

TAXATION OF SERVICES RECEIVED FROM ABROAD

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Service tax levy was introduced for the first time in 1994 vide Chapter V of Finance Act 1994 seeking to tax services provided in the country. The service providers were made responsible to collect the service tax from the service receivers and remit the same to the government. For several years the liability was only for service providers in the country with the exception of Jammu and Kashmir. But with the passage of time and the increased contribution of the service sector to the Indian GDP, the Government started looking at increasing the revenue from the services sector.

In this scenario one aspect which caught the government's attention was that of Indian entities entering into agreements for professional consulting and transfer of technology with the organizations abroad. Further the domestic service providers were at a disadvantage as against the providers from outside India. For the multi national service firms, the possibility of billing from elsewhere also existed. This could not be subjected to service tax in India unless changes were made to Chapter V levying service tax specifically on services received from abroad. It is interesting to note here that there has been considerable confusion in the past regarding the taxability of services received from abroad and the confusion to a certain extent had arisen due to the amendment to Rule 2 of Service Tax Rules 1994 with effect from 16.08.02. The amendment was in terms of Rule 2(1)(d)(iv) seeking to treat the service receiver in India as the person liable to pay tax where the service provider was a non-resident not having an office in India. However, the tax liability on the service receiver could not be fastened as the amendment in the Rules was held to be not sufficient for introducing a liability in the absence of anything specific in the statute as laid down in Hindustan Zinc Ltd. Vs CCE Jaipur (2008-TIOL-1149-CESTAT-DEL-LB). Moreover, departmental Circular 36/04/2001-CX (ST) dated 08.10.01 had clarified that service provided beyond the territorial waters of India was not liable to tax keeping in mind the spirit of Section 64. This Circular was withdrawn on 10.05.07 after introduction of Section 66A in Chapter V of Finance Act 1994 as amended from time to time.

The Government had also introduced an explanation to Section 65 (105) of Chapter V (which dealt with taxable services) with effect from 16.06.05 deeming a service as a

taxable service where the same was provided by a person having place of business or fixed establishment or permanent address or usual place of residence in a country other than India and was to be received or received by a person who had his place of business, fixed establishment or permanent address or usual place of residence in India. This was done despite section 64 being very clear as to the applicability of provisions of this Chapter only to India. The government had also overlooked the fact that services were intangible and also that no two services could be said to be the same. Thus determining what could be regarded as having been received in India, in what context and what could not was very difficult and had to be clarified. Moreover, the territorial nexus theory was also something to be dealt with.

Considering these factors the Central Government introduced Section 66A with effect from 18.04.06 charging service tax on services received from outside India. Along with this, the Government also introduced Taxation of Services (Provided from Outside India and Received in India) Rules 2006 (though section 94 which grants power to government to frame rules does not specifically deal with import of services) besides amending Rule 2(1)(d)(iv) of Service Tax Rules 1994 regarding the service receiver as a person liable for paying service tax. The Mumbai High Court in late 2008 held that such transactions would only be liable from 18.4.2006 onwards.

Charging section

The charging section which seeks to tax services received in India from abroad is section 66A of Chapter V of Finance Act 1994 as amended from time to time. In order to tax the service concerned, it should first of all be a taxable service. Where the taxable service covered u/s 65(105) is -

- Provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and
- Received by a person (hereafter referred to as the recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India,

Then, such taxable service shall be treated as if the recipient had himself provided the service in India unless such recipient is an individual and the service is received for purposes other than for use in any business or commerce.

Where the service provider has his business establishment both in that country as well as in some other country, the country where the establishment concerned directly with the provision of service is located, shall be treated as the country from where the service is provided or to be provided.

Readers should note here that the service in question should be a taxable service finding mention under one of the sub-clauses of Section 65(105) of Chapter V of Finance Act 1994 as amended from time to time. An example could be of an advocate legal service received from outside Indian, which would not be liable under these provisions. Moreover, such taxable service received by an individual for his personal use would not be liable to service tax as a receiver of such taxable service provided by the service provider abroad as the first proviso to section 66A (1) specifically exempts the same from levy of service tax.

Where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section. In other words, where the establishment abroad provides services finding a mention in section 65(105), to the establishment in India, then such services would be taxed in the hands of the Indian establishment as per the Taxation of Services (Provided from Outside India and Received in India) Rules 2006.

It is worthwhile to note that the concept of “establishment” has not been defined or clarified under service tax and one would have to refer the dictionary meaning of the term establishment. As per the meaning given by Webster’s Unabridged Dictionary, establishment means a place of business together with its employees, merchandise, equipment etc.

The first explanation to section 66A (1) specifies cases where there would be deemed to be a business establishment. As per this explanation, where a person carries on a

business through a branch or agency in any country, he shall be treated as having a business establishment in that country.

The second explanation to section 66A (2), clarifies the concept of usual place of residence in relation to a body corporate to mean the place where it is incorporated or otherwise legally constituted.

Importance of correct classification of taxable service

One of the important requirements for determining one's liability to service tax on receipt of taxable services from abroad is to classify the said service under the appropriate heading. This is critical as the criterion for ascertaining whether the service is regarded as having been received in India or not is not the same for all the taxable services u/s 65(105). Rule 3 of the Taxation of Services (Provided from outside India and Received in India) Rules 2006 divides the taxable services into three categories for this purpose.

- The first category deals with the taxable services received in relation to an immovable property. With regard to this category, the taxable services provided or to be provided in relation to an immovable property situated in India shall be regarded as having been received in India. In other words the location of the immovable property would be the critical factor. Where it is outside India, the taxable service provided in relation to such property would not be liable in the hands of the receiver.
- The second category deals with taxable services with regard to which the place of performance would be the critical factor. Here, the taxable services shall be regarded as having been received in India if such services have been **performed in India**. Performance here could even be part performance in India. Such part performance would result in the service being regarded as having been received in India.
- The third category deals with taxable services with regard to which the location of the recipient himself would be the critical factor. Here, the taxable services shall be regarded as having been received in India if such services have been **received by a recipient located in India** for use in relation to business or commerce. Here, the actual place of performance of the service would not be relevant and the service would be treated as having been received in India as long as the recipient of service is located in India.

Readers may refer a proper commentary on service tax for the list of services which fall under each of the aforesaid three categories.

The categorization as explained above would go a long way in determining whether a taxable service is regarded as having been received in India from abroad or not and consequently, whether liable to tax in the hands of the service receiver in India or not. Where the services are wrongly classified, there could be risk of future demands of tax with penalties. Where liable, the service receiver would have to register himself under service tax and pay the tax.

Case laws

Whether taxable services received in India from abroad before insertion of section 66A with effect from 18.04.06 were liable to service tax in the hands of the service receiver in India?

The readers should be careful enough to note the distinction between services received in India and those received outside India. Where the service provider happens to be outside India as explained earlier and provides service which is received outside India by a service receiver in India, the same cannot be taxed before 18.04.06 going by the decision of the Tribunal in Foster Wheeler Energy Ltd Vs CCE Vadodara (2007-TIOL-785-CESTAT-AHM) and of the Mumbai High Court in Indian National Shipowners Association Vs UOI (2008-TIOL-633-HC-MUM-ST). But where the service is received in India, the same can be taxed here prior to 01.01.2005 going by the decision of the Larger Bench of the Tribunal in Hindustan Zinc Ltd Vs CCE Jaipur (2008-TIOL-1149-CESTAT-DEL-LB). This would apply to services performed or provided in India and received by service receiver in India. The introduction of Section 66A has in reality affected services which are taxed at present on the basis of the location of the recipient rather than on the basis of the performance. This is the humble view of the authors until we get a decision to the contrary from the Tribunal or the Courts.

Is territorial nexus theory valid while determining the service tax liability?

The Supreme Court had laid down the importance of the territorial nexus theory in Ishikawajima Harima Vs Director Income Tax Mumbai (2007(01) LCX 0034) case in determining the tax liability under Income Tax. As a general principle to be followed for determining the tax liability, the principle is valid even today and was affirmed even in

Foster Wheeler Energy Ltd case. With regard to service tax however, the liability would now have to be determined by referring the Taxation of Services (Provided from outside India and Received in India) Rules 2006 as well as section 66A since the amendment with effect from 18.04.06 and the liability would be for the service receiver in India under the reverse charge mechanism and not the non-resident service provider.

Issues

Whether cenvat credits can be availed for the purpose of paying the service tax on taxable services received in India from abroad?

No. Rule 5 of Taxation of Services (Provided from outside India and Received in India) Rules 2006 specifically bars the service receiver from regarding the taxable service received as an output service for availing credits. Thus, cenvat credits cannot be availed for paying service tax liability on such services received.

Whether the service provider providing taxable services within India can avail credit of the service tax paid on such services received from abroad?

Yes. Where the taxable service received in India from abroad qualifies as an input service as laid down under Cenvat Credit Rules 2004, the assessee can avail Cenvat credit of the service tax he pays on such services received from abroad.

Whether service tax is to be paid on booking of the expenses?

Yes. Where the taxable service is received or to be received in India from an associated enterprise as defined u/s 92A of Income Tax Act 1961, service tax would have to be paid by the service receiver in India on booking of the expenses or adjustment vide credit note/debit note. In other cases, the service tax is to be paid on payment of consideration to the service provider.

Whether cost allocation between units located in different countries would attract liability?

There could be a situation where expenses incurred by a unit are allocated between various other units. We may have a situation where a unit abroad (holding company/subsidiary or a company falling under the same group) charges a unit in India a sum representing the latter's share of expenses. In such cases, one would have to see

whether there is any service at all. Pure cost allocation without there being a service, would not be liable in the hands of the Indian unit.

Where there is a service received in India but there is no consideration for the service apart from meeting of costs, the matter may be subject to litigation. Though the authors are of the opinion that service tax should not be charged in such cases, the assesseees to be on the safer side of the law would be better off paying the service tax on taxable services received (as even reimbursement of expenses are liable to service tax) and avail credit of service tax paid where the services qualify as input services.

However if there is taxable service and there are reimbursements the provision of Rule 7 of the Service tax Determination of Value Rules 2006 appear to clarify that only the service would be liable. Case law confirmation in this regard is awaited.