

# Intensive Study Course on “Enabling Service Tax Practice”

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CA Varun Vijaywargi

# Overview of Indirect Tax Structure in India

## Definition of 'Service' and 'Declared Service'

- Authority to levy a tax is derived from the **Constitution of India**
  - Which allocates power to levy various taxes between the Centre and State
  - Article 265 of the Constitution which states that "No tax shall be levied or collected except by the authority of law"
- Article 246 of the Indian Constitution, distributes legislative powers including taxation, between the Parliament of India and the State Legislature
- Schedule VII enumerates matters in three lists;
  - **List – I** Where the parliament is competent to make laws
  - **List – II** Where only the state legislature can make laws
  - **List – III** Where both the Parliament and the State Legislature can make laws upon concurrently

# ...Constitutional Framework

## Union List

- Income Tax
- Custom Duty
- Excise Duty
- Corporation Tax
- Service tax
- Central Sales Tax
- Stamp duty in respect of bills of exchange, cheques, promissory notes, etc

## State List

- Taxes on lands and buildings
- Excise duty on alcoholic liquor etc
- Sales Tax
- Entry tax
- Tolls
- Luxury Tax
- Stamp duty in respect of documents other than those specified in the provisions of List I

## Concurrent List

- Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty

# Overview of Indirect Taxes in India

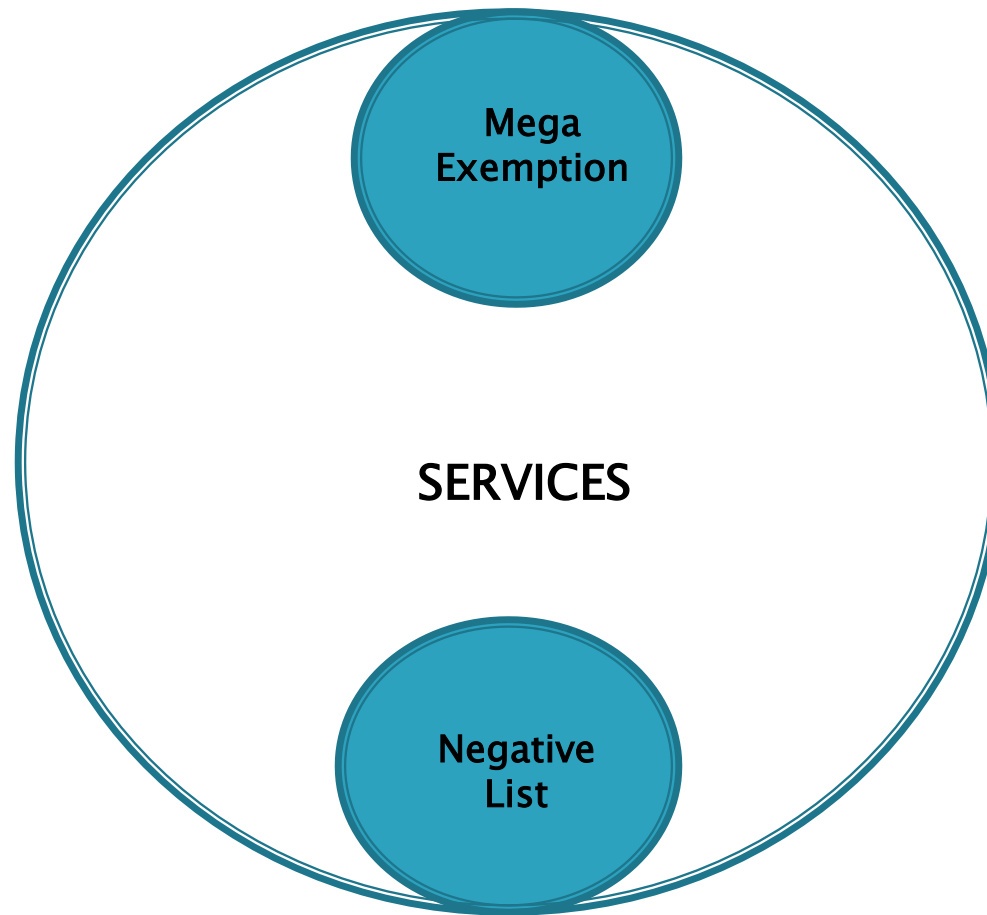
Taxing Authority	Indirect tax	Taxable event	Effective Rate
Central Government	Customs Duty	Import / Export of goods India	28.85%/ (23.55% for most of the capital goods covered under chapter 84 & 85)
	Excise Duty	Manufacture of goods in India	12.36% (10.30% for capital goods covered under chapter 84 & 85)
	Service Tax	Provision / Receipt of taxable services	12.36%
	Central Sales Tax ('CST')	Inter-state sale of goods	2% / 4% / 12.5%
State Governments	Value Added Tax ('VAT')	Intra-state sale of goods	Nil / 4% / 12.5%
State Governments / Local Authorities	Entry Tax / LBT	Entry of goods into a State/ local area for consumption, use or sale	Nil to 12.5%



- CETA specifies some processes as ‘amounting to manufacture’
  - Galvanizing of Articles of iron and steel falling under chapter 73 is manufacture
  - For the purpose of heading 8523, recording of sound or other phenomena on any media is manufacture
- In respect of goods specified in third schedule to the Central Excise Act, the following amounts to manufacture [w.e.f. 14-5-2003]:
  - Packing or Repacking of goods in a unit container;
  - Labelling or Relabelling of containers
    - Including declaration or alteration of retail sale price
  - Adoption of any other treatment on the goods to render the products marketable

- The categories of deemed sales as defined in article 366(29A) of the Constitution are –
  - transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration
  - transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract
  - delivery of goods on hire-purchase or any system of payment by installments
  - transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration
  - supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration

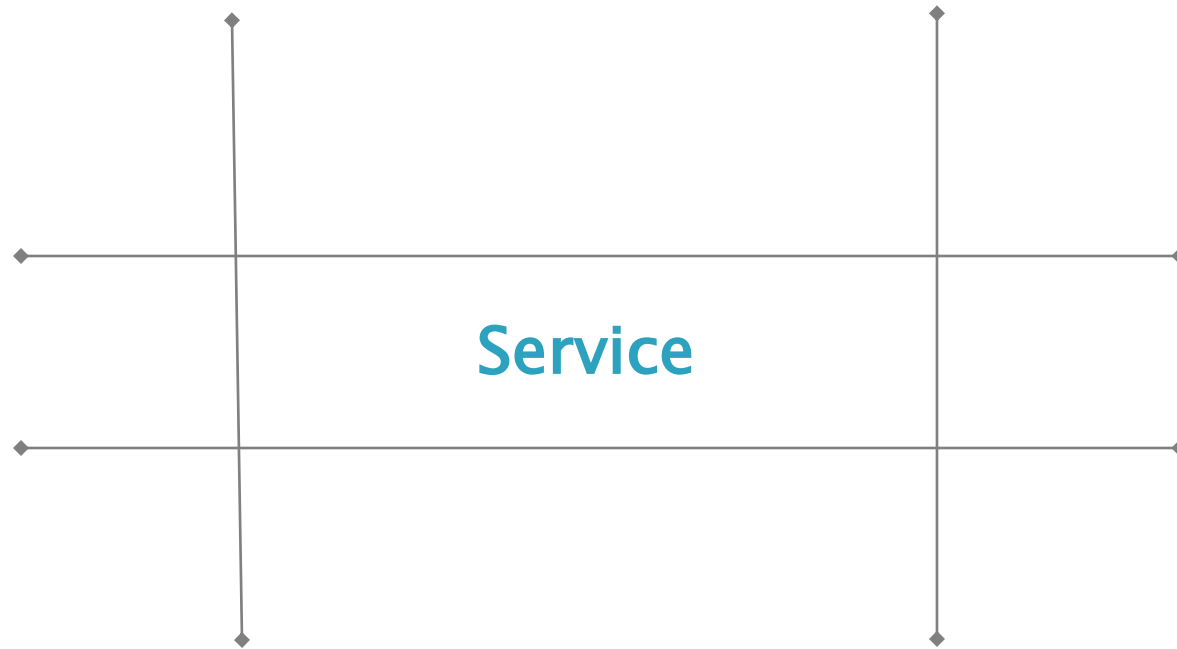




*w.e.f. 1-7-2012*

- The services sector has emerged as the largest and fastest-growing sector of the economy with a CAGR of 9% during the period from 2001 to 2012
- The services sector has contributed around 57 per cent to the gross domestic product (GDP)
- Services have also contributed substantially to foreign investment flows, exports and employment

*Source: Economic Survey 2013-14*



- **SECTION 66B –Charge of service tax on and after Finance Act, 2012**

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

- The phrase “agreed to be provided” implies as under:
  - Services which have only been agreed to be provided but are yet to be provided are taxable
  - Receipt of advances for services agreed to be provided become taxable before the actual provision of service
  - Advances that are retained by the service provider in the event of cancellation of contract of service by the service receiver become taxable as these represent consideration for a service that was agreed to be provided

- **Taxable territory means** the territory to which the provisions of Chapter V of the Finance Act, 1994 apply
  - Taxable territory implies the whole of territory of India other than the State of Jammu and Kashmir

Definition of Service means	Comments
Any activity	Not defined and has very wide implications
Carried out by a person for another	<p>Service provided by a person to self is outside the ambit of taxable service. There are two exceptions to this rule contained in <i>Explanation 3</i> to the definition of Service:</p> <ul style="list-style-type: none"><li>– Legal entity in India and its foreign branch are treated as two distinct persons; and</li><li>– An unincorporated AOP and members are treated as distinct persons</li></ul>

Definition of Service means	Comments
For consideration	<ul style="list-style-type: none"><li data-bbox="888 297 1870 502">▪ Includes any amount that is payable for the taxable services provided or to be provided, i.e. activity without consideration is not a service</li><li data-bbox="888 565 1870 771">▪ If after receiving the amount, recipient of service is under no obligation to perform any activity, then, such amount paid would not be treated as 'consideration';</li><li data-bbox="888 833 1870 936">▪ Activity for consideration involves an element of contractual relationship</li><li data-bbox="888 999 1870 1205">▪ Fines and penalties which are legal consequences of a person's action are not in the nature of consideration for an activity</li></ul>



# ...Definition of Service...

Definition of Service means	Comments
and includes a declared service	There are 9 declared services and most of them were part of the positive list
but shall not include	
a. an activity which constitutes merely –	
i. transfer of title in goods or immovable property, by way of sale, gift or in any other manner;	▪ It implies change in ownership and not merely transfer of custody / possession of goods or immovable property
ii. Such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the constitution;	▪ Deemed sale has been specifically excluded from the definition of service

# ...Definition of Service...

Definition of Service means	Comments
<p>iii. a transaction in money or actionable claim;</p>	<ul style="list-style-type: none"><li>▪ While the transaction in money, per-se, would be outside the ambit of service, the related activity for which a separate consideration is charged, would not be treated as a transaction of money and would be chargeable to service tax if other elements of taxability are present. <i>Explanation 2</i></li><li>▪ Actionable claims means a claim to any debt or to any beneficial interest in any movable property</li></ul>

# ...Definition of Service...

Definition of Service means	Comments
b. a provision of service by an employee to the employer in the course of or in relation to his employment;	▪ Service provided by an employer to an employee is a Service
c. Fees taken in any court or tribunal established under declared that time being in force	

**Explanation 1** – clarifies that ‘service’ does not cover functions or duties performed by Members of Parliament, State Legislatures, Panchayat, Municipalities or any other local authority any person who holds any post in pursuance of the provisions of the Constitution or any person as a Chairperson or a Member or a Director in a body established by the Central or State Governments or local authority and who is not deemed as an employee.

***Explanation 2*** – clarifies that transaction in money does not include any activity in relation to money by way of its use or conversion by cash or by any other mode ,from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged.'

***Explanation 3*** – creates two exceptions, by way of a deeming provision, to the general rule that only services provided by a person to another are taxable. As per these deeming provisions establishment of a person located in taxable territory and establishment of such person located in non-taxable territory are deemed to be establishments of distinct persons. Further an unincorporated association or body of persons and members thereof are also deemed as separate persons.

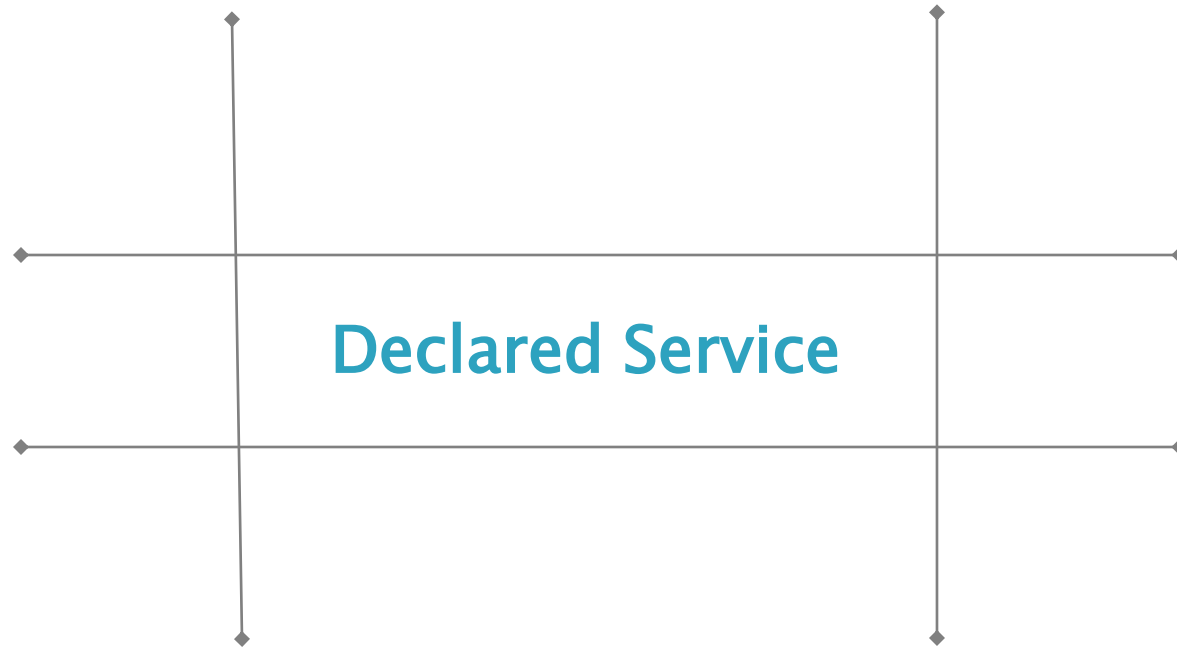
***Explanation 4*** – explains that a branch or an agency of a person through which the person carries out business is also an establishment of such person.

# Whether you are providing a 'Service'

S. No.	Question	Answer
1	Am I doing an activity (including an activity specified in the Negative List) for another person*?	Yes
2	Am I doing such activity for a consideration?	Yes
3	Does this activity consist only of transfer of title in goods or immovable property by way of sale, gift or in any other manner?	No
4	Does this activity constitute only a transfer, delivery or supply of goods which is deemed to be a sale of goods within the meaning of clause (29A) of article 366 of the Constitution	No
5	Does this activity consist only of a transaction in money or actionable claim?	No
6	Is the consideration for the activity in the nature of court fees for a court or a tribunal?	No
7	Is such an activity in the nature of a service provided by an employee of such person in the course of employment?	No
8	Is the activity covered in any of the categories specified in Explanation 1 or Explanation 2 to clause (44) of section 65B of the Act	No

# Whether 'Service' provided by you is taxable

S. No.	Question	Answer
1	Have I provided or have I agreed to provide the service?	Yes
2	Have I provided or agreed to provide the service in the taxable territory?	Yes
3	Is this activity entirely covered in any of the services described in the negative list of services	No



- (a) renting of immovable property
  - **Does not mean** transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property'
  - Renting of all immovable properties would be taxable unless covered by negative list and mega exemption
  - Halls, rooms etc. let out by hotels/restaurants for a consideration for organizing social, official or business or cultural functions are covered within the scope of renting of immovable property and would be taxable if other elements of taxability are present



- (b) 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
  - (A) architect registered with the Council of Architecture constituted under the Architects Act, 1972 (20 of 1972); or
  - (B) chartered engineer registered with the Institution of Engineers (); or
  - (C) licensed surveyor of the respective local body of the city or town or village or development or planning authority;

# ...Declared Services...

Giver	Receiver	Nature of transaction	Taxability
Builder	Customer	Construction Service	Taxable *
Land owner	Developer	Sale of land	Not Taxable as such sale is not a service
Land owner	Developer	Development Rights	Taxable * – Such rights are treated as consideration
Developer	Customer	Construction Service	Taxable *
Land Owner	Customer	Sale of flat while under construction	Taxable *

- *Where a part / entire consideration is received before issuance of completion certificate*

- (c) temporary transfer or permitting the use or enjoyment of any intellectual property right;
  - IPR has not been defined in the Act. The phrase has to be understood as in normal trade parlance as per which intellectual property right includes the following:
    - Copyright
    - Patents
    - Trademarks
    - Designs
    - Any other similar right to an intangible property

- (d) development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software;

Information technology software means 'any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment'

- Indian Constitution empowers
  - Central Government to levy tax on ‘provision of services’
  - States to levy tax on purchase / sale of goods
    - No fungibility of credits
- Different facets of software transactions may render them liable to both levies of VAT and Service Tax
  - Contrary judicial precedents under both Service Tax and VAT add to the ambiguity in the position
  - Issue of whether precedence requires to be given to the license of the software, or the copy of the software which may be stored on a physical medium

- (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;
  - Agreeing to the obligation to
    - refrain from an act;
    - tolerate an act or a situation; and
    - do an act

- (f) transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods;

‘Transfer of right of goods’ involves transfer of possession and effective control over such goods. Mere transfer of custody shall not amount to transfer of right to use such goods

- The test laid down by the Supreme Court in the case of ***Bharat Sanchar Nigam Limited vs Union of India*** [2006(2)STR161(SC)] to determine whether a transaction involves transfer of right to use goods, is as follows:
  - There must be goods available for delivery;
  - There must be a consensus ad idem as to the identity of the goods;
  - The transferee should have legal right to use the goods – consequently all legal consequences of such use including any permissions or licenses required therefore should be available to the transferee;
  - For the period during which the transferee has such legal right, it has to be the exclusion to the transferor – this is the necessary concomitant of the plain language of the statute, viz., a ‘transfer of the right to use’ and not merely a license to use the goods;
  - Having transferred, the owner cannot again transfer the same right to others



- (g) activities in relation to delivery of goods on hire purchase or any system of payment by installments;
  - Scope – financial services that accompany a hire purchase agreement fall in the ambit of this entry;
    - *Interest or other charges like lease management fee, processing fee, documentation charges and administrative fees, which is chargeable to service tax*

Type of Lease	Scope
Operating Lease	<ul style="list-style-type: none"><li>■ The lease is for a term shorter than property's useful life;</li><li>■ The lessor is responsible for taxes and other expenses on the property;</li><li>■ The lessee does not have an option to purchase the property at the end of the period of lease</li></ul>

Type of Lease	Scope
Finance Lease / Capital Lease	<ul style="list-style-type: none"><li>▪ The lessee pays maintenance costs and taxes;</li><li>▪ The lessee has the option of purchasing the lease end</li><li>▪ Such arrangements resemble a hire-purchase agreement and would fall under the said 'deemed sale' category</li></ul>

- (h) service portion in the execution of a works contract;

“works contract” means

- A contract wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods

And

- Such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any movable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property

- (i) 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
  
- The following activities are illustration of activities covered in this entry–
  - Supply of food or drinks in a restaurant;
  - Supply of foods and drinks by an outdoor caterer

# Deemed sale vis-à-vis Declared Services

Deemed sale	Declared Service
Transfer of property in goods involved in the execution of a works contract	<u>service portion</u> in execution of a works contract
Delivery of goods on hire-purchase or any system of payment by installments	<u>activities related to</u> delivery of goods on hire-purchase or any system of payment by installments
Transfer of the right to use any goods	transfer of goods by way of hiring, leasing or licensing or in any such manner without involving transfer of right to use goods
Supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink	service portion in an activity where such supply of food or drinks takes place

- Evidently activities specified as declared services do not encroach upon the area of deemed sales
- Most of the declared services have been specified with the intent of clarifying the distinction between deemed sales and activities related thereto

Topic	Issue
The word 'activity' used in the definition of service	<ul style="list-style-type: none"> <li>–The term has not been defined and has wide connotations</li> <li>–For instance, liquidated damages, forfeiture of advance against future sale of goods, etc. may qualify as 'service'</li> </ul>
Service provided by Employer to Employee	<ul style="list-style-type: none"> <li>– Difficulties in determining the taxable value along with administrative hassles in collecting the same</li> </ul>
Reimbursement of expenditure	<ul style="list-style-type: none"> <li>– The valuation of reimbursable expenditure after Rule 5(1) of the Valuation Rules has been held to be ultra vires by the High Court in the case of <i>Intercontinental Consultants and Technocrats Pvt. Ltd.</i> *</li> </ul>
Sharing of expenses between associated companies	<ul style="list-style-type: none"> <li>– Cost sharing without mark-up may also attract Service Tax</li> <li>– Cross-border deputation of employees</li> </ul>
Declared Services – Potential for duality of tax	<ul style="list-style-type: none"> <li>–Leasing and hiring of goods</li> <li>–Temporary transfer or use of IPR</li> <li>–Works contract</li> <li>–Download of Software</li> </ul>

\* W.P. (C) 6370/2008]



# THANK YOU

CA Varun Vijaywargi II [varun@vkassociates.in](mailto:varun@vkassociates.in) II 91681 75444