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**CONSTRUCTION
FEDERATION OF
INDIA**

22nd November 2011

**Shri Pranab Mukherjee
Hon'ble Union Finance Minister
Ministry of Finance
Department of Revenue
North Block
NEW DELHI-110 001.**

Sir,

**Sub: Non-applicability of Service Tax on Toll Revenue in
Road BOT Projects**

Road development in India is a high priority sector and is recognized as essential both for integration and to sustain India's socio-economic development. To achieve the goal, the Government of India has embarked upon development, improvement and maintenance of the National Highways system through its agencies like National Highways Authority of India (NHAI), State Public Works Department (PWDs) and Border Road Organisation (BRO).

For the past few decades, in order to give boost to the economic development of the country, the Government has embarked upon a massive National Highways Development Projects in the country.

However, the road projects were financed only out of budgetary grants and were controlled by the Government. This traditional system of financing road projects through budgetary allocation has proved to be inadequate to meet the constantly increasing traffic at a rapid pace. To finance the highly capital intensive road projects the Government has been encouraging private sector participation through Public Private Partnerships (PPP). The Public Private Partnerships also envisages for multiple benefits viz. attracting private capital, improves efficiency, planned management, technical innovation etc. In this regard, we would like to submit the following for your kind consideration:

1. National Highways Authority of India (NHAI)/ State Authorities invite bids through competitive bidding process for construction, operation and maintenance of national highways on BOT basis.

2. As per the guidelines of NHAI/ State Authorities, the successful bidder is required to form a separate Special Purpose Vehicle (SPV) company for execution of the Project during concession period.
3. After incorporation of the SPV, NHAI/ State Authorities execute the concession agreement with the SPV and further **recognize & declare the SPV as 'Concessionaire / Contractor' for the Project.**
4. Under the terms of the concession agreement, the Concessionaire / Contractor is required to bear the cost of construction, operation & maintenance of the project highway for a particular period (hereinafter referred to as 'concession period'). The scope of the project involves following activities:
 - (i) **Construction or expansion of the existing road (Build):** The SPV first embarks on the construction activities viz., laying of a new road/additional lanes or widening of highway by arranging its own finance.
 - (ii) **Operation and maintenance (Operate):** After construction, the SPV have an obligation to maintain the road during concession period which is normally 15 to 20 years.
 - (iii) **Transfer:** At the end of the concession period, the roads assets are transferred back to NHAI/ State Authorities.

In consideration for the concessionaire's / contractor's obligation of bearing the cost of construction, operation & maintenance, the Concessionaire / Contractor is given a right to collect and retain the toll revenues during the concession period (normally 15 to 20 years).

Based on the terms of the contract with NHAI/ State Authorities, the SPVs collect toll revenue and retain it as per the provisions of the concession agreement towards recovery of road project cost.

The SPVs do not collect the toll on behalf of NHAI/ State Authorities and hence they are not 'Agents' of NHAI/ State Authorities. The relationship between SPV and NHAI/ State Authorities is that of Principal to Principal. The toll is collected by the SPV as business recovery or cost recovery of the SPV on its own account and not on account of or on behalf of NHAI / State Authorities. It is the SPV's exclusive income. Losses/Profits arising out of BOT projects is on the SPV's account and NHAI/ State Authorities are in no way responsible to bear the same.

Considering the importance and high priority of development & improvement of Infrastructure in the country, Service tax on road Projects is specifically exempted under section 65 (25b) i.e. 'Commercial Industrial Construction Service' and also under section 65 (105) i.e. 'Works Contract Services' of Finance Act, 1994. Operation and Maintenance of road is also exempted from ambit of service tax. In this regard it has to be appreciated that in some respect the toll collection allowed to be kept with us is in effect



a compensation for constructing the road which in any case is exempt from service tax.

We draw your kind attention to the table drawn below:

S. No.	Projects	Category of Taxable Service	Funded by	End use	Collection of Toll
1	Road Construction	Commercial or Industrial Construction or Works Contract Service	Government	Public Utility	By Government
2	Road Construction	Commercial or Industrial Construction or Works Contract Service	Public Private Partnership	Public Utility	By PPP/(SPVs)

From the above table you will find that being a Public Utility Service Government has not included construction of road under the ambit of service tax with an intention to make the road project cost effective. Likewise, when the source of funding is shifted to Private Capital, there is no change in the intention of the Government and the purpose of public utility of the road also remain changed. When project is funded by the Government, the Government collects the toll whereas when the project is funded by the PPP route the toll is allowed to be collected by the Concessionaire/SPVs to recover the capital cost/cost recovery. **The difference between the two is only the source of funding and nothing else.**

However, recently the Service Tax department has taken a view in case of some SPVs of Road BOT Projects that *SPVs are acting as agent of NHAI/ State Authorities and providing merely toll collection services to them.* As mentioned above, we wish to reiterate that SPVs are in no way agents of NHAI/ State Authorities and they collect and retain toll as per the concession agreement on their own account basically towards recovery of Project cost expended by them. Thus, both the toll income and the expenditure on the road projects is that of the SPVs who bear the traffic risk. It would be pertinent to note that in case of all the SPVs, they have been recognized by NHAI/ State Authorities as "Concessionaire / Contractor" and not as an agent. In fact the Hon'ble Customs and Central Excise and Service Tax Tribunal in a decision dated May 12, 2011 in the case of M/s. Swarna Tollway (Pvt.) Ltd. ('STPL') V/s. Commissioner of Custom and Central excise Guntur also held that ***"It is significant to note that NHAI, being party to concession Agreement and the Assignment Agreement, accepted STPL as the 'Concessionaire' and declared so in above letter unequivocal terms. Upon receipt of the letter from NHAI, the Commissioner of Service tax not to have any doubt lingering in his mind about the status of the assessee in relation to concession agreement"***.

In other words, when NHAI/State Authorities recognize SPVs as Concessionaire, the activity of collection of toll during the course of concession period is to recover capital cost/cost recovery which amounts to act of self and hence there cannot be provision of any taxable service to oneself hence no service tax is attracted. This is based on the principle of 'mutuality'.

In spite of Tribunal's decision, the Department has taken a view that *SPVs are acting merely as an agent of NHAI/ State Authorities and has issued Show Cause cum Demand Notices (SCNs) levying service tax on the gross amount of toll collected under the concession agreement to some the SPVs of Road BOT project.*

Further, the service tax department while issuing the SCNs have contended that not only are the SPVs merely an agent of NHAI / State Authorities but are also providing services to the users of the road on behalf of NHAI / State Authorities and accordingly the SPVs' services are liable for service tax under the category of business auxiliary services more particularly under clause (vi) of section 65(19) of Chapter V of the Finance Act, 1994 (the law dealing with service tax) viz., 'provision of a service on behalf of a client'. In this regard it is to be appreciated that the NHAI / State Authorities who are statutorily entrusted with the development, maintenance and operation of highways / roads are performing a statutory duty / function for public welfare and cannot be said to be providing a 'service' to the users of the roads since there is no service provider – client /customer relationship between NHAI / State authorities and the users. Consequently, the SPVs cannot be said to be providing services to the users of the road on behalf of NHAI / State Authorities. Hence the SPVs would not be liable for service tax under the category of 'business auxiliary services'.

"Business Auxiliary Service" generally means any service which would aid in or help in or support in performing main functions of the business. NHAI/State Authorities are not undertaking any business and the road development and improvement projects for public utility by no stretch of imagination can be construed as business. Therefore, the activity undertaken by the SPVs is not "Business Auxiliary Service" and hence not liable for service tax.

Vide Circular No.89/7/2006-S.T. dated 18.12.2006, CBEC has also stated that statutory functions performed in terms of specific responsibility assigned to a sovereign/public authority under law in force, do not constitute provision of taxable service to a person and therefore, no service tax is leviable on such activities.

Further where toll is collected by any authorized banking company or a financial institution including a non-banking financial company or any other body corporate or commercial concern, to the Govt. of India or the Government of a State in relation to collection of any duties or taxes levied by the Government of India or the Government of State, the same is exempted from service tax vide Notification No.13/2004-S.T. dated 10.09.2004.



The above Circular of CBEC and the Notification issued by the Government it is clarified that toll is a tax and collection of tax by any person is not a service and hence not taxable.

In spite of the above facts, clarifications and the legal decisions, the Service Tax Department has failed to understand and appreciate the intention of the Government of promoting development & improvement of infrastructure in the country by exempting the roads & highways from levy of service tax.

Therefore, in order to avoid frivolous litigation and unnecessary delay and cost to the assessee and the Government, for road projects under BOT, the **Federation humbly request your good self to clarify to the field formation that SPVs are the Concessionaire / Contractor or their sub-contractors are not mere toll collection agents of NHA/ State Authorities and thereby collection of toll revenues is not liable for service tax.** This will enable to focus their energy towards completion of the projects on schedule which is in the best interest of the Nation.

With kind regards,

Yours sincerely,

A handwritten signature in black ink, appearing to read 'SS', is written over a faint, illegible stamp.

(Siddharth Singh)
Secretary General