Budget 2012: Changes in Service Tax

July 13, 2012
Disclaimer

This presentation has been made as a part of our initiatives to provide educational assistance at the door steps of our stakeholders.

It does not command any statutory status and should not be referred to by way of a Departmental clarification on any subject. The users are strictly advised to refer to only the legal texts while drawing any inference on any issue.
Budget at glance....

- ST Rules
- Cenvat Rules
- Valuation Rules
- POP rules
- POT Rules
- Reverse charge

Harmonization with CX
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Negative list: concept....

Activity for consideration

Not mere IMAGE

1. Taxable territory
2. Negative list
3. Exemption

Taxable

I: Immovable property
M: Money
A: Actionable claim
G: Goods
E: Employee
Activity....

- Legal obligation to do or not to do an act:
  - A beggar playing music on road not taxable even if soliciting money
  - But taxable if same beggar performs at a function for consideration

- May be active or passive i.e. forbearance to act
  - Non-compete agreements taxable;
Activity....

➢ “Direct” and “immediate” link between activity and consideration

  ▪ Direct: no casual link
    - Services received from government against taxes paid not taxable per se;
    - Free seminar to educate about prudent investment indirectly promoting a mutual fund
    - Services received from a club against membership: direct link of making the facilities available for use, whether or not immediately used
Activity....

- Immediate connection: not too remote
  - amount received in consideration for life time contribution not taxable e.g. Nobel Prize;
  - consideration may actually be payable at a later point of time but linkage should be immediate
Activity....

- Not to include any activity where no such reciprocity:
  - Activity without consideration
    
    ...Tourist information free of charge
  
  - But many activities may have indirect or deferred or disguised considerations; need careful study
    
    ..Free TV channels: indirect consideration from advertisers
    ..Construction: deferred consideration
    ..Service provided ostensibly free with “persuaded” donations to a charitable cause: disguised
Activity....

- Not to include any activity where no such reciprocity:
  - Activity without consideration
    - Tourist information free of charge
    - Free TV channels
  - Consideration without activity:
    - Pure gifts
    - Tips and ex gratia payments
    - Personal obligations e.g. pocket money
    - Donations without conditions
Consideration....

- Not merely “against payment”

- Monetary or non-monetary: any thing payable (both monetary and non-monetary) in return for provision of service
  - Recharges between MNCs;
  - Adjustments between government undertakings
1. Accidental damages
   Not related to provision of service:
   not taxable e.g. damages to a rented property

2. Damages for longer duration of use
   Related to provision of service:
   Taxable e.g. containers retained beyond permissible period

3. Subsidies
   Taxable when influence the unit price:
   price must change proportionate to amount given
   Deficit subsidies not taxable

4. Amount received in court settlements
   Consideration taxable;
   Costs not taxable
Persons....

- Two distinct entities – Service Receiver & Service Provider

- Two exceptions
  - Establishments in non-taxable territory and taxable territory are separate persons
  - Unincorporated association / body of individuals and their members:
    - Clubs or associations
    - Unincorporated JVs
1. Immovable properties

- No definition: thus definition as per General Clauses Act applicable (not Transfer of Property Act: which is a negative definition)

- Land, benefits arising out of land, things attached to earth:
  - things rooted in earth; or
  - embedded in earth; or
  - permanently fastened to anything embedded in earth
2. Money

- Any legal tender and other specified forms e.g. cheque/PN/electronic form

- Following not taxable:
  - Loans/deposits/investments;
  - Commercial paper issued as promissory notes;
  - Amount repatriated from abroad (circular 163 dated July 10, 2012)

- However charges for such use or conversion taxable
3. Actionable claims

Defined in Transfer of Property Act: any claim to a debt other than a secured debt or beneficial interest in any movable property not in possession

- Includes unsecured debts, lotteries;
- Not to include coupons and vouchers
4. Goods

- Sale of Goods Act, 1930: “stocks and shares” replaced with “securities”: wider meaning
  - Securities defined SCRA, 1956; definition covers derivatives
  - Derivatives too defined in SCRA, inclusive definition: covers contracts for differences
  - Definition in section 45U of RBI Act, 1935 relevant: derivatives to include interest rate swaps and foreign currency swaps

- Deemed sale of goods as per the Constitution [Article 366(29A)] specifically excluded but only to the extent of value of goods
5. Employee to employer:

- Casual employees covered; contractual outside
- Services provided outside the terms of employment will be taxable e.g.
  - Private coaching beyond school hours when under no obligation under the contract taxable
  - Bonus, overtime and termination amount not taxable
  - Non-compete taxable
Not excluded and thus taxable

- Expenses recovered from employees for private use of company facilities: taxable unless otherwise exempt; can take Cenvat credit if employee registered
  - Canteen charges (usually exempt unless AC and alcoholic liquor being served)
  - To and fro transportation will be taxable;
  - Stay in guest house Rs 1000 per day or more taxable
  - Charges for private use of official car: taxable unless “right to use”
  - Training: taxable
  - Recovery of pay for breach of contract: taxable
Payments to directors...

Not excluded and thus taxable:

- Applicable to all kinds of directors except of government regulatory bodies
- Any monetary or no-monetary consideration
  - Director’s fee
  - Commission/bonus
  - Company car/ travel reimbursements
Excludes specified activities...

A. Similar to employees

1. Members of legislatures & local bodies
2. Persons holding constitutional positions: president/governor/Judges
3. Persons holding positions of chairperson, member or director in an entity established by govt. e.g. regulatory bodies, commissions (not Ltd. companies)

B. Courts and tribunals against a fee
TRU

Includes declared services...

A. Possibility of being *wrongly* considered as sale of goods or immovable property; specified in the interest of uniform implementation of law:

1. Renting of immovable property
2. Construction services in the sale of flats/commercial complex
3. IPR Services: temporary transfer/use only
4. Information technology software: customized software (other than packaged software)
B. Services other than deemed sale transactions (Article 366(29A))

1. Hiring, leasing or licensing of goods without transfer of right to use (effective control & possession).
3. Service portion of Works Contract
4. Service portion of Catering contract

C. Agreeing to act or not to act or tolerate an act: forbearance
Some declared services...

**Construction**

- No major change in taxability from previous regime
  - Construction for own use is now taxable if > one residential dwelling unit unless otherwise exempted (low-cost housing)
  - Mere receipt as fixed deposit; colorable device
  - Resale by individuals before payment of all installments: not taxable; for remaining installments; new allottee liable
Some declared services...

**Information technology**

- Sale of pre-packaged or canned software is sale of goods
- A mere license to use such canned software, which is not transfer of “right to use” is a provision of service
  - Conditions of transfer place restriction on the free enjoyment of software
- On-site development of software is service
- Internet downloads also service
Some declared services...

**Hire purchase**

- Possession is transferred (and not mere custody);
- Hirer has the obligation to purchase the goods on payment of installments;
- Mere hiring is not sale of goods

**Types of leases:**

- **Operating leases:** Normally no option to purchase the property at the end of lease period
- **Financial leases:** Option available to purchase
Some declared services...

**Right to use**

1. Transferee has the legal right to use the goods in his own capacity

2. For the period of transfer such right to use is to the exclusion of the transferor

   ....Owner can not transfer the same right to another person

3. Normally effective control and possession with the owner
There shall be levied a tax (hereinafter referred to as the service tax) at the rate of 12 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.
## Negative list: rationale

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Legal constraints</strong></td>
<td>1. List II i.e. tolls, betting, gambling, entertainment &amp; amusement, advertisement other than radio and TV, specified transportation</td>
</tr>
<tr>
<td></td>
<td>2. Services by diplomatic missions in India</td>
</tr>
<tr>
<td><strong>Taxed as goods</strong></td>
<td>1. Manufacture or production: both centre &amp; state law: may not amount to transfer of title</td>
</tr>
<tr>
<td></td>
<td>2. Trading of goods: forward markets</td>
</tr>
<tr>
<td><strong>Administrative difficulties</strong></td>
<td>1. Margin-based financial services: interest</td>
</tr>
<tr>
<td></td>
<td>2. Services by Government or RBI</td>
</tr>
<tr>
<td><strong>Lasting entries</strong></td>
<td>1. Education</td>
</tr>
<tr>
<td></td>
<td>2. Agriculture</td>
</tr>
<tr>
<td></td>
<td>3. Renting of residential dwellings</td>
</tr>
<tr>
<td></td>
<td>4. Funeral</td>
</tr>
</tbody>
</table>
## Impact on major sectors

<table>
<thead>
<tr>
<th>Area</th>
<th>Taxability</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Transportation</td>
<td>-</td>
<td>Railway by higher classes; repair of trucks/auto,</td>
</tr>
<tr>
<td>• Construction</td>
<td>-</td>
<td>&lt; 12 units and for personal use taxes, Repairs etc. of airports/ports/railways; Pvt. roads</td>
</tr>
<tr>
<td>• Real estate</td>
<td>-</td>
<td>Renting to govt., charities, &gt; 90 days in hotels</td>
</tr>
<tr>
<td>• Education</td>
<td>-</td>
<td>Largely status quo, NSDC exempted; greater clarity provided: e.g. bundled services</td>
</tr>
<tr>
<td>• Govt. and community</td>
<td>-</td>
<td>To business entities reverse charged; regulators/autonomous bodies taxed</td>
</tr>
<tr>
<td>• Entertainment</td>
<td>-</td>
<td>Film artists, sports commentary, IPL; reality shows; satellite hire</td>
</tr>
<tr>
<td>• Business</td>
<td>-</td>
<td>Director fee; non-compete, international calling cards, certification and cleaning</td>
</tr>
<tr>
<td>• Miscellaneous</td>
<td>-</td>
<td>Marriage makers, couriers abroad, some services from J&amp;K, demurrages as provision</td>
</tr>
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Rules of interpretation

**Goods v services**
- Dominant nature or pith and substance test;
  - Rate same or higher
  - (Notification 12/2003 to be rescinded)

**Services v services**
- Normally uniform rate
- When differential treatment:
  - Specific over general
  - Bundled services:
    - Natural bundle: essential character
    - Unnatural: highest liability
Rules of interpretation...

- Reference to a service will not include reference to its input service:
  - Tolls and service used to collect tolls
  - A travel agent booking transportation by inland waterways

- Specific will prevail over a general description:
  - Real estate agent: a service provided in relation to immovable property (Rule 5 of POP) or an intermediary (Rule 9 ibid)
  - Purpose for which description is relevant
Rules of interpretation...

- Bundle itself specifically defined in the law:
  - Outdoor catering and hiring of space or pandal, shamiana (abatement 30%) will not be outdoor catering (abatement 40%) or hiring of space (100%)
  - Transportation, with or without accompanied baggage, by stage carriage
Rules of interpretation...

- Service definable specifically as conglomerate of services
  - Convention in which organizer has been given stay, meals, access to health club, business centre, convention centre, pick-up and drop of delegates etc. as convention service
  - Freight forwarder giving packaging, loading/unloading, Customs clearance, local transportation and international transportation
Rules of interpretation...

- Naturally bundled
  - Meals and air/rail travel: air travel
  - Breakfast and hotel accommodation: hotel accommodation
  - Boarding school: education

- Unnatural bundles
  - Unnaturally segregated: Dry cleaning billed as electricity, chemicals, ironing
  - Unnaturally joined: Construction and club membership

Guidelines specified in education guide para 9.2.4
Rules of interpretation...

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TT = India \textit{minus} J & K; India defined in the Act to include EEZ
Main rule

Taxable Territory

- ABC
  - Service Provider

- Taxable (SP)

Non-taxable Territory

- DEF
  - Receiver

- XYZ
  - Service Provider

- Taxable (SR)

- Not Taxable
Other rules

To determine the place closest to the point of consumption:

- Either the location of receiver is uncertain; or
- It will produce different result in respect of identical business for two different users
- Order: later prevails over previous
Intermediaries...

**Meaning:** person who arranges or facilitates a service between two persons but **does not include a person who provides the main service on his own account:**

- **Essentials:**
  - Not applicable to goods
  - Two services: main service by principal to customer: e.g. air travel and own service to customer or principal i.e. ticket booking
  - Can not influence the characteristics or price of main service
Intermediaries...

1. **Call centre:** There is only one service to a client
2. **Stock Broker:** Not an intermediary; dealing in goods (securities)
3. **Freight forwarder:** When books shipping space and resells: dealing in own account; not an intermediary
4. **Money transfer:** Person who reaches out foreign remittances by NRIs in India on behalf of foreign bank not an intermediary; Main service is transaction in money
A few special cases...

1. **Partly in TT and partly outside:** Fully provided in TT; mainly an anti-avoidance rule; normally location specific services should be rendered by independent establishments (thus separate persons)

2. **Both parties outside TT:** Exempted; Force of attraction and compulsory registration of foreign service provider principles not invoked under Indian Law

3. **Both parties in TT:** Taxed on reciprocal basis

4. **Service recipient an individual:** Exempted if use is non-commercial; errata in Education Guide (Question 7.11.18)
Point of taxation...

- Rule changes from April 1, 2012:
  - Continuous supply made subordinate to Rule 4 & 5
  - Services by specified individuals and firms likewise

- Rate changes (Rule 4):
  - 10% to 12% and a few others from 1.3.2012
  - Once again by way of abatements from 1.7.2012
  - Exemptions from 1.7.2012

- New services taxed (Rule 5): 1.7.2012
Once a POT is determined chargeability is decided; subsequent change will not change the chargeability.

If POT is not determined under an earlier rule then governed by new rule and consequences follow.
## POT in difficult cases...

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<tr>
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<th>Payment</th>
<th>Invoice</th>
<th>Completion</th>
<th>POT</th>
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<tr>
<td>Taxable WC with no effective rate change</td>
<td>20.6.2012</td>
<td>1.7.2012</td>
<td>10.7.2012</td>
<td>20.6.012</td>
</tr>
<tr>
<td>Newly taxed WC</td>
<td>20.6.012</td>
<td>1.7.2012</td>
<td>10.7.2012</td>
<td>No Tax</td>
</tr>
<tr>
<td>Reverse charge</td>
<td>If POT of provider before 30.6.2012 no tax on RC</td>
<td></td>
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### POT in difficult cases...

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On the mid night of June 30, 2012 POT is date of payment and one second past the service comes under rule 4, being exempt and no more reverse............

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Point of taxation ...

- Once a POT is determined chargeability is decided; subsequent change will not change the chargeability
- POT in the previous example will remain the date of payment i.e. 10.7.2012
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Works contracts

**Normal value** = Gross amount - value of materials included in such amount

- Value of materials for the purpose of VAT to be such value
- When VAT not paid on such value option to pay on actual cost or as follows:

**Abatement**

- Immovable property
  - Original works: @ 40% of total amount
  - Others: @ 60% of total amount
- Movable property: @ 70% of total amount
Total amount

- Where some materials supplied by receiver same to be added to FMV less amount charged for such materials by the receiver;
  - **FMV to be determined as per GAAP**

- Cenvat credits available on materials to receiver but not to service provider
Transaction to comprise exports if...

- Service provider in India
- Receiver outside India
- Both not mere establishments
- Service not in negative list
- Service provided outside India
- Payment in convertible currency
If payment not received in 6 months...

- Service will remain non-taxable, being provided in a non-taxable territory

...but input tax credits will need to be reversed

......extended period permissible

- But if payment received before the period allowed it will comprise exports
Cenvat reform

1. Facilitation: allow ITCs to abated services and simplified refunds and refunds on exempted services

2. Scientific allocation of common credits: proportionate to turnover; relevant period prescribed

3. Service-specific descriptions removed with further liberalization
Reverse charge

Service provider:
- Portion specified:
  - Transport: 60%
  - Manpower: 25%
  - Construction: 50%
- Avail ITC
- Refund if necessary

Service receiver:
- Portion payable:
  - Transport: 40%
  - Manpower: 75%
  - Construction: 50%
- Independent liability
Reverse charge

- Liabilities of both the service provider and service receiver are independent of each other:

- Small scale benefit available only to the service provider, if entitled
  - Unlikely for the listed services

- Valuation of service receiver and service provider can be on different principles, if permitted by law e.g. works contracts

- Liability for ongoing contracts as per POT Rules, 2011; not applicable if provider was liable before 1.07.2012
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Towards common code for CX & ST

Commonalities

- **Already common**: Cenvat credit, many provisions incorporated in section 83 of FA 1994 e.g. Settlement Commission, appellate matters etc.

- **Can be easily common**: Essential processes like registration, return, assessment compliance.

- **Difficult areas**: Charging section and one common law

- **Harmony with other laws**: with VAT, Customs and Income Tax in matters relating to business processes: to the extent possible

---

*A Vat at uniform rate is nothing but income tax*
Roadmap to GST

- **Common tax code**
  - By year end
  - Within 2012
  - Ongoing

- **Harmonized key processes & law**

- **GST Network**

- **Constitutional Bill**

- **GST**
Balancing budget

Tax widening

Negative list

Familiar environment

Budget 2012

Harmonization

Reducing cost of compliance

Simplification

Exports promotion

Neutralità

Good VAT

Facilitation

Compliance

Improve competitiveness

Optimizing & strengthening

Compliance

TRU

MOF

Exports promotion

Improve competitiveness
Budget 2012: Changes in Service Tax