

ITC of Health Service - A Case for General Insurance Industry

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Sherin Daniel

Advocate

1. General insurance sector in India has seen an accelerated growth in the past and yet there is immense growth potential as the insurance sector continues to penetrate into the untapped market in India. The Government on its part has taken various key policy measures to subsidize the insurance related to agriculture and health. Schemes like National Agricultural Insurance Scheme ("NAIS"), Pilot Weather Based Crop Insurance Scheme ("WBCIS") have gone a long way in covering of risk associated with the agriculture sector for the farmers. Further, schemes such as Ayushman Bharat and Pradhan Mantri Jan Arogya Yojana have enabled benefits of health insurance to the rural sector. COVID-19 pandemic also proved to be a key driver of insurance business as it helped customers self-realize the necessity to have the risk cover. Post pandemic era has seen insurance business infiltrate into new sectors. The Annual Report FY 2020-21 of the general insurance sector issued by the Insurance Regulatory and Development Authority ("IRDA") records that the general insurance industry underwrote total direct premium of Rs. 1.99 lakh crore in India for the FY 2020-21 as against Rs. 1.89 lakh crore in FY 2019-20, registering a growth rate of 5.19 per cent. The underlying fact is that the insurance sector certainly has the potential to generate more employment opportunities in India and at the same time it can become a larger contributor of tax revenue to the Government. That said, while the policy measures have given a radical push to the insurance sector in India, the unsettled tax related issues have caused inefficiencies in insurance sector and resultantly, contributed to increasing cost for the sector. This article highlights the issue related to loss of the Input Tax Credit ("ITC") borne by insurance companies, as a result of a new GST levy on the room rent exceeding Rs. 5000/- recovered by hospitals, which was introduced by the GST council in its 47th meeting held on 28th and 29th June, 2022.

2. Traditionally, the general insurance industry has borne the brunt of input tax credit costs on health services. ITC related to consumables such as surgical equipment, drugs and medicines, etc. never gets passed on to the general insurance companies even though the commensurate expenses and the ITC amount towards the same is borne by insurance companies. The loss of ITC in this case is largely because the invoice for such consumables are issued to the hospitals instead of insurance companies. While, the issue related to ITC loss borne by the insurance companies because of above issue has remained unresolved, the GST council in its 47th meeting has cast a new burden of ITC cost on insurance companies by way of a fresh GST levy on the room rent exceeding Rs. 5000/- recovered by hospitals from patients.

3. In line with the recommendation provided by the GST Council in its 47th meeting, the Press release dated 29th June 2022 was issued which recorded that room rent (excluding ICU) exceeding Rs. 5000 per day per patient, charged by a hospital to be taxed to the extent of amount charged for the room at 5% without ITC. Accordingly, following amendments were brought into effect by the Government :

i. Withdrawal of GST exemption on hospital room charges exceeding Rs. 5000/- per day - Notification 04/2022 inter alia introduced amendments to Entry 74 of the Exemption Notification to withdraw GST exemption on services provided by a clinical establishment by way of providing room [other than Intensive Care Unit (ICU)/Critical Care Unit (CCU)/Intensive Cardiac Care Unit (ICCU)/Neo natal Intensive Care Unit (NICU)] having room charges exceeding Rs. 5000 per day to a person receiving health care services.

ii. Introduction of GST levy of 5% on hospital room charges exceeding Rs. 5000/- per day - Notification No. 03/2022- Central Tax (Rate) dated 13th July, 2022, inter alia introduced entry 31A under heading 9993, whereby Central Goods and Services Tax ("CGST") rate of 2.5% (i.e. CGST and State Goods and Services Tax ("SGST") rate totalling to 5%) was prescribed for services provided by a clinical establishment by way of providing room [other than Intensive Care Unit (ICU)/Critical Care Unit (CCU)/Intensive Cardiac Care Unit (ICCU)/Neo natal Intensive Care Unit (NICU)] having room charges exceeding Rs. 5000 per day to a person receiving health care services.

4. In effect, clinical establishments or hospitals are now required to discharge GST at 5% on the room rent exceeding Rs. 5000/- per day paid by a patient. Pertinently, cost of all the services provided by hospitals and clinical establishments such as surgical costs, doctor charges, cost of consumables including room rent gets masked under the category – 'health services'.

5. Appositely, ITC of GST charged and recovered by clinical establishment or hospitals for 'health services' has remained ineligible to all persons including insurance companies as a suitable amendment by way of an exception, allowing the ITC to insurance companies was not made in Section 17(5) of the Central Goods and Services Tax Act ("CGST Act"). In other words, Section 17(5) (b) of the CGST Act continues to debar ITC related to 'health services' without an exception.

6. The key factors because of which it is argued that the health insurance sector deserves an exception by allowing ITC is set out in the paras below.

A. Unlike any other sector, 'health service' is directly linked to and used in the furtherance of insurance business

6.1 The *sine qua non* for the eligibility of ITC under Section 16 of the CGST Act is that, the input service should be used or intended to be used in the course or furtherance of registered person's business. Health service provided by clinical establishments or hospitals are directly used by insurance companies for their business. The cost related to health services of customers is borne by insurance companies and therefore, the health services are directly linked to the output services supplied by insurance companies.

6.2 The position on eligibility of ITC related to health services to insurance companies is not res integra and is in fact a settled position of law. It is apposite to draw attention to the fact that when health services was originally brought to tax in the erstwhile service tax regime under the Union Budget 2010-11, it was out rightly clarified in the **Circular D.O.F. No.334/1/2010-TRU** issued by Tax Research Unit, Ministry of Finance, Government of India, that insurance company is service receiver for health services provided by clinical establishments and hospitals and therefore, the tax paid by the hospitals would be available to the insurance companies as credit. The relevant extract of the circular is reproduced below for ready reference :

"2.2 A large number of health insurance schemes are being offered by the insurance companies under which charges for hospitalization, surgery, postsurgical nursing etc. are generally paid by the insurance company. Such insurance policies, which fall under the category of general insurance service, are already taxable. Under general insurance service, an insurance company is a service provider to its clients. Under the proposed new service, tax is also being imposed on the medical charges paid by the insurance companies to the hospitals on behalf of a business entity for its employees. As such, the insurance company would be the service receiver and the tax paid by the hospital would be available to the insurance companies as credit."

6.3 Given the above, the intention with which taxation on health services was introduced always factored the typical business of insurance companies and therefore, credit related to such services was always allowed to insurance companies. The circular was relied upon by the Customs Excise and Service Tax Appellate Tribunal ("CESTAT"), Chennai in **United India Insurance Co. Ltd. v. CCE, ST, LTU, Chennai [ST /412/2011 dated 01st June 2018]** wherein, the question was on the eligibility of credit related to repair services for the vehicle insured by insurance companies. The CESTAT relied upon the circular and recorded the validity of entitlement of credit related to health services for insurance companies. This position was also followed and recorded by the CESTAT, Chennai in **Cholamandalam MS General Insurance v. LTU Chennai [ST/47/2012 dated 17th July, 2018]**.

6.4 The GST law has been framed to allow ITC to the person who bears cost related to service procured. As per Section 2(93) of the CGST Act, 'recipient of supply' inter alia is the person who is liable to pay the consideration. In case of health services availed by an insured customer from hospitals or clinical establishment, it is the insurance company which is liable to pay the consideration towards health services. Therefore, insurance companies are the recipients of health services. Accordingly, the insurance companies are entitled for ITC related to such services.

B. ITC related to motor garage service is allowed as an exception to insurance companies; The logic of exception stands true for health service as well

6.5 The CGST Act [under Section 17(5)(ab)] takes cognizance of the typical nature of business of insurance companies engaged in general insurance and allows ITC related to servicing, repair and maintenance of motor vehicles, vessels or aircraft which is otherwise ineligible to ITC to players in other sectors^[1]. The ITC eligibility related to motor garage services to insurance companies has also been specifically clarified in the Sectoral FAQ issued by Central Board of Indirect Taxes and Customs ("CBIC").

6.6 It is an accepted fact by GST department that the idea behind exceptional treatment for insurance companies by allowing ITC related to servicing, repair and maintenance of motor vehicles is that such services are directly linked with the provision of output services i.e. motor insurance. That said, this logic stands true for health services as well, as the health services are directly linked with the provision of health insurance service. Therefore, the insurance companies should certainly be entitled for ITC related to health services. Hence, there is no reason to bar ITC related to health services to insurance companies which are used in the course of or furtherance of business.

C. Without prejudice to the above, the true nature of service which has been brought to tax levy is renting service and not 'health services'

6.7 Without prejudice to the rationale for entitlement of ITC related to health services stated above, it is pertinent to highlight that in terms of Notification 04/2022, the GST exemption has been withdrawn for room rent services provided by clinical establishment with charges exceeding Rs. 5000/- per day to a person receiving health care services. Now at the outset, it is apposite to note that in determining the taxability including ITC eligibility of a transaction, the Ministry of Finance has by its Circular^[2] reiterated the settled law^[3] that before determining the taxability of a transaction, it is essential to first determine the true commercial nature of the transaction in question.

6.8 In the present scenario, the true nature of services which has been brought to levy of tax under Notification No. 03/2022, is not the health service per se, but the room charges or room rent recovered from the insured patient as a part of health service. This aspect is clear from the fact that the Press Release issued by GST Council in connection with the Council's 47th meeting, recommended inter alia that "room rent (excluding ICU) exceeding Rs. 5000 per day per patient, charged by a hospital to be taxed to the extent of amount charged for the room at 5%". Further, entry 31A of Notification No. 03/2022, whereby CGST rate of 2.5% has been prescribed relates to "services provided by a clinical establishment by way of providing room [other than Intensive Care Unit (ICU)/Critical Care Unit (CCU)/Intensive Cardiac Care Unit (ICCU)/Neo natal Intensive Care Unit (NICU)] having room charges exceeding Rs. 5000 per day to a person receiving health care services". Therefore, the true nature of transaction which has become taxable by virtue of the amendment is the charges recovered by hospitals from patients for renting of room. That said renting of immovable property service (i.e. room in the present case) is not excluded from ITC eligibility under Section 17(5) of the CGST Act. Therefore, even by this logic ITC related to such services should be eligible to insurance companies.

6.9 To conclude, on the one hand, radical policy measures have been implemented to make the health insurance affordable to the society at large. On the other hand, issues resulting into tax inefficiencies in the insurance industry have remained unaddressed and on top of it fresh issues discussed above have emanated. These have contributed to the costs of insurance business to the insurance companies. The objective of tax amendments should align with the policy measures of the Government, such that sectors specific issues are not ignored during the deliberations of GST council. In order to allow ITC of health service, the Government should introduce an amendment in Section 17(5) of the CGST Act in order to make an exception in debar of ITC related to health service to the insurance sector taking into account the typical business of health insurance industry.

[1] Section 17(5) of the CGST Act - “(5) Notwithstanding anything contained in sub-section (1) of [section 16](#) and sub-section (1) of [section 18](#), input tax credit shall not be available in respect of the following, namely:-....Provided that the input tax credit in respect of such services shall be available-

(i) where the motor vehicles, vessels or aircraft referred to in clause (a) or clause (aa) are used for the purposes specified therein;

(ii) where received by a taxable person engaged-

(I) in the manufacture of such motor vehicles, vessels or aircraft; or

(II) in the supply of general insurance services in respect of such motor vehicles, vessels or aircraft insured by him;”

[2] Circular D.O.F.NO.334/4/2006-TRU dated 28.2.2006

[3] UOI v. Playworld Electronics Private Ltd [AIR 1990 SC 202]; Amaresh Enterprises v. CCE [2007 (8) S.T.R. 611 (Tri.-Kol.)]