L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

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GST

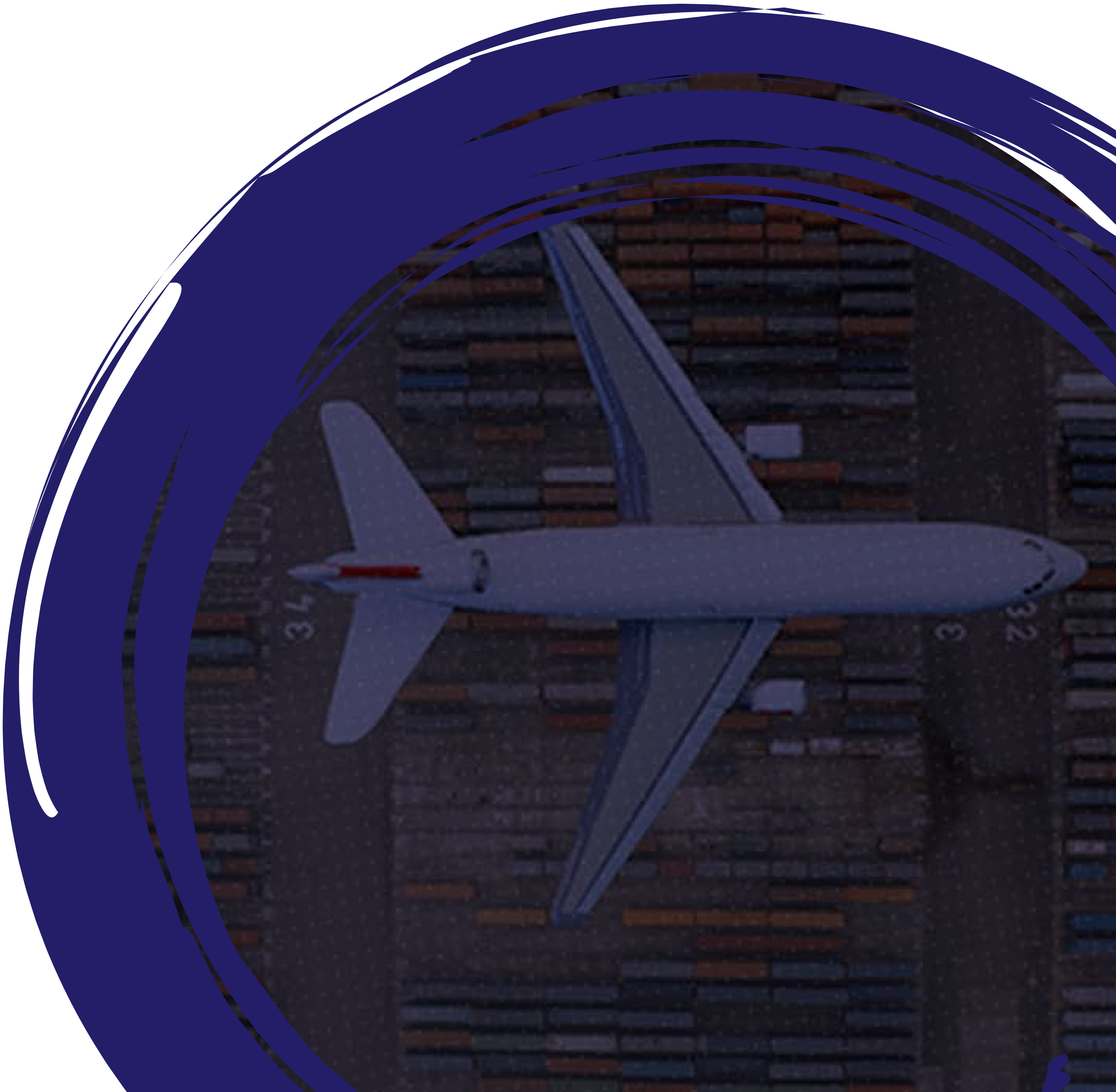
Incentives received by air travel agents from airlines and CRS companies are not taxable under Business Auxiliary Service: CESTAT Larger Bench

UPDATE NO. 4 OF 2021

Lakshmikumaran & Sridharan attorneys

exceeding expectations
SINCE 1985

The Larger Bench of CESTAT has held that service tax on target incentives / Performance Linked Bonus ('**PLB**') Commission received by air travel agents from the airlines and commission received from Central Reservation System ('**CRS**') companies is not subject to service tax under the category Business Auxiliary Services.



ISSUE IN BRIEF

Air travel agents are authorized to sell airline tickets directly from the airlines to passengers / sub-agents. For sale of tickets, the agents receive commission from the airlines. In addition to the said commission received for booking of airline tickets, the airlines also incentivize agents by paying target-based incentives. This incentive is normally termed as 'PLB commission'.

Further, the Computer Reservation System (CRS) companies provide online information database access retrieval services to airlines. In lieu of these services, the airlines pay consideration to the CRS companies in the form of 'charges / commission'. Further, the CRS companies allow air travel agents to subscribe to their portals for booking tickets for the passengers/ sub-agents. In order to increase the flow of business, the CRS companies pay part of their consideration (charges / commission) to the air travel agents when the agents achieve a minimum quantum of bookings through the concerned CRS portal. This incentive is normally termed as 'CRS commission'.

The department has sought to levy service tax on PLB Commission and CRS Commission under the category Business Auxiliary Services ('**BAS**').

LITIGATION BACKGROUND

The New Delhi bench of CESTAT in the case of *D. Pauls Consumer Benefit Ltd.* [2017 (52) S.T.R. 429 (Tri. - Del.)] held that incentives / commission received by assessee from CRS companies is taxable under the category of Business Auxiliary Services.

Subsequently Allahabad Bench of CESTAT in the case of *Akbar Travels India Pvt. Ltd.* [2018 (14) G.S.T.L. 248 (Tri. - All.)] took a contrary view and held that once the assessee has discharged service tax under composition scheme under Rule 6(7) of Service Tax Rules, 1994, the assessee is not liable to pay service tax on incentives received from the airlines.

The New Delhi Bench of CESTAT in the case of *Kafila Hospitality and Travels Pvt. Ltd.* observed that since contrary views have been taken by CESTAT New Delhi and CESTAT Allahabad, the issue needs to be referred to the Larger Bench.

QUESTIONS REFERRED TO LARGER BENCH

i. Whether the incentive received by service receiver from service provider, on appreciable performance, can be subjected to service tax?

ii. Whether incentives / commission paid to travel agents by companies providing Computerized Software Reservation services would be subject to service tax?

PRELIMINARY OBJECTION RAISED BY REVENUE BEFORE LARGER BENCH

- Revenue objected to the Intervention Applications filed by various intervenors on the ground that there is no procedure prescribed for intervention before a Larger Bench of the Tribunal.

  The Larger Bench dismissed such objection and held that any decision taken by the Larger Bench on the issues referred to it would bind the Division Bench as well and therefore in the interest of justice such intervention applications are allowed. Rule 41 of CESTAT Procedure Rules, 1982 confer power on the Tribunal to make such orders as may be necessary to secure the ends of justice

- The Revenue also raised objection regarding the admissibility of the reference to the Larger Bench. It contended that the Supreme Court has disposed the Civil Appeal filed against the decision in *D Pauls* and therefore the said decision of the Tribunal has attained finality.

  The Larger Bench dismissed this objection as well and held that doctrine of merger will apply only when the appeal is dismissed on merits. Thus, when appeal is dismissed without going into merits of the case the doctrine of merger will not apply. In the case of *D Pauls*, the appeal filed by D Pauls was remanded by Supreme Court to Appellate Tribunal for reconsideration of the order with regard to invocation of extended period of limitation. The Supreme Court had not disposed the appeal on merits.

ARGUMENTS BY APPELLANTS ON MERITS

- The air travel agent was promoting its own business and not the business of the airlines. In support of this contention reliance was placed upon the decision of the Madras High Court in *Airlines Agents Association* v. *Union of India*

- The air travel agent is not promoting the business of CRS Companies. In fact, the CRS portal used by the air travel agent is immaterial to the passengers.

- The services rendered by air travel agents are more specifically classifiable under the category 'Air travel Agents' services in view of Section 65A of the Finance Act, 1994. Once an option under Rule 6(7) of the Service Tax Rules 1994 is exercised for discharge of service tax liability, no further liability arises.

- The incentives paid for achieving targets are not taxable. Reliance was placed on decision of Delhi High Court in *Intercontinental Consultants and Technocrats Pvt. Ltd.* as affirmed by Supreme Court and decision of Federal Court of Australia in *AP Group Limited.*

ARGUMENTS BY REVENUE ON MERITS

- Even though the CRS Platform was used for booking of ticket, but in the contract, consideration received was not dependent on booking of ticket but dependent upon particular functionality of particular CRS Company which was used to book the ticket. Therefore, it is an activity of promotion of the functionality (service) provided by the CRS Companies.

- The transaction of booking of an air ticket is not the essential feature of the contract with CRS companies. The essential feature is the exercise of choice by the assessee to prefer a particular software system. This is promoting the business of CRS software companies and, therefore, classifiable under sub-clause (ii) of the definition of BAS.

- Rule 6(7) is an option available only to an air travel agent. By the essential character test, the role of the assessee is not that of an air travel agent, but of a subscriber, who exercises his choice for a preferred software system.

LARGER BENCH DECISION

The Larger Bench of CESTAT has decided the issue in favour of the air travel agents and held that target incentive and CRS Commission cannot be subject to service tax under the category Business auxiliary services. The issue wise findings of the Larger Bench are summarised below:

1. **Whether the air travel agent is promoting its own business or business of the airline?**

    - The Larger Bench relied on the judgment of *Airlines Agents Association* [Madras High Court] and held that the commission paid to air travel agents by the airlines has direct nexus to 'Air Travel Agent' services. Relying on the said judgment the Larger Bench also observed that air travel agent was not promoting or marketing the business of airlines.

    - Larger Bench also relied on the judgment of *Shabeer Travels* [Kerala High Court] wherein the Court had held that the services provided by the sub-agent to main agent cannot be subject to service tax under the category of Business Auxiliary Services.

2. **Whether the air travel agent is promoting the business of CRS companies?**

    - The Larger Bench observed that the passenger is not aware of the CRS company being utilised by the travel agent for booking the air ticket. For tax to be levied under 'Business Auxiliary Service', promotional activity should be undertaken, and the passenger should be able to directly use the service of CRS company. However, the passenger cannot directly use the CRS software himself and therefore it cannot be said that air travel agent is promoting the CRS company to passenger.

    - The Larger Bench observed that the Department has failed to point out any activity undertaken by air travel agent that promotes the business of CRS company.

3. **Whether incentives paid for achieving targets are taxable?**

    - The Larger Bench observed that incentives are based on general performance of the service provider and not related to any particular transaction of service.

- Section 67 provides for levy of service tax on the gross amount charged for providing '**such**' taxable service. Reliance was placed on the judgment of *Intercontinental Consultancy and Technocrats* [Supreme Court].

- The Larger Bench relied on the judgment of *AP Group Limited* [Federal Court of Australia] wherein it was held that in order to levy tax, a payment must be attributable to a particular supply and not just be attributable to supplies in general. The Federal Court held that target incentives paid by a motor vehicle manufacturer to a dealer would not qualify as consideration as these incentives would be in relation to all supplies, and not in relation to a particular supply.

- There should be direct correlation between consideration and activity undertaken. Incentives paid for achieving targets cannot be termed as consideration and therefore not liable to service tax under Section 67 of the Finance Act, 1994.

Implications

The Larger Bench has held that incentives paid for achieving targets cannot be termed as 'consideration' and, therefore not subject to service tax. This will have repercussion on the bulk discounts / volume discounts provided by the manufacturers to distributors and dealers as well. Many a times the parameters for providing such incentives/volume discount are decided mutually amongst contracting parties or are purely gratuitous by manufacturers. The application of the decision of Larger Bench has to be analyzed on case to case basis.

This decision has provided great relief to tourism sector and will have a precedential value in the Negative List regime and GST regime as well.

[*Kafila Hospitality & Travels Pvt. Ltd.* v. *Commissioner, Service Tax, New Delhi* – Interim Order No. 4 /2021 dated 18 March 2021]

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