tax on reimbursements of electricity charges and exemption should be granted for the same.

3.3. Identified as basic necessity, Service tax on reimbursements seeks to defeat the very objective of tax rationalization on electricity

3.3.1. Significance of electricity as a key item of basic necessity and growth has been acknowledged and identified by none other than by the Prime Minister Dr. Manmohan Singh. The Prime Minister has time and again said that energy is a key driver of growth and pricing policies including taxes and subsidies should be framed by the Government keeping in mind the consumers' interest. Reflective of this commitment are few of his addresses, relevant extracts of which has been reproduced below:

"Pricing policies play an important role in consumers' selection of energy sources. We must examine the relevance of the entire gamut of taxes and subsidies on various energy forms and energy using devices."

- Energy Conclave 2006 – "Implementing the Integrated Energy Policy: The Way Forward"

July 26, 2006 at New Delhi

"The Power Sector in our country has come a long way. The basic legal and organizational structure is now in place. It is time, therefore, to move ahead. It is time, therefore, to get down to the task of improving the performance of this vital sector. It is time to apply ourselves collectively to ensure that power shortages are a thing of the past. It is time to ensure that people get good quality power reliably and at a competitive price."

- Conference of Chief Ministers on the Power Sector

3.3.2. These addresses of the Prime Minister reflect the consistent commitment of the Government towards providing optimal energy at affordable prices to the consumer at large. While a part of this commitment has seen the grant of various benefits to entities setting up power plants, the other part has seen the conscious and informed commitment to not subject electricity to any of the Indirect tax most notably being Excise duty and Service tax on transmission as well as distribution.

- 3.3.3. Fully appreciative of the Government of India's commitment to provide optimal and affordable power, the States also do not subject the transmission and distribution of electricity to applicable VAT. This despite the fact that issue whether the electricity is "goods" or not⁸ has been long settled and electricity finds mention in the Central Excise Tariff, 1985⁹ ("CETA").
- 3.3.4. Unequivocally, the intention of the legislature (Central as well as States) has always been not to tax electricity so as to provide the same to the end consumer at the most affordable price. The possible levy of Service tax on reimbursements collected by the landlords/lessors seeks to negate the entire philosophy and consistent commitment of the Government of India to not subject the entire process of generation, transmission and distribution of electricity to either Excise duty or Service tax.
- 3.3.5. Not to mention the adverse impact it will have on consumers in general and Retail sector including member retailers in particular which already is one of the heavily taxed sectors in India with multifarious indirect taxes without any robust credit mechanism. Levy of Service tax on reimbursements towards electricity charges would be an additional burden/sunk cost on the Retail sector and would substantially add to their operational costs.
- 3.4. Levy of Service tax on mere reimbursements of electricity charges amounts to indirectly taxing the primary service of supply of electricity**
- 3.4.1. Keeping with the basic philosophy of not subjecting electricity to any Indirect tax, the services of transmission or distribution of electricity provided by an "electricity transmission or distribution utility" has been declared a Negative list service not liable to Service tax. However, merely because the landlords/lessors seek to collect the electricity charges for the purposes of payment or as reimbursement, the entire amount (which is nothing but electricity charge) is liable to Service tax, whereas the very amount in the hands of landlord *vis-a-vis* the electricity board/distribution company is exempt.
- 3.4.2. This clearly obviates the very objective of granting exemption to distribution of electricity as indirectly there is a charge of Service tax (in relation to distribution of electricity) on the end consumers *viz.* member retailers. One way to look at this issue is that the end consumer/member retailers are at a disadvantageous position merely because they have been rented the premises and do not have the power supply meter registered in their own name.
- 3.4.3. The fact that the member retailers does not own the premise and have the power supply meters registered in their name should not result in a levy of Service tax on electricity charges which otherwise is exempt. The effective way to remedy this incongruous tax position is by granting an exemption to reimbursements of electricity charges, denying the benefit of such exclusion in the Negative list.

⁸ Madhya Pradesh Electricity Board(25 STC 188) and National Thermal Power Corporation (127 STC 280)

⁹ Tariff heading 2716 00 00 in the First Schedule of CETA covers "Electrical Energy" and in the column for rate of duty has been left blank.

3.5. The Negative list approach to tax services clearly distinguishes the taxation of goods even in the cases where the supply of goods form part of provision of service

3.5.1. It is to be noted that the new taxation approach to tax services on Negative list draw all its efforts to not to tax goods at any given point of time. Though, even prior to the implementation of Negative list regime, the Service tax legislations never intend to charge Service tax on the consideration of the value of goods, the same has been more clearly specified under this new Service tax regime.

3.5.2. The definition of services has been prescribed for the first time which specifically excludes the sale of goods. Further, in case of catering services, the law specifically provides for the deduction on account of value of food supplied. More so, in case of construction services, the value of material has been specifically provided for exclusion. Also, under the works contract, the Service tax legislation provides the *ad-hoc* deductions on account of the value of supplies made during the works contract even in cases when the value of goods is not determined separately by the contractor. Basis above, it is clearly evident that the boundaries for levy of Service tax has been more clearly defined so as to avoid any litigation on the levy of Service tax on any part value of good.

3.5.3. As discussed above (in para 3.3.3), the issue that the electricity is a good has been long settled by the Apex Court in various judicial precedents, the charging of electricity to Service tax would not be in line with the aforesaid philosophy of the Service tax legislation wherein, to every possible extent, the value of goods is not exposed to Service tax.

3.6. Reimbursement of electricity charges to landlord/lessors on actual basis is a fit case for granting exemption

3.6.1. The electricity charges, originally paid/payable by the landlords/lessors are sought to be recovered from the member retailers. This recovery ideally would not have been necessitated but for the fact that the member retailers does not own the premise and do not have the power supply meters registered in their names. The electricity charges sought to be recovered are based upon the actual consumption of power by the member retailers.

3.6.2. Therefore, the activity of recovery of electricity charges on actuals for further payment to the electricity board by landlords/lessors is undertaken in their fiduciary capacity of “pure agent”. There possibly cannot be any other way to view this activity. In fact, Service tax law recognizes the concept of “pure agent” and the fact that expenditures incurred in the capacity of pure agent should not be subjected to Service tax. This is borne out of Rule 5(2) of Service tax (Determination of Value) Rules, 2006 (“Valuation Rules”) which provides that if any expenditure has been incurred in the capacity of a pure agent of the recipient, than such expenditure shall be excluded from the value of taxable service.

- 3.6.3. While, Rule 5(2) specifies 8 conditions that must be cumulatively satisfied in order to qualify for the exclusion from the levy of Service tax, however, in the present case, it may not be possible to satisfy all of the 8 conditions, though, it is undeniable that in spirit the transaction of reimbursement of electricity charges is nothing but one of “pure agent”. Therefore, it is a fit case for grant of exemption.
- 3.6.4. Alternatively, these reimbursements could be classified as one of the specified cases, say similar to the reimbursement received by the authorized service station, as exclusion for the purposes of determining the value of taxable service specified under Rule 6 of the Valuation Rules.

4. RELIEF SOUGHT

- 4.1. It is therefore prayed that the CBEC
- (i) Issues an exemption Notification granting exemption from the applicability of Service tax on electricity charges recovered by the landlords/lessors from the member retailers should be provided. This will be in conformity of the policy of the Government of India to not subject electricity to any levy of Indirect tax. or
 - (ii) Provide a specific clarification that such reimbursements of electricity charges made by the member retailers to their landlords/lessors do not attract Service tax.