

OVERVIEW OF SERVICE TAX LAW

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Introduction

Service tax was being collected in India 3000 years back for a plethora of services some of them being ferry tax, betting tax, courtesans, and many others. Service Tax in its present shape was brought into existence in the year 1994. Initially 3 services were brought into the net, which today has expanded to 115 categories covering millions of service providers. Eight more categories have been added in this year's budget. It is expected that the number of service tax assessees would cross the number of income tax payers in a few years due to the fact that general exemption/ threshold limits have not been put into place for all categories. In recent times the Government has been looking at this sector to raise substantial resources and has fixed ambitious targets of collection.

Approach to Understand Service Tax

The service providers in India who have been covered are not restricted to the literate/ large/ organised sector. The illiterates, unorganized and small service providers are also covered under service tax. The service provider requires following the steps depending on the need and the stage at which the assessee is presently. Once the liability under Service Tax is confirmed then the procedural compliance to avoid demands and dispute is essential. This has also been provided stage wise. The detailed aspects of service, principles of classification, service tax credit, valuation broadly applicable to all services has been provided below:

Determination of the Taxability of Service

Introduction

Service tax is applicable to defined service providers, providing defined taxable services, to defined service receivers, in India. The tax is liable on the gross amounts charged for such service less the deductions and exemptions set out therein normally at the rate of 10% (plus education cess of 2% on 10% and SHE cess of 1% on 10%). The levy should get attracted on providing of the services, whereas the charge is to crystallize only on receipt of the consideration. Services, which are received by residents in India from service providers resident abroad would also be liable. The payment of the tax is to be

made after utilization of eligible service tax credits on input services as well as the eligible cenvat credit on inputs used for providing the taxable service and the capital goods credit used for providing taxable service.

The service tax is payable only on receipt of the monies for the service whether partially or fully. The non-payment of service tax component charged to the customer is not relevant and the amount received would be considered to be inclusive of Service Tax. As the levy of service tax is on the provision of service, the services provided before the date of the levy coming into being would not be liable. It also means that billing made for prior periods when the levy was not in place would not be liable. However it maybe prudent to ensure that the evidence of providing the service earlier is available.

Similarly, the credit on the input services is available only when the payments are made for the value of services. If there were a part payment of services, proportionate credit would be admissible.

In case of a transaction with an associated enterprise service tax is payable as soon as entry is made in the books of person liable to pay tax.(as per explanation to rule 6(1) to Service Tax Rules 1994 w.e.f.10.5.2008.)

Scope of Service Tax Provisions

There is no separate Service Tax Act as on date and the Provisions contained in Chapters V & VA (Section 64 to 96-I) of the Finance Act 1994 govern the levy of Service Tax. Section 64 extends the same to whole of India except the States of Jammu & Kashmir. This means that the services provided outside India for persons in India would not be a subject matter of levy. The view of the bureaucracy that Service Tax is a destination based levy and consequently services though provided from outside India but consumed in India appears to be flawed and assumes extra territorial jurisdiction on other countries. This may not stand the judicial review. The services provided outside India by residents for their clients located outside India would also not be a subject matter of service tax as it is an export of services. Where a Non Resident/ Foreigner/ Foreign Company in India provides taxable services, the levy would be attracted.

What is Service?

Where there is no service the levy of service tax would not be attracted. Service to self or divisions of the same entity would not be liable. Further there is no payment of service

tax where there is no receipt of monies for the same. If services are not charged to service tax under any of the categories specified in the Finance Act 1994 at all then also liability to pay service tax would not be attracted. Section 65 (95) defines Service Tax as the tax leviable under the provisions of this Chapter. We need to examine whether “service” exists. Service as per dictionary meaning is as follows - “an intangible commodity in the form of human effort such as use of labour, skill or knowledge for the benefit of another.” There is no definition in the provisions of Service Tax for the word “service”.

The Supreme Court in the case of State of Uttar Pradesh Vs Union of India { 2004 (170) ELT 385 } has held that merely because the service tax has been imposed on telephones, it does not stop the State Government to impose sales tax on rentals received from the customer. This was on the reasoning that in that particular activity both sales and service were involved.

In the case of supply contracts or works contract where some amount of service is also provided, the important decision to be taken is to find out the dominant motive for the contract. This could be as under:

- Only supply: The contract maybe only of purchase and sale as a trader. In such cases the question of providing service does not arise.
- Only manufacture and supply: The contract maybe of purchase processing and sale thereafter. In such cases the question of providing service does not arise.
- Supply and Service: The contract may be for both. Here the possible break up of the contract is to be examined. If break up is possible as evidenced by the contract, offer, acceptance, and then the component of service only would be taxable. In case the contract is composite and the break up is not possible then the examination to find out the basic intention and motive behind the contract would be required to be examined. If the predominant objective were to supply then there would be no liability under service tax. In case the predominant objective is either service or sales or manufacture with no clear predominant characteristic then the service tax levy would be applicable on the gross value less permissible deductions/ exemptions. This type of subjective ness will invariably lead to a lot of judicial action.
- Manufacture and Service: The analogy as discussed in supply and service is also applicable in this case.

- Only Service: Then the levy maybe attracted if it is set out in the provisions.

At times it maybe preferable to use the principles of costing to artificially break up the sales, services portions and pay the service tax on the portion liable. However this also may not be free of issues as the amount allocated may not be reasonable for the Sales tax officer or the service tax officer.

Further where the provider of services has doubts, it is advisable to examine the status of the service receiver. In the event that the receiver himself is eligible for the Service Tax credit then erring on the side of revenue maybe prudent.

Taxable Services

Examine whether the Services are specified in any of the 115 categories of specified taxable services as on date. Only those services, which are set out in Section 65(105) as taxable services are liable to the tax. Only those services, which have been defined therein and that also only from the date the same was brought into charge in terms of section 66. Therefore only for the services provided after that date would Service Tax be attracted. The Taxable Service Provider (TSP) should therefore examine the services for which he is liable and those, which are exempt, or cases where there is no service at all.

Classification of Service

The classification of the service provided should be with reference to the specific coverage within the 115 alternatives. It is possible that the services provided by one service provider may appear to fall under more than one category of specified services. It is possible that one service provider maybe providing numerous individual services or combined services. He would be required to register under all of them. Where however the main service is provided along with other incidental and ancillary services the need to classify himself in all would not exist. The growth of service tax has also led to some of the services being more specifically covered at a later date. At this point whether the service was earlier covered at all is a question, which comes to mind.

Where the entry is not clear or more than one classification appears to be correct then reference is to be made to Section 65A for the rules of interpretation. This sets out that where the service is covered under a specific category the classification in the general category is not proper. In case of mixed service, the service, which provides the essential character, is to be chosen. In the event that even then the same is doubtful, the

classification appearing first in the sub clauses of the definition of taxable services [Section 65(105)] is to be chosen. Where an alternative with no taxability is chosen, the justification of the choice should be clear and legally defensible. This would also be equally applicable where any exemption is claimed. The exemption should squarely cover the service provided. In case of airport and port services the principles of interpretation are not applicable as the services starting and ending within such places would be considered as port/ airport services even though they may otherwise be classifiable elsewhere. This type of amendment due to excessive zeal to tax at any cost is against the reform process.

In case of doubt, erring on the side of revenue is preferable since the law is nascent. Alternatively, the entity may choose to pay the tax under protest and claim for refund if the incidence of the tax is not passed on to the customer.

The importance of proper classification could be gauged by the effect of incorrect classification of the service:

- In case of wrongly classifying, due to which additional liability of tax is burdened on the service provider, the customer at a later date would not be willing to pay for the same. This is especially true after the date of annual closing.
- Some of the exemptions / deductions are specific to one category which may not be claimed or wrongly claimed.
- The dispute with the department would add to the transaction cost with the cost of litigation, interest and penalty being added up.
- Further the possible loss/ denial of service tax credit/ input and capital goods credit exists.
- The customer may also not be able to avail the credit at a future date or may not be able to utilize the same (though there is a possibility to avail such benefit by resorting the decisions of court).
- In case of erring on the side of revenue, competitors would become more cost effective. (Where services which are not liable are opted to be covered voluntarily)
- The image of a tax compliant assessee would also be tarnished to a certain extent if there is protracted litigation.

The Circulars, which are at present being issued along with the category being covered or a few days earlier to such coverage, can provide the departmental view. Certain favorable clarifications can be used and those, which go to expand the law, may require to be challenged. In many departmental clarifications the objective appears to be to issue circulars to cover borderline cases where there is a legal loophole. At times the Circulars go beyond the provisions / Rules and extend the law. This is a case where the tail wags the dog instead of the dog wagging the tail. It is judicially well settled that the departmental circulars are binding on the departmental officers and they cannot take a stand, which is at variance to the circular. {See decision of Supreme Court in British Machinery Supplies Co Vs UOI 1996 (86) ELT 449 & CCE Vs Maruti Foam P Ltd. 2004 (167) ELT 18}. Also the decision in Commissioner of C.Ex. Bolpur vs. Ratan Melting & Wire Industries (2008(231)E.L.T.22(S.C.) says that Circulars and instructions issued by C.B.E. & C. are binding on authorities under respective statutes. However a circular contrary to statutory provisions has no existence in law. Since this is a central levy the clarifications issued anywhere in India would be equally applicable anywhere in India. {See decision in SAIL Vs CC 2000(115) ELT 42(SC)}.

Exemptions

We have ascertained that a taxable service is provided in India under one of the specified categories. The next examination is whether the service provider wishes to avail the exemptions if any, which are available at his option. There are some general exemption and some specific exemptions. The decision to claim the exemption should depend on the type of service as well as the customers' orders. The orders if generally received as basic + taxes as applicable would mean that the service provider would benefit by opting for tax payment. A comparative analysis of the two situations (opting for registration and opting for exemption) from the start of providing services to the ultimate consumption of the service would highlight the benefit to the ultimate client. The service provider doing very low value addition may also find opting for registration preferable. The exemption notification is to be examined carefully as non-following of the substantive conditions could lead to a denial of the benefit. The general exemption to the services is only with regard to services provided to certain diplomatic missions, SEZ, and exemption to the value of goods sold in providing of the service among some others.

Sub-Contract

The provisions of service tax as they stand today require even sub-contractors to charge service tax. The service receiver would be entitled to claim credit of the service tax charged by the sub-contractor. Thus the cascading effect of tax on services at various levels can be avoided. In earlier times circulars (upto 24.8.2007) had opined that sub contractors within the same service would not be liable if the principal had paid.

Input Service Distributor (ISD)

The concept of the service tax distributor has been envisaged where the corporate office or regional office or branch will be able to distribute the service received among the service providers within the entity. There is a requirement of Registration of such ISD. He would also require filing the returns. The provisions are to be somewhat similar to the registered dealer under central excise.

Cenvat Credit / Service Tax Credit

The cenvat credit rules 2004 has subsumed the service tax credit rules of 2002 and includes the cross sectoral credits of excise duty. The credit of excise duty paid on inputs used in the providing of the service would be eligible. The duty on capital goods used for providing the output service is also eligible for the service provider. The service tax credits for input services used by a manufacturer would be available. These credits would go to reduce the impact of service tax on the service provider. This move has come as a boon to the manufacturers as it can reduce their net cost of excise. There are some conditions on the eligibility and the restriction on utilization at times of providing taxable and non-taxable manufactured goods or services.

Broadly the steps are to determine the eligibility for the credit and then examine whether the taxable and non taxable services are being provided. If only taxable services are provided there are no issues and total credit can be utilized. Where only part of the services is taxable then there is an option to maintain separate accounts and avail full credit for those services, which are used in relation to taxable services. Alternatively, the service provider not maintaining separate accounts can arrive at the eligible credits by using the formula notified in this regard. Readers may refer Rule 6(3A) of Cenvat Credit Rules 2004 for this formula.

Concept of consideration and valuation

The service provided should be for a consideration. As per section 67, where the consideration is wholly in money, the gross amount charged for the service would be liable. Even reimbursements of expenses shall be liable unless the same is incurred by the service provider as a pure agent of the service receiver. The gross amount charged shall include payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment. One would have to refer the Rules on valuation to ascertain the value where the consideration is not wholly or partly in monetary terms or where the same is not ascertainable.

Notes on procedures

Registration

Every person liable to pay service tax is required to register himself by making an application to SCE as per section 69. Before registering himself, he shall ensure that he crosses the exemption limit of Rs. 10 lakhs specified by notification 6/2005 ST dated 01.03.05 as amended from time to time. Branded service providers who provide the same service as another would not be admissible for the exemption. An illustration could be the Commercial coaching franchisees. The limit for obtaining registration under service tax is rupees 9 lakhs.

As per Rule 4 of Service Tax Rules 1994, an application in Form ST 1 would have to be filed within thirty days from the date on which the taxable service is provided/tax is levied on such service. The assessee would also have the option of going in for centralised registration where the accounting and billing activities are centralised. A change in the information or any additional information sought to be given shall be intimated in writing to the jurisdictional Assistant Commissioner of Central Excise or Deputy Commissioner of Central Excise.

Initial Declarations

The service provider who has registered is to provide a declaration of the books of account, returns and documents maintained for recording the day to day transactions as well as ensuring service tax compliance in respect of his business/profession. The law enjoins on the service provider to keep record of service provided, service tax charged, amount received, proportionate service tax on amount received. The input services (paid for), inputs and capital goods similarly require the account of their usage and records of receipt, consumption and inventory as far as inputs and capital goods are concerned.

The capturing of the information on payments made and received for the services used and provided is very important and could be a cumbersome exercise for the service providers who have been accounting on accrual basis. In case the accounts and registers are computerised the same maybe disclosed in the initial declaration. This is also an opportunity for the service provider to provide the details of his activities and provide the previous years financials. This could be useful in the event of any demand on them for suppressing any information.

Billing / Invoicing

The invoice in general is to have details of name of service provider, address, service tax registration number, break up indicating the goods sold, exempted service, the taxable service, other deduction claimed, the out of pocket expenses receivable as reimbursement and service tax payable. In case of any doubt the written clarification from the service provider maybe obtained.

The goods at times maybe involved in the provision of services. The contract for the service should specifically include a clause to ensure that the goods involved would be sold to the service receiver wherever possible. This is however to be examined in the light of the provisions of applicable sales tax law and the effect of sales tax on total cost. In such cases wherever the sales tax is applicable the same would be payable. The control on the documents evidencing the purchase should be retained where the deduction for materials involved is allowed.

The incoming bill/ invoice for receiving of service or the outgoing invoice for providing of service is a vital document of control and therefore whenever invoices are brought into use the contents should be clear.

Payment of service tax

The service provider providing taxable services shall be required to pay service tax under section 68(1). However, the service provider does not have to pay service tax until he collects the amount that he is liable to collect, from the service receiver towards the taxable services provided by virtue of Rule 6 of Service Tax Rules 1994. Once the payments are received, the service tax shall be paid by the 5th of the month following the month in which the sums are received towards such taxable service (payment is by 6th of the following month where it is made electronically). However, in respect of the amounts

received in the month of March, the payment would have to be made by the 31st of March and not by 5th of April.

The liability to pay would even arise where the service provider receives amounts in advance towards taxable services to be provided by virtue of Rule 4A of Service Tax Rules 1994. Where the assessee pays excess service tax as result of collecting amounts in advance from the customer and then not providing the service, the excess amount paid can be set off against the service tax liability for the subsequent period provided the excess service tax collected from the customer has been refunded to him.

Payment u/s 68(2) by the service receiver

Generally it is the service provider who provides the taxable services who is called upon to collect service tax from his customer/client and pay the same to the government. But section 68(2) empowers the government to notify the services with regard to which the service receiver would be held liable to pay service tax to the government. The government has consequently notified the following services in this regard through notification 36/2004 ST dated 31.12.2004 as amended from time to time –

- Goods Transport Agency service – specified person paying the freight
- Business auxiliary service of distribution of mutual fund by a mutual fund distributor or agent – mutual fund or asset management company receiving such service
- Sponsorship service provided to any body corporate/firm - body corporate or firm receiving such sponsorship service
- Taxable services received by any person in India from abroad – the recipient of such service in India.
- Insurance auxiliary service by an insurance agent – person carrying the general insurance business or life insurance business

Payment of Interest

Sections 73B and 75 of Chapter V of Finance Act 1994 as amended from time to time also provide for payment of interest by the assessee where there is short payment or delay in payment of service tax. The present notified rate is 13% p.a. and this should be paid along with the tax. The interest shall be for the period beginning from the first day of the month succeeding the month in which the amount ought to have been paid, till the date of payment.

Records & Accounts

There are no specific mandatory records. However the assessee's own records, which will provide the information as to billing, date of receipts, credits etc would be acceptable. This means that the need to bill, account for the same, need to account incoming bills, tracking the date of payment would be required to be captured. Though this may not be a problem for the organised sector this additional record keeping for small service providers would lead to some difficulty. However with the advent of technology, the accounting software may help to minimize the difficulty.

Export of Services

The service provider who exports his service in accordance with the Export of Service Rules 2005 would not have to pay service tax on such exports. He shall also have the option of going in for the rebate of service tax paid on input services or excise duty on inputs used in providing such taxable services exported in accordance with Rule 5 of Export of Service Rules 2005 and the notifications specified there under. Another option would be that of refund in accordance with Rule 5 of Cenvat Credit Rules 2004.

Filing of returns

The service provider is required to submit half-yearly returns in Form ST-3 or Form ST-3A (as the case may be) with relevant copies of Form GAR 7, in triplicate by the 25th day of the month following the end of the relevant half-year as per Rule 7 of Service Tax Rules 1994. Form ST-3A is to be used where a deposit is to be made provisionally (i.e. the assessee has opted for provisional assessment). The returns are to be filed for the half year ending September and for the half year ending on 31st March. Where the assessee makes a mistake in the return, the revised return in Form ST 3 should be submitted within ninety days from the date of submission of the return under Rule 7.

Where the filing of the return is delayed, the service provider would have pay a sum to the credit of the central government as follows under Rule 7C of Service Tax Rules 1994

- Rs. 500 for a delay of 15 days from the prescribed date
- Rs. 1000 where the delay is between 15 and 30 days from the prescribed date
- Rs. 1000+ Rs. 100 per day of delay where the delay is beyond 30 days from the prescribed date.

The late fee cannot exceed Rs. 2000 as per section 70.

Rule 7C has been amended with effect from 01.03.08 to empower the Central Excise Officer to reduce or waive the penalty for delayed filing of return, where the gross amount of service tax payable is nil.

Assessment

The assessee is required to assess the tax payable by him and pay the same on monthly or quarterly basis as applicable. In other words, what is envisaged here is self-assessment. Rule 6(4) of Service Tax Rules 1994 enables him to opt for payment on provisional basis where there is difficulty in ascertaining the amount to be paid. For this, he shall make an application to ACCE/DCCE. The assessment would be finalized at a later date. The departmental authorities can call for further information as they may require from time to time. The provisions of Central Excise Rules would apply here in relation to such provisional assessment with the exception as to requirement of furnishing of bond.

Is best judgement assessment possible under service tax?

Yes. Under section 72 the Central Excise Officer is empowered to make such assessment after allowing the assessee to represent his case, where the assessee has failed to make service tax returns or assess the tax. Thus where the assessee fails to assess tax or fail to furnish return itself they could face the risk of the department calling for a best judgement assessment.

Provisions as to recovery

As per section 73 of Chapter V of Finance Act 1994 as amended, where the service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded, the Central Excise Officer handling service can serve a Show Cause Notice on the person chargeable with service tax as to why he should not pay the amount specified in the notice. The notice shall state the amount involved.

This can be done within one year from the relevant date unless such short payment/non-levy/refund was by reason of fraud or collusion or willful mis-statement or suppression of facts or contravention of the provisions of Chapter V or rules made there under with the intent to evade payment of service tax. In such cases, the time limit would be five years.

The tax amount shall also be accompanied by payment of interest u/s 75. In cases pertaining to fraud, collusion etc., penalty of 25% of the service tax specified in the notice would have to be paid. But in order to get the benefit of reduced penalty the payment of tax and interest and penalty would have to be made within 30 days of the receipt of the notice.

Provisions pertaining to penalty

Section 76 of the Finance Act provides for a penalty of an amount equal to the higher of

1. A sum of not less than rupees two hundred for every day during which the failure to pay tax in accordance with section 68 continues, or
2. Two percent of the tax for every month, starting with the first day after the due date till the date of actual payment of service tax due.

The total amount of penalty cannot exceed the amount of service tax payable.

The penalty in cases of suppression of value of taxable services would be u/s 78.

Provisions pertaining to Appeals

Section 85 of the Finance Act, allows an assessee aggrieved by any decision or order passed by an adjudicating authority subordinate to the Commissioner of Central Excise, to appeal to the CCE (Appeals) within three months from the date of receipt of the decision of the authority.

Rule 8 of Service Tax Rules 1994 requires the appeal to be made on Form ST-4 in duplicate. A copy of the order sought to be appealed against is also to be filed with the appeal.

Section 86 allows the assessee to make an appeal to the Appellate Tribunal against the order passed by either the CCE or CCE (Appeals). The appeal is to be filed within three months of the date on which the order sought to be appealed against is received by the assessee and as per Rule 9 of Service Tax Rules 1994, would be filed on Form ST-5 and would be in quadruplicate. The order appealed against may be passed either under section 73 dealing with recovery or a revision order of the CCE u/s 84 or order adjudging penalty u/s 83A.

As far as appeals to High Court and Supreme Court are concerned the provisions of sections 35G and 35L of the Central Excise Act 1944 would apply. The appeal to High

Court can be made against the order of the Appellate Tribunal once the High Court is satisfied that the case involves a substantial question of law. The appeal shall be within 180 days from the date on which the order appealed against is received by the assessee. The fee shall be rupees two hundred.

The appeal against the order of the High Court shall be with the Supreme Court once the High Court certifies the case to be one that is fit for appeal to Supreme Court. This may be done on its own motion or on an application by the assessee once its judgement is delivered. The decision of the Supreme Court shall be final and binding on the parties concerned.

The purpose of this article to is provide a birds eye view of the law and procedures.