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Seminar on Key Latest Developments under Direct Taxes and Service Tax

Overview of the new Service Tax Regime and key issues

October 9, 2012

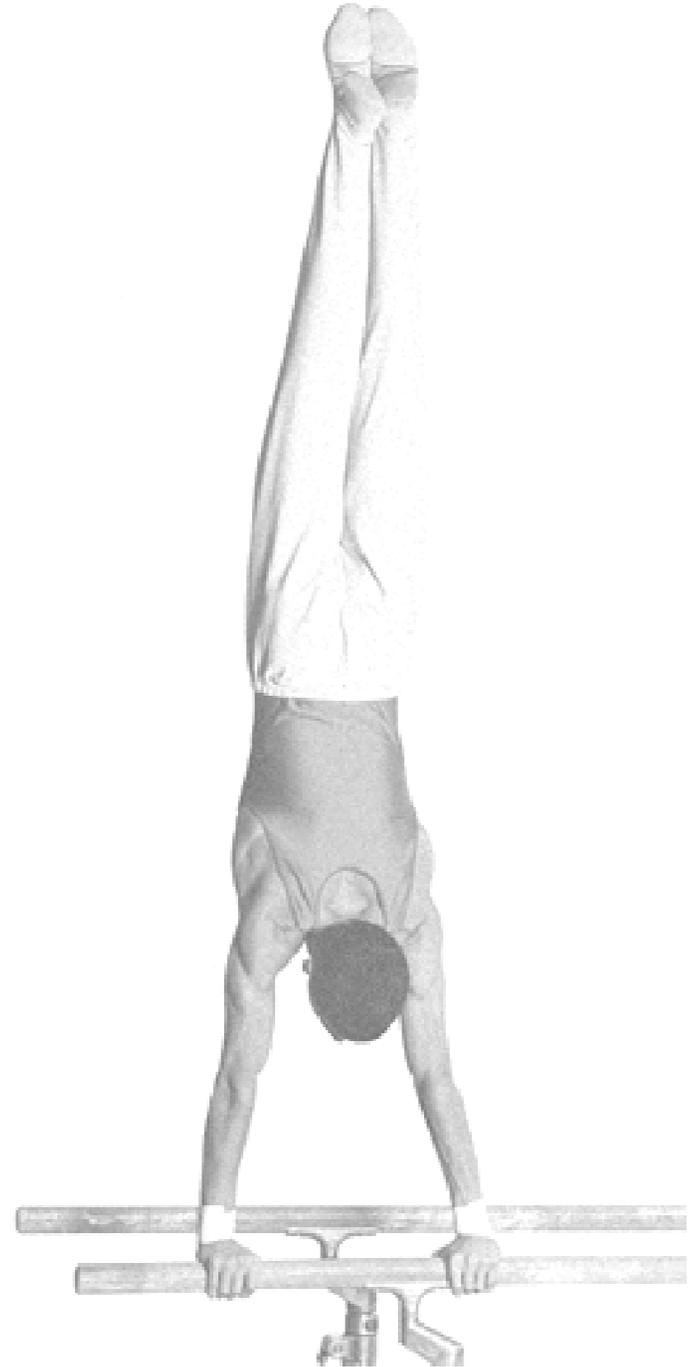
Rajeev Dimri | Partner



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GROWTH IN SERVICE SECTOR

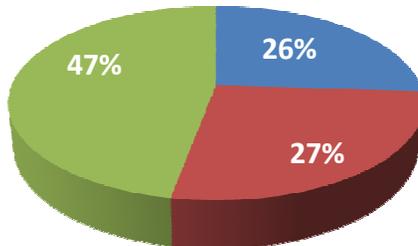


SECTORAL GROWTH

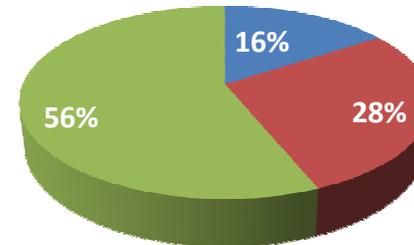
Changing pie of GDP Growth

- Continued growth in GDP accompanied by higher rate of growth in service sector

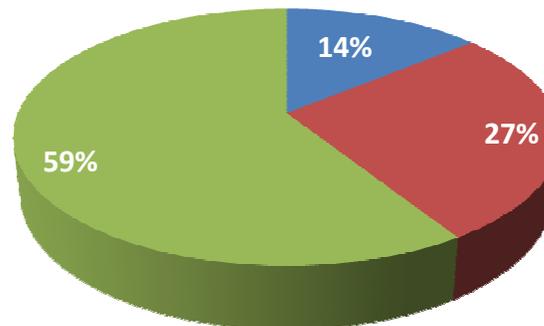
Sector Share in GDP 1996-97QE



Sector Share in GDP 2008-09



Sector Share in GDP 2011-12RE



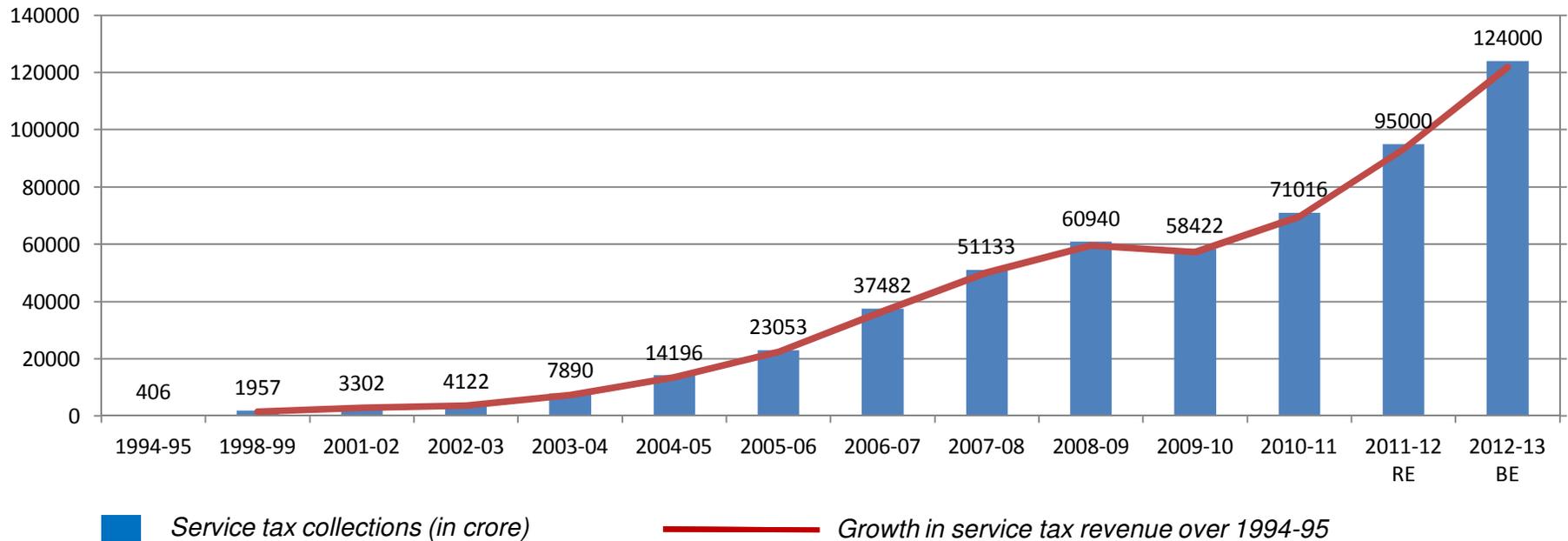
Source: Monthly Economic Report,
Ministry of Finance , RBI, BMR Research

■ Agriculture ■ Industry (incl construction) ■ Service

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INCREASE IN SERVICE TAX COLLECTIONS

Service tax collections

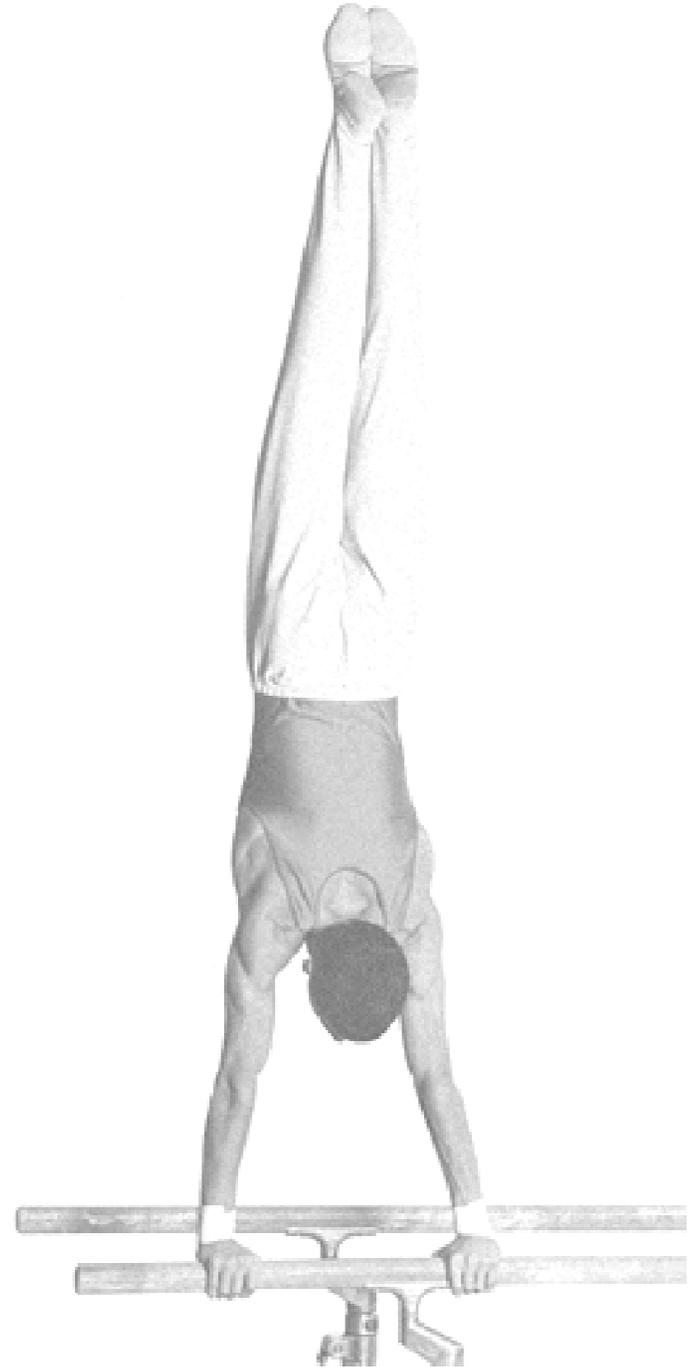


- Service Tax collections have shown a steady rise since its inception in 1994
- Tax collections have grown manifold since 1994-95 i.e. from INR 406 Cr in 1994-95 to INR 95,000 Cr in 2011-12
- With the introduction of negative regime, the revenues are estimated to be INR 124,000 Cr

Source: India budget, CBEC, BMR Research

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INTRODUCTION



OVERHAUL OF SERVICE TAX REGIME

Erstwhile service tax regime

- Levy of service tax based on a positive list – including 119 specific categories of ‘taxable services’ under the Finance Act, 1994

New Comprehensive Scheme of Service Tax (“New Regime”)

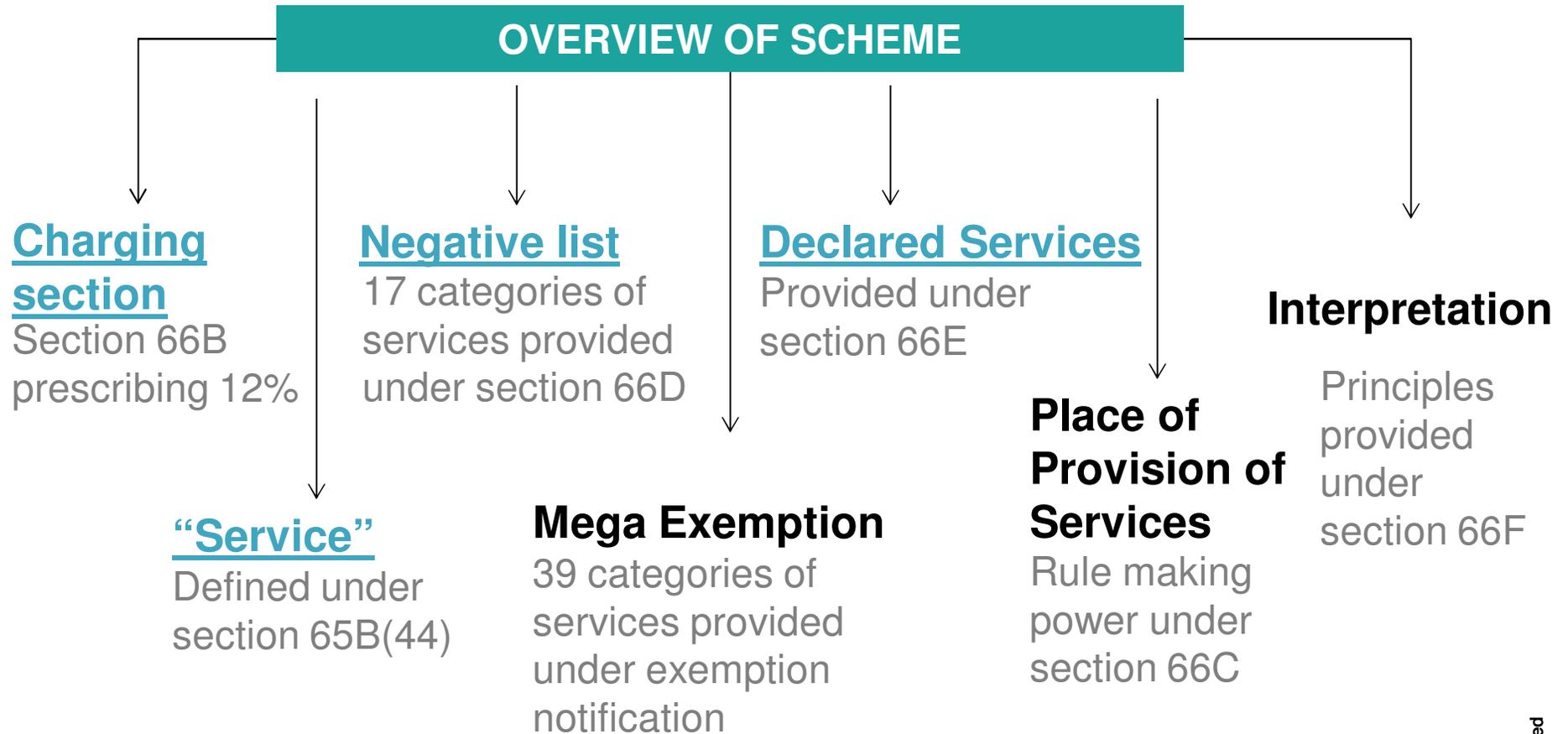
- Effective from July 01, 2012
- From Positive list to Negative list approach
- Term ‘service’ has been defined under the law
- Comprehensive levy on all activities except those:
 - specifically **excluded from the definition of service** or
 - listed under **negative list** of services; or
 - specified under any **exemption notification**

OVERHAUL OF SERVICE TAX REGIME

New Comprehensive Scheme of Service Tax (“New Regime”)

- Certain activities specifically clarified to be taxable and covered under the declared list
- Only services rendered in taxable territory are taxable
 - Place of Provision of Service Rules, 2012 (‘PPSR’) notified to determine the place of performance of service

COMPREHENSIVE SERVICE TAX REGIME

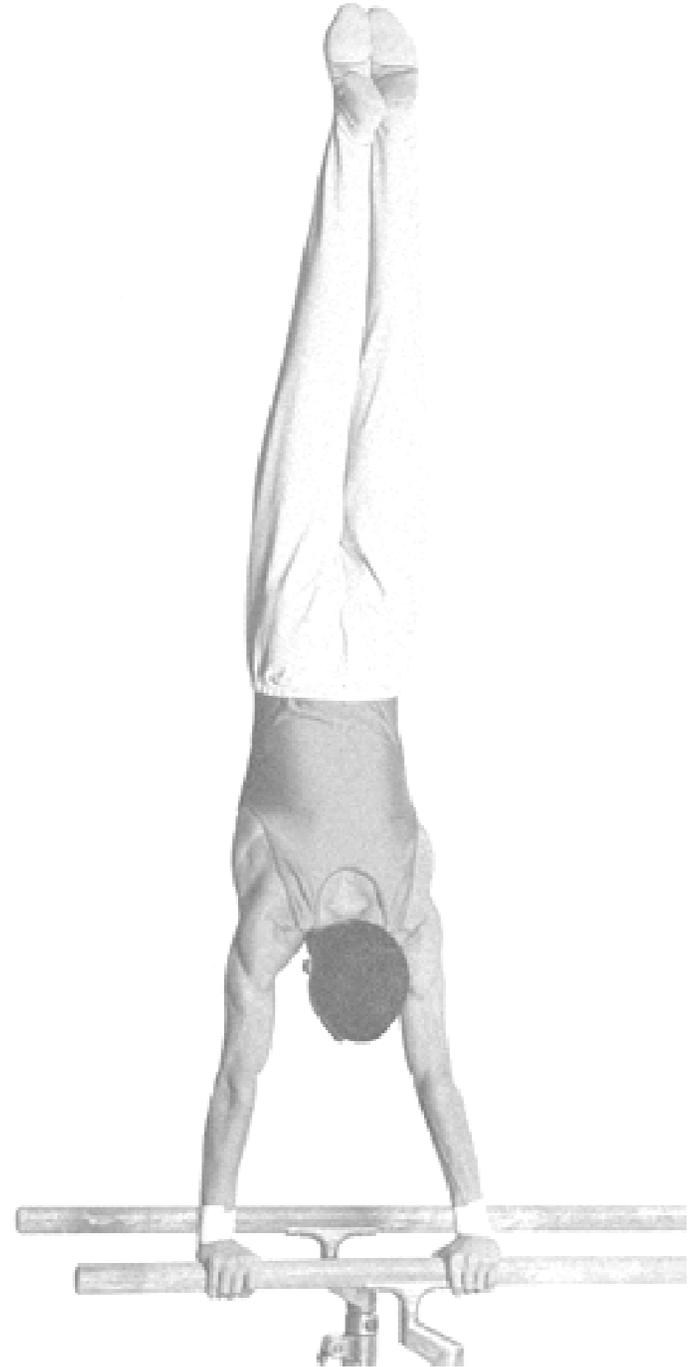


GALLOPING SERVICE TAX AND LITIGATION

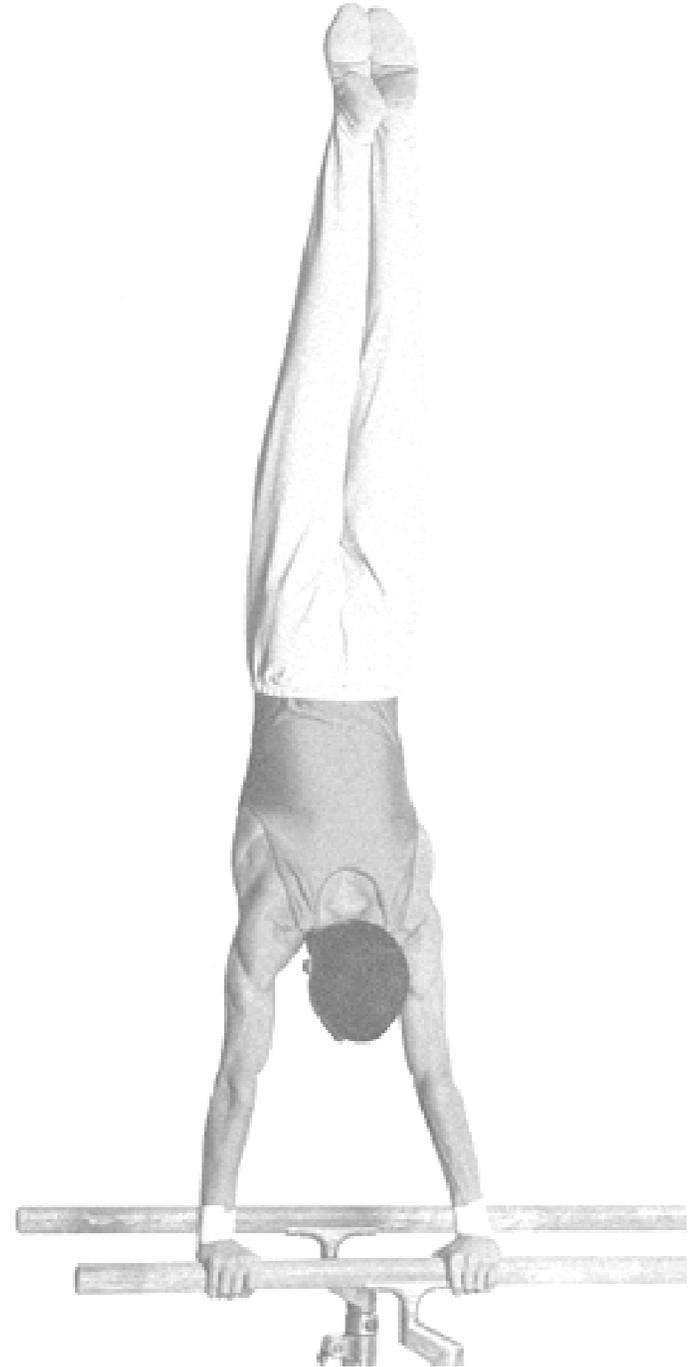
Prior to July 1, 2012	From July 1, 2012
New services each year	All services taxed except in negative/ exempt list
Multiple definitions <ul style="list-style-type: none"> ▪ Service not defined 	Definitions to continue partly <ul style="list-style-type: none"> ▪ Service defined ▪ Declared Service
Classification disputes <ul style="list-style-type: none"> ▪ Classification Rules 	Classification disputes to continue <ul style="list-style-type: none"> ▪ Bundling of services
Valuation disputes	Valuation disputes to continue <ul style="list-style-type: none"> ▪ Consideration – more focus
Cenvat credit disputes	Cenvat credit – scope not expanded
Export/Import of service <ul style="list-style-type: none"> ▪ Settled positions 	Place of Provision of service <ul style="list-style-type: none"> ▪ Revisit positions

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KEY ISSUES ARISING OUT OF NEGATIVE LIST



**SERVICES FROM
EMPLOYER TO EMPLOYEE**



EMPLOYER TO EMPLOYEE SERVICES

- Definition of service only exclude services from employee to employer
- Any activity performed by the employer for employee for consideration likely to fall under service tax net

Draft Circular on services from employer to employee

- Activities carried out by employers for employees for a consideration shall be liable to service tax
- Manner of recovery of consideration:
 - Where employees pay consideration for such services; or
 - Amounts are deducted from the salary; or
 - Where the employee foregoes a portion of the salary
- Any activity available to all employees free of charge without any reduction from the emoluments - not liable to service tax

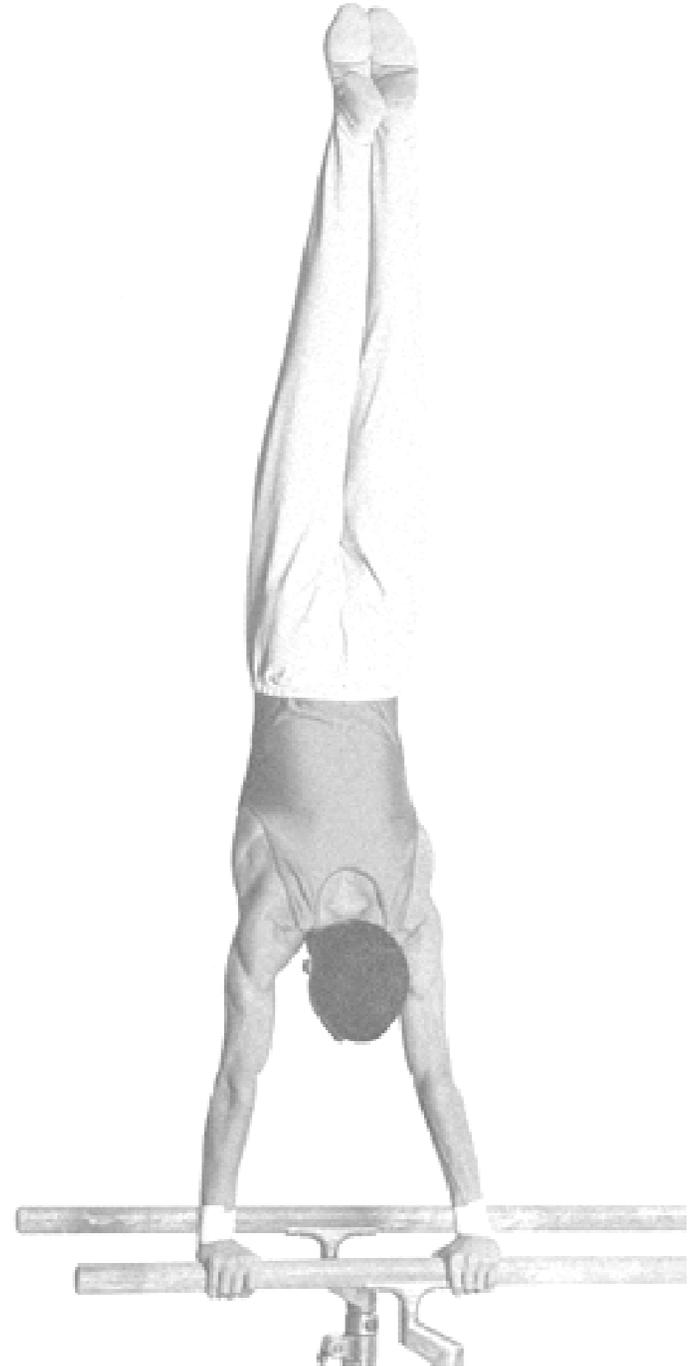
EMPLOYER TO EMPLOYEE SERVICES

Draft Circular on services from employer to employee

- Taxability needs to be examined in light of negative list and exempt list of services
- Credit eligibility of services provided to employees
 - Cenvat credit on ineligible input services like rent-a-cab services
 - In case of partial recovery from employee
 - Valuation of service – restricted to extent of recovery or entire cost of facility?
 - Cenvat credit availment only proportion to recovery ?
 - Non taxable entities – brought under service tax only for such transactions – separate books to be maintained under Rule 6?

Can the benefit provided by employer to employee under the employment contract be liable to service tax, merely because part of the cost is borne by employee???

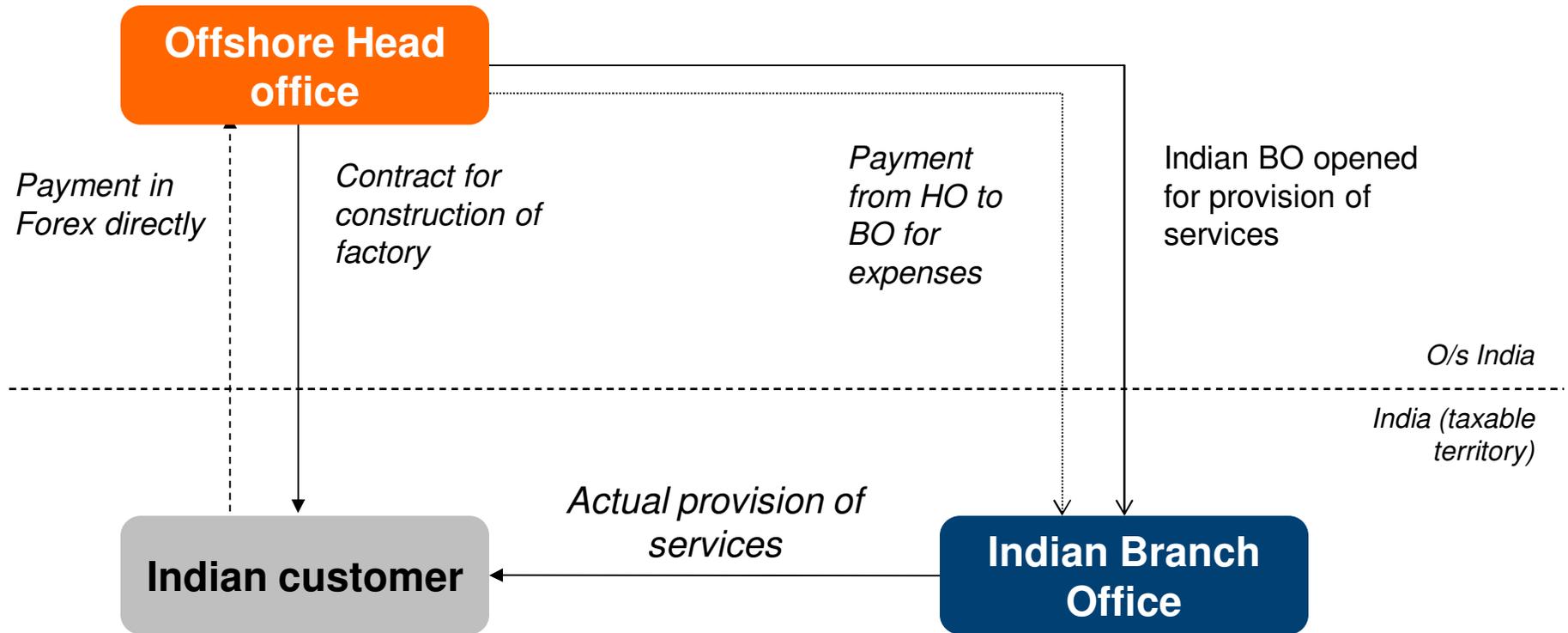
**BRANCH/PROJECT OFFICE AND
HEAD OFFICE IN DIFFERENT
TERRITORY TO BE TREATED AS
DISTINCT PERSONS**



CROSS BORDER TRANSACTION BETWEEN BRANCH AND HEAD OFFICE

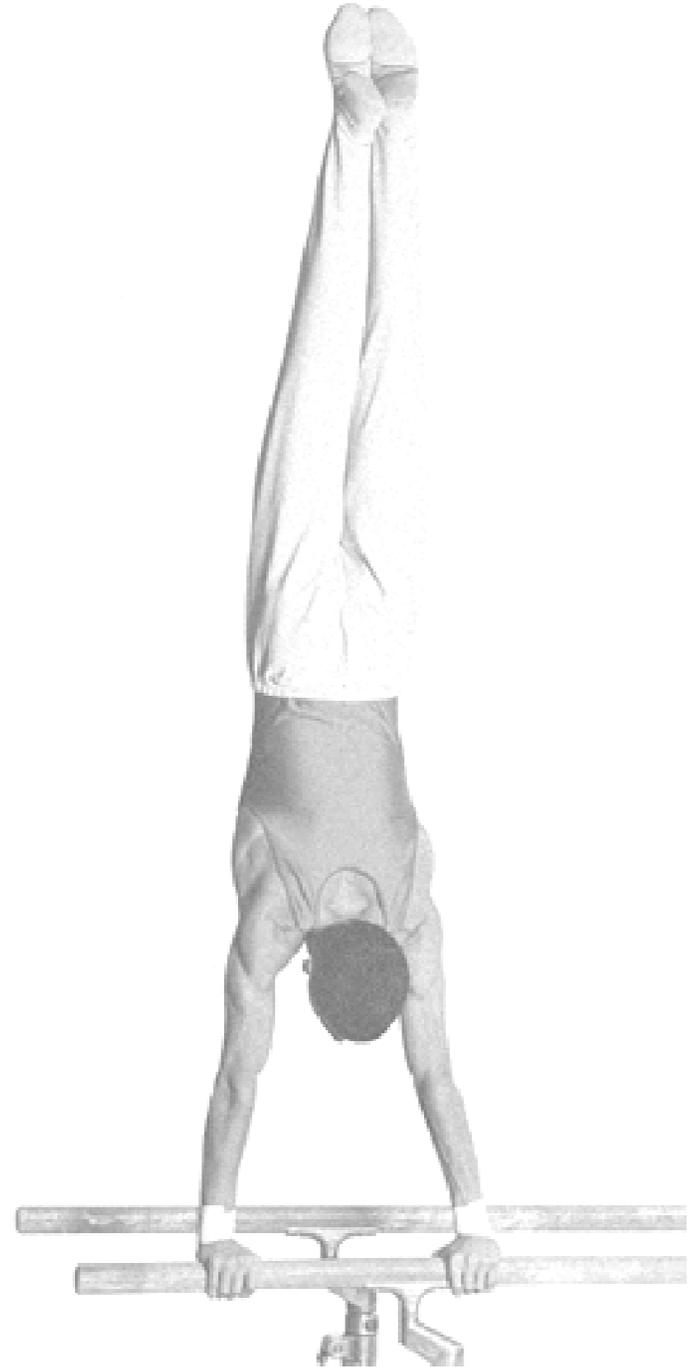
- Branch Office (BO) and Head Office (HO) if located in two taxable territories shall be treated as distinct person
- Transaction between the two may fall under service tax purview
- HO located outside India may receive services from BO located in India for providing services to:
 - offshore customer
 - Indian customer
- Implications of service tax where the services are for Indian customers
 - Can the Indian Customer be made liable to pay service tax under reverse charge?
 - Will the Indian BO be required to pay service tax on services provided in India?
 - For BO, who would be the service recipient – HO located outside India or actual service recipient in India?

CROSS BORDER TRANSACTION BETWEEN BRANCH AND HEAD OFFICE



- What would be the tax implications if the HO sets up a Project Office (PO) only to execute the Contract
- Will this lead to double taxation?

**AOP TO BE DISTINCT FROM ITS
MEMBERS**



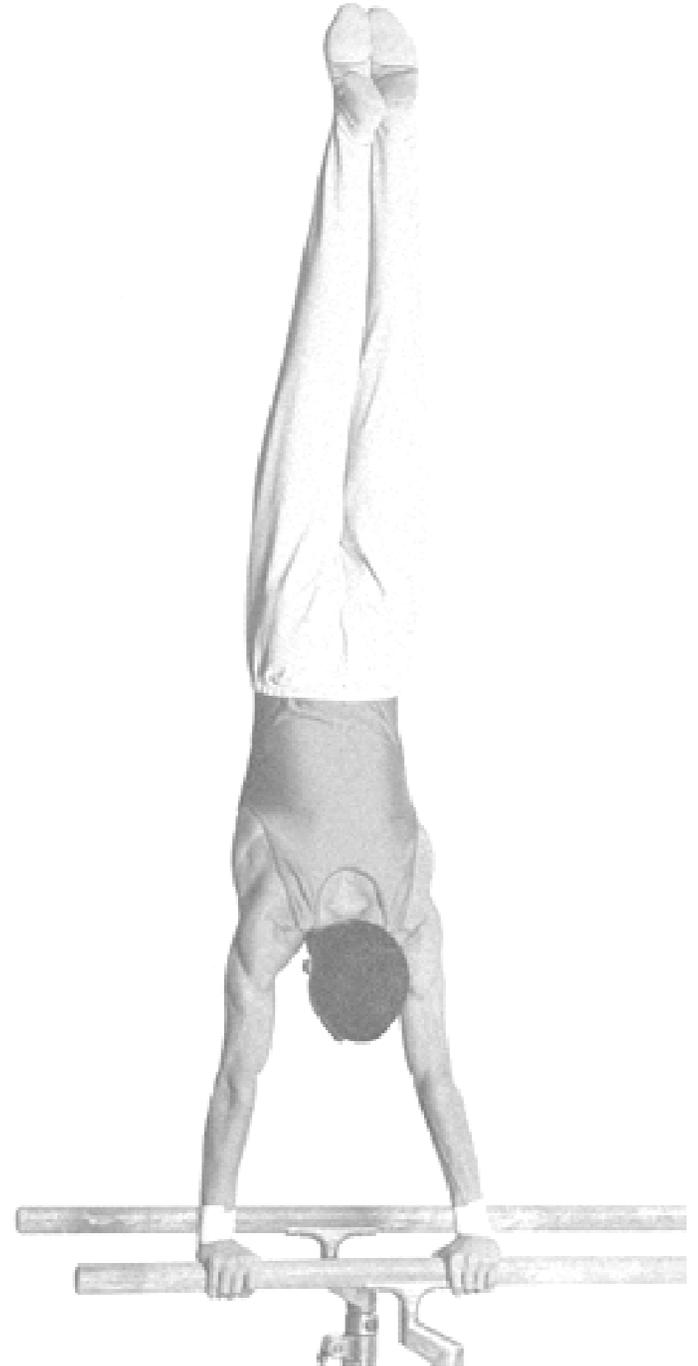
UNINCORPORATED ASSOCIATION IS DISTINCT FROM ITS MEMBERS

- Explanation added in 2006 to Section 65(121) – to include service provided by AOP to its members, **not vice versa**
- Explanation to definition of service provides that an unincorporated association or a body of persons and its member shall be treated as distinct persons
- Terms ‘unincorporated association’ or ‘body of persons’ are not defined under the law
- Meaning of Association of Person
 - Whether the meaning has to be taken from Income Tax Act, 1956 or it has to be interpreted on first principles?
 - If a consortium is alleged as an AOP by the Service tax authorities, would it create exposure under Income tax Act a well?

UNINCORPORATED ASSOCIATION IS DISTINCT FROM ITS MEMBERS

- Transaction between members and consortium
 - Is intent to create legal obligation not determinative factor?
 - Is it a transaction in money?
- Share of profit in AOP
 - Whether consideration for service provided by member to AOP
 - Independent activity vs capital contribution
- The implication on following contracts needs careful examination
 - Production sharing contracts between Government and Consortium
 - Consortium bids for infrastructure projects
 - Other revenue sharing contracts
- Applicability of reverse charge in case of works contract on AOP and on the Project Owner

**DUAL LEVY OF TAX
(SERVICES COVERED
UNDER DECLARED LIST
OF SERVICES)**



DUAL LEVY OF TAX

Leasing and hiring of goods

- Deemed sale transactions are specifically excluded from definition of service
- Transaction of leasing and hiring of goods (which qualify as deemed sales) are specifically covered under the declared list of services
- Conflict between specific exclusion to service and declared list of services
- Valuation for levy of service tax
 - Treated as deemed sales and full value attracts VAT/ CST
 - Financial lease – 10 percent of the interest component attracts service tax

to the extent of such 10 percent value, the same value gets liable to double taxes

DUAL LEVY OF TAX

Works contract services

- In case of composite contracts (involving goods and services):
 - Material portion is liable to VAT/ CST
 - Service portion is liable to service tax
- Where the separate values are not identifiable, then the option of abatement available under both the laws
- Such abatements should be synchronized to ensure that the same value is not liable to tax twice

DUAL LEVY OF TAX

Electronic download of software

➤ Electronic download of software

- Under earlier regime, was specifically covered under the IT Software Services
- Not specifically covered in the declared list of services

➤ **Education Guide** on software transactions

- **Pre-packed or canned software on media** – sale of goods and not liable to service tax
- Reliance on the decision of **Tata Consultancy Services** - Decision applicable **only when software is put on media before sale**
- The manner in which software is transferred makes material difference to the nature of transaction – if the software is on media it would be considered as goods but if it is downloaded electronically, the same would be considered as service

DUAL LEVY OF TAX

Electronic download of software

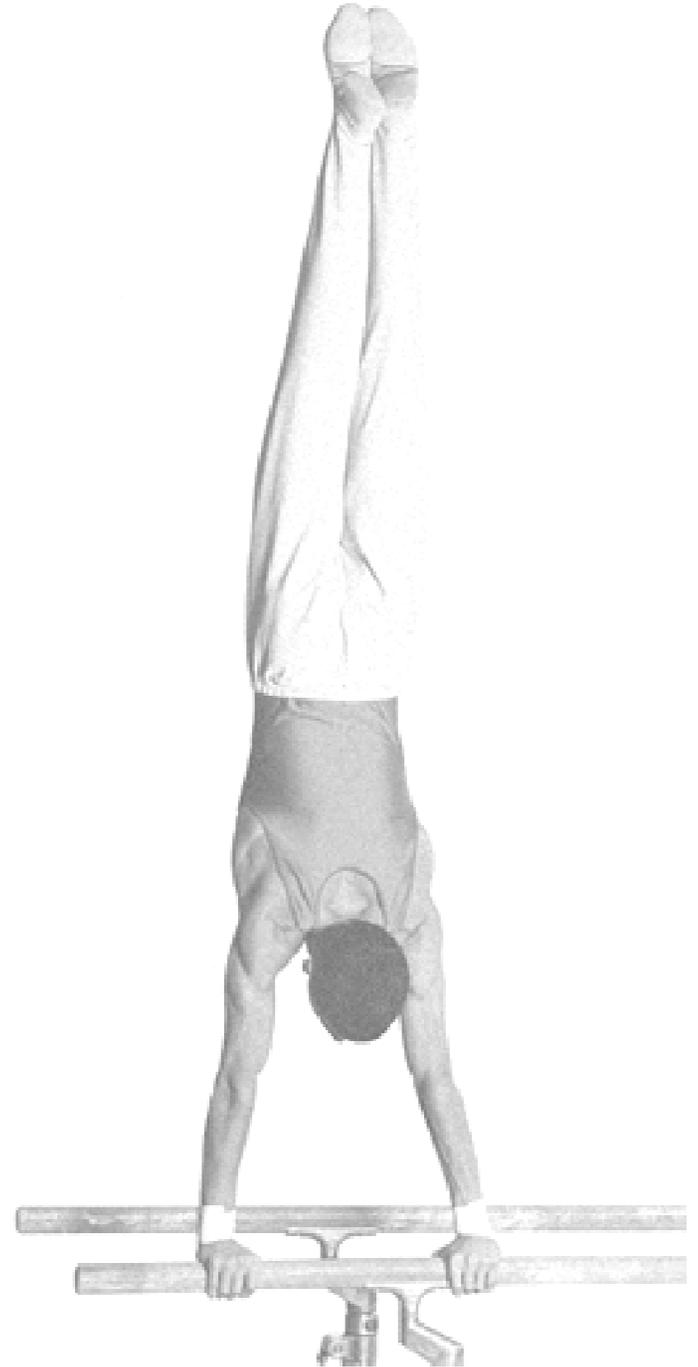
- Whether software downloaded qualify to be “goods”
 - Should we apply the said **guidelines to “electronically supplied software”** and treat it as “goods” on which no service tax is applicable
 - Definition of **“goods” under Customs Act** includes all kinds of moveable property

E-mail transfers/ electronic delivery of software is not "goods" for levy of customs duty as held in various Tribunal decisions

- Whether “right to use” is transferred in case of software supplied electronically - If yes, should it be in exclusion to the transferor?
- “Goods” for sales tax purposes is wide enough to cover tangible and intangible goods and software supplied electronically also qualifies as “goods”

Hence, VAT would be applicable on software supplied electronically resulting in dual taxation

CENVAT CREDIT ISSUES

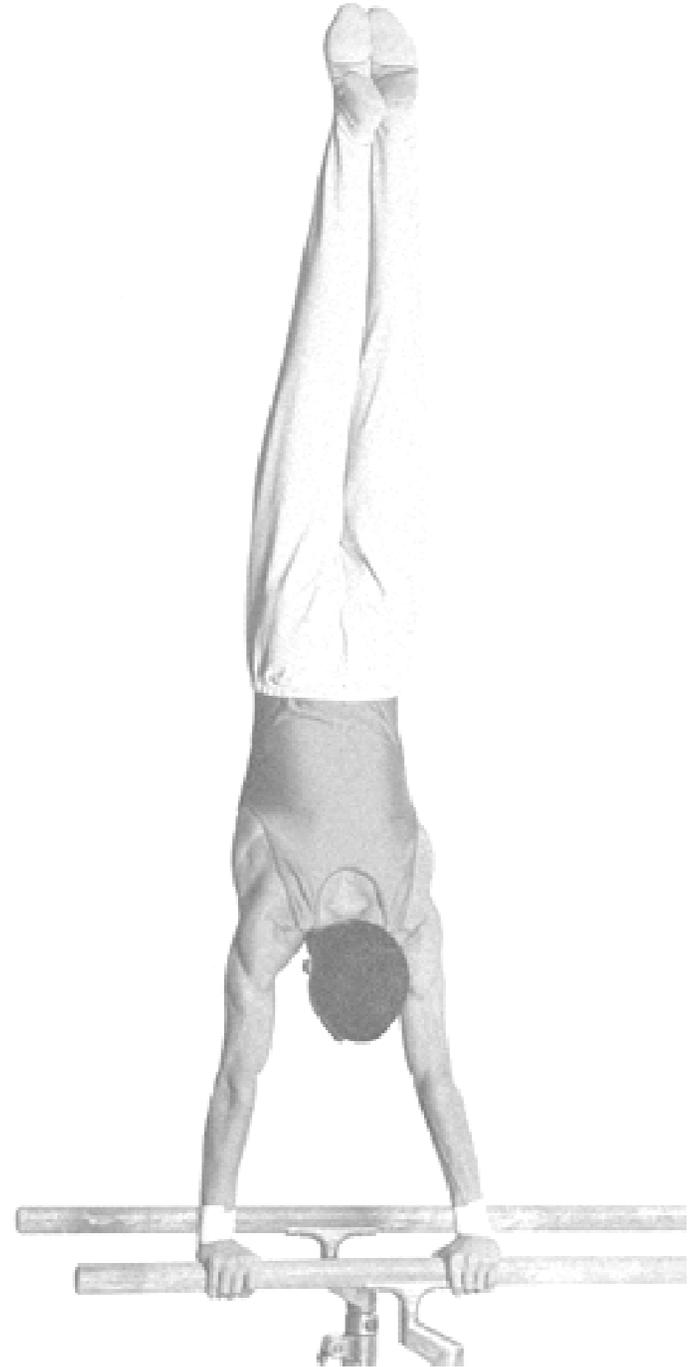


CENVAT CREDIT ISSUES

Restriction in availment of cenvat credit

- Service tax is leviable on the broad spectrum of all the services except those specified in the negative list
- However, there are several limitations and exceptions for availment of credit on input services
- Given the broad taxable base, credit should also be available on all services other than services personal in nature
- Credit should be available on input services which are used in business and are allowed as expense for income tax purposes

REALISATION OF EXPORT PROCEEDS



EXPORT OF SERVICE

Export of services – earlier regime

- Export of service was governed by Export of Service Rules, 2005 (“Export Rules”)
 - exports not liable to service tax subject to fulfillment of conditions based on category of taxable service

Export of services – new regime

- Export Rules would be replaced by Place of Provision of Service Rules (“PPS Rules”)
- PPS Rules provide the method to determine the place where the services are provided or deemed to have been provided
- As per PPS Rules, if the place of provision is outside India, then such services are not liable to service tax
- The export status of outbound transaction needs to be determined in light of:
 - PPS Rules
 - Rule 6A of service tax Rules

EXPORT – REALISATION OF EXPORT PROCEEDS

Rule 6A of Service Tax Rules prescribe the conditions for export

- Provision of any service shall be treated as export of service when:
 - Service provider in the taxable territory
 - Service recipient outside India
 - **Not Negative list** services
 - Place of provision of service outside India
 - **Receipt in convertible foreign exchange**
 - Service provider and recipient of service **not merely establishments of a distinct person**
- In case of outbound transaction, if place of provision is outside India and
 - the conditions prescribed under Rule 6A are met – the services would qualify as export
 - the conditions prescribed under Rule 6A are not met – the services would qualify as exempt
- The benefit of input tax credit shall be available only when the transaction would qualify as export

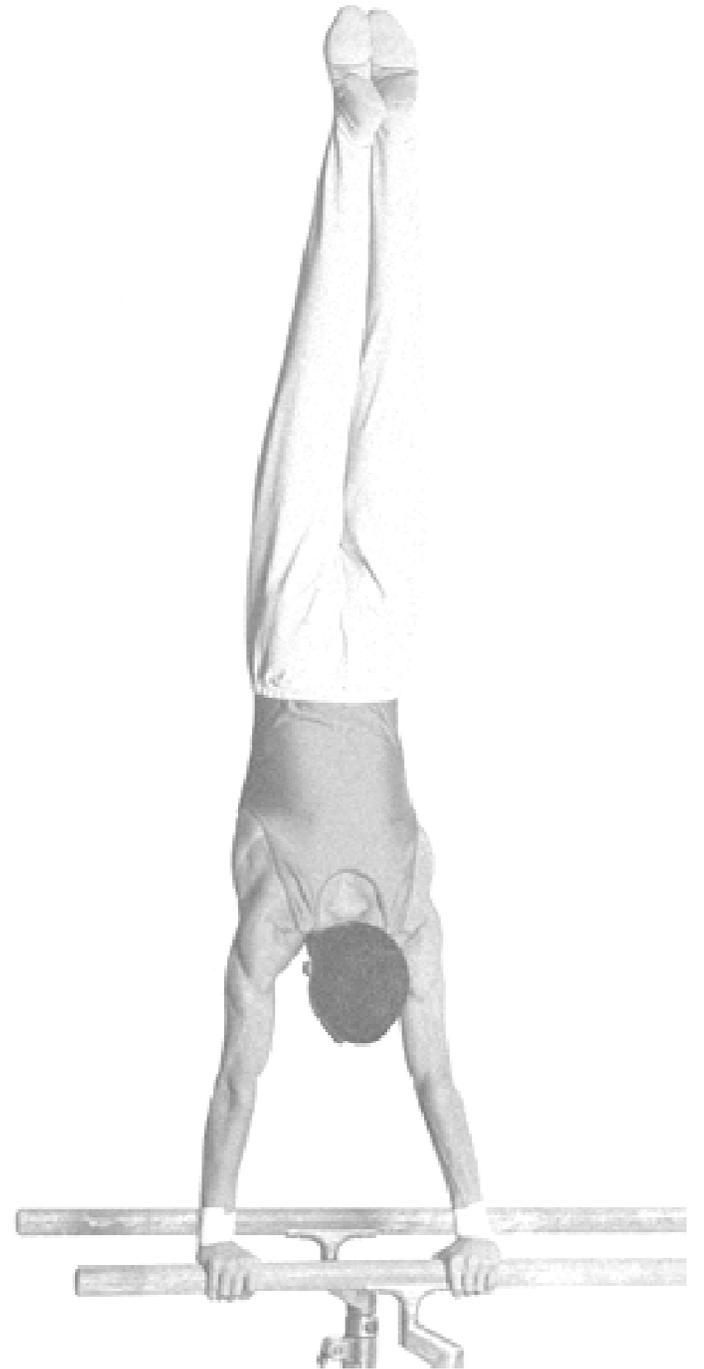


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ANNEXURE



NEW CHARGING SECTION

- Section 66B – “There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of **all services**, other than those services specified in the **negative list**, provided or agreed to be **provided in the taxable territory** by one person to another and collected in such manner as may be prescribed”

As per Section 65B(52) - “**Taxable territory**” means the territory to which provisions of Chapter V of Finance Act, 1994 apply i.e. **whole of India excluding the State of Jammu & Kashmir**

As per Section 66C – The Central Government may by rules determine the place where services are provided or deemed to be provided



SERVICE

Definition of “service”

Definition of service

- Any “**activity**”
- “Carried out” by a person “for another”*
- For “**consideration**”, and
- Includes “**declared services**”

Exclusions

- Transfer of title in **goods** or immovable property in any manner including deemed sales
- **Transaction only in money or actionable claim**
- Service provided by an **employee to an employer** in the course of the employment**
- Fees payable to court or tribunal

SERVICE

Definition of “service”

Explanations

- Foreign establishment and Indian establishment treated as distinct persons
- Unincorporated AOP / BOP and a member treated as distinct persons
- Establishment includes branch/ agency/representation office



NEGATIVE LIST – KEY SERVICES

Key services

- **Services by Government** excluding specified services (post, transport of passengers, [support services](#) etc)
- **Services by the Reserve Bank of India**
- Relating to **Agriculture** or agricultural produce
- **Education** Services
- Renting of **Residential dwelling**
- **Transmission or distribution of electricity**
- **Selling of space** or time slots (other than broadcast by radio or television)
- Processes amounting to **manufacture or production** of goods

NEGATIVE LIST – KEY SERVICES

Key services

- Services by way of **transportation of goods**
 - by road except (GTA/Courier)
 - by an aircraft or a vessel from a place outside India to the **customs station of clearance** in India
 - by inland waterways
- **Trading** of Goods
- **Interest/discount** on deposits, loans or advances
- Sale or purchase of **foreign currency**



DECLARED SERVICE

- **renting** of immovable property
- **construction of a complex**, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion-certificate by the competent authority
- **service portion** in the execution of a [works contract](#)
- **service portion** in an activity wherein goods, being **food** or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity
- **agreeing to the obligation to refrain from an act**, or to tolerate an act or a situation, or to do an act

DECLARED SERVICE

- temporary transfer or permitting the use or enjoyment of any **intellectual property right**;
- development, design, programming, customization, adaptation, upgradation, enhancement, implementation of **information technology software**
- **transfer of goods** by way of **hiring, leasing, licensing** or in any such manner **without transfer of right to use** such goods
- activities in relation to delivery of goods on hire purchase or any system of payment by installments

