

BUDGET 2008 - AN OVERVIEW OF SERVICE TAX

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The budget of 2008 has brought invoked considerable interest as this happened to be the present government's last budget before the elections are to be held next year. Considering this fact as well as the emphasis on economic growth, quite a few changes were expected in this budget. As far as indirect taxes are concerned, we have significant changes in service tax considering the contribution of this sector to economic growth in recent years, as the government seeks to increase its revenue to meet its expenditures. This article emphasises some of the important changes in service tax, which would have to be noted by the assessee / advisor. In this article first the discussion is of general changes in rates and procedure, the introduction of the new service followed by the change in the existing entries and then the other important amendments.

A. GENERAL CHANGES IN RATE AND EXEMPTION.

The peak rate of the Excise Duty has been reduced from 16% to 14%. However surprisingly there is no compensating increasing in the service tax and the rate remains to stay at 12%. However in case of the Composition rate of works contract the rate has been increased to 4% from the existing 2%. This increasing in rate may now make the department not to litigate for changing the classification from commercial or industrial construction / residential construction / erection to works contract. In the opinion of the paper writer although the rate is increased to 4%, it shall be the best option compared to abatement scheme (4.08%) as this would allow the credit of the sub-contractors and other input service in addition to capital goods credits.

A bonus for the small service providers has been the increase in the exemption limit from Rs. 8 lakhs to Rs. 10 lakhs with a corresponding increase in the limit for registration to 9lakhs.

B. INTRODUCTION OF NEW SERVICE

Information technology software services

This is a provision based on the industry demand as they were losing out on the refund of the input services. The falling dollar hastened this effort. Services provided in relation to Information Technology software for use in the course, or furtherance, of business or commerce is to be taxed u/s 65(105)(zzzz). However, all the IT related services would not be taxed under this category alone and the category which one would have to adopt would depend on the nature of services that are provided. Moreover, what is sought to be taxed here is the service element, which would be present in case of development of customised software. Readers may also note that packaged software sold off the shelf in the form of discs etc., (generally called as packed or canned or off the shelf software) would be subject to duty of Excise at 12% as per the new rates notified. Henceforth the activities like study, analysis, design and

programming of software (normally done in case of customised software) apart from adaptation, up-gradation, enhancement, implementation and other similar services in relation to IT software would be liable to service tax. Feasibility studies, provision of specifications for database design, guidance on start-up, would also be liable. Acquiring the right to use IT software for commercial exploitation or the right to use software components for inclusion in other IT software products would also be liable.

The idea now is that all forms of software would be either liable as goods or as services under central excise, customs, service tax or/ and VAT. Its gist of taxable can be summarised as under

- Sale of off the shelf Software - Chargeable to Excise Duty and VAT
- Customisation of the software of the client - Chargeable to Service Tax
- Customisation of the software and then the IP is transferred/sold - Exempt from Excise Duty and Service tax, however this may attract VAT

The answer to the question whether introduction of Service Tax on Information Technology Sector is a boon or burden? For the exports it is certainly a godsend. This amendment indicates that the quantum of work especially in Hyderabad would leapfrog with thousands of refund applications requiring to be made and followed up.

Certain amendments have also been made in existing categories like Business Auxiliary services, consulting engineer services, technical testing and analysis services and technical inspection and certification services to tax those IT related services which would not fall under this new category. For instance, provision of information technology service on behalf of client could be liable under business auxiliary service while technical testing and analysis of IT software could be liable under technical testing and analysis service. Certification services in relation to IT software could fall under technical inspection and certification services. Pure advisory services in relation to computer hardware and software engineering is expected to fall under consulting engineer category.

Supply of tangible goods for use

Services provided in relation to supply of tangible goods, without transferring the right of possession and effective control of the said tangible goods would be taxed u/s 65(105)(zzzz). What is sought to be taxed here is a case of supply of goods where there is no transfer of the legal right as to possession and effective control or ownership to the transferee, as such transactions may not be subject to payment of VAT. Where the supply is regarded as amounting to deemed sale as per the VAT laws of states, the same

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would be outside the scope of this category of service. Temporary hiring of goods where VAT is not charged like for instance hiring of excavators, dump trucks, aircrafts, audio visual equipments etc., could be liable here. The idea is to tax those supply activities where the concept of deemed sale as per the VAT laws cannot be made applicable and consequently, VAT cannot be charged.

There is a possible judicial challenge that there is no "deemed service" concept in service tax since service has not been defined and the logic of anything not suffering VAT being liable for service tax is probably going to be tested.

Services in relation to management of investment under ULIP scheme

Services in relation to management of investment (known as segregated fund) under ULIP scheme is sought to be taxed u/s 65(105)(zzzzf). What is sought to be taxed here is the charges collected by insurance companies for management of segregated fund in addition to risk premium. The risk premium is already taxed under the life insurance service category and now the charges for management of investment would be taxed here. The consideration would be arrived at by calculating the difference between the total premium paid and the sum of the premium for risk cover plus amount of segregated fund. Service tax would have to be paid once the amount is charged to the policy holder. However the amount kept for the purpose of investment is not subject to service tax.

Stock exchange, commodity exchange and clearing house services

Three categories have been introduced to tax comprehensively the activities carried out by stock exchanges and clearing houses. The taxability would be as follows -

- Services provided by a recognised stock exchange in relation to securities
- Services provided by a recognised association or a registered association in relation to sale or purchase of any goods or forward contracts
- Services provided by a processing and clearing house in relation to processing, clearing and settlement of transactions in securities, goods or forward contracts

Readers may note that quite a few of the service providers in the capital markets are already being taxed like registrars to an issue, stock brokers and share transfer agents while others like bankers to an issue service and custodial services were taxed under banking and other financial services category. With the introduction of these services, almost all the important functions would have been covered. Here, the service tax paid by one could turn out to be the input service tax for the other.

C. EXTENSION OF THE EXISTING ENTRIES

Internet telecommunication services

There has been an amendment in the Internet

Telephony services category to change the scope of the levy under the stated category. In this regard, Internet telecommunication service is being defined comprehensively to bring all the related activities under this one single category. Internet telecommunication services generally include Internet backbone services (including carrier service of internet traffic by one Internet Service Provider to another ISP), Internet access services and telecommunication services. Henceforth, services provided by ISPs would be covered under this head and not under on-line information and database access or retrieval service.

Purchase or sale of foreign currency to be liable

Amendments are being made in clauses (zzk) and (zm) of section 65(105) in order to include the services provided in relation to purchase or sale of foreign currency within the scope of taxable services. This has been done to specifically tax such transactions where the consideration for the service is not specified separately. Thus even money changing without specific mention of consideration for the services would be liable and this has been clarified.

The payment of service tax on margin is envisaged. A optional scheme of service tax payment at 0.25% of the gross amount of the currency exchanged is expected to be notified as per departmental letter 334/1/2008 dated 29.02.08.

The fact that in this transaction there could be a loss / profit within the limited time is an argument against the levy.

Specific clarification regarding marketing of games of chance, organised or conducted by client

The Business Auxiliary Service category is being amended to specifically include by way of an explanation, services in relation to promotion or marketing of games of chance, organised, conducted or promoted by the client. Readers may note that service in relation to promotion or marketing of service provided by the client is already taxed under this category. This would now include services in relation to promotion or marketing of games of chance.

This amendment has been made consequent to the states losing out on lotteries as they are actionable claims not liable to VAT as per the decision in the case of Martin by the High Court of Sikkim.

Cargo handling services being amended to include transportation portion as well

The definition of cargo handling service u/s 65(23) is being amended to specifically include services of packing together with transportation of cargo or goods, with or without one or more other services like loading, unloading, unpacking. Readers may note that mere transportation services (where there is transportation alone) would be assessed under the heading Goods Transport Agency service and what is being discussed here is the composite services of packing together with transportation of cargo with or without loading, unloading, unpacking services.

Scope of levy under the category of tour operator's service

The definition of tour operator u/s 65(115) is being amended so as to include any person engaged in the business of operating tours in a contract carriage and to provide that the term "tour" would not include a journey organised or arranged for use by an educational body imparting skill or knowledge or lessons on any subject or field (educational body for this purpose would not include a commercial training or coaching centre). Through this amendment, contract carriages are specifically sought to be covered for the purpose of levy of service tax. There would be no confusion in case of tours on a tourist vehicle as the same would be liable. Departmental letter 34/1/2008 TRU dated 29.02.08 also goes on further to state that services of tour conducted in a vehicle having stage carriage permit would not be liable. It is understood that stage carriage permits are not normally issued to private parties. Therefore the possibility of point to point carrying of passengers could also be covered.

Renting of immovable property service

This category is being amended to expand the scope of levy by providing that the activity of allowing or permitting the use of space in an immovable property without the transfer of right of possession or control of the immovable property in favour of the user would also be liable to service tax. In other words, letting out of space on temporary basis without giving the user any legal right over the property would also be liable henceforth. Through this, the department aims to tax letting out of spaces in malls on temporary basis for placing vending machines, temporary counters, mobile towers, hoardings, cinema theatres etc. where the control / possession of the same is with the owner/ lessee.

D. OTHER AMENDMENTS

Concept of Associated Enterprise introduced under service tax

The concept of Associated Enterprise that is prevalent u/s 92A of Income Tax Act 1961 has been adopted under Service Tax by amending Section 65 in this regard. However, under service tax the concept would not be restricted to international transactions alone and would apply even to services provided within the country to associated enterprises. Here the liability to pay service tax would arise even if any amount for the service is debited or credited in the books. Receipt of the consideration would not be a pre-requisite for paying service tax. Where any amount is received in advance, service tax would have to be paid on such advances received. This concept of paying service tax on the basis of any book adjustment would extend only to transactions with associated enterprises and not to other cases. Even where services are received from abroad from associated enterprises and the same would be regarded as import of services, the same philosophy is to be applied for the purposes of paying service tax u/s 66A. This provision could lead to increase in litigation in those cases where

services are provided within the group from one entity to another as in some cases, the relationship between the concerned enterprises would have to be determined considering the facts and circumstances prevailing. Assessee may also note that this concept is far wider in scope as compared to the related party relationship prevailing under Central Excise. We could see some amendment in this definition.

Amendment in Rule 6 of Cenvat Credit Rules 2004

Rule 6 of Cenvat Credit Rules 2004 has been amended by notification 10/2008 CE (NT) dated 01.03.08 which has altered the concept of availing and utilising credits with effect from 01.04.08 in case of a service provider who provides both taxable as well as exempted services. At present, the service provider has two options - (1) maintaining separate accounts as to the receipt, issue and consumption of inputs and input services meant for use in providing taxable and exempted services and availing credit only on inputs and input services to be used in providing taxable output services. (2) Where he is not in a position to maintain separate accounts as aforesaid, utilise credits subject to a maximum of 20% of the service tax payable on taxable output service. Where the assessee receives input services falling under the 16 categories specified under Rule 6, the input service credits in respect of such services would be outside this restriction of 20%.

Now, with effect from 01.04.08, the scheme of ascertainment of credits as introduced last year with regard to the insurer/re-insurer providing general insurance business service, under clause (d) of section 65(105) has been extended to cover all service categories with a slight modification.

As per this scheme, the change would be in case of a service provider providing both taxable as well as exempted services and opting not to maintain separate accounts with regard to the receipt, issue and consumption of inputs and input services in providing such taxable and exempted services. The scheme in such a case gives the service provider two options -

- (1) Pay an amount equal to 8% of the value of the exempted services or
- (2) Calculate the credits available on a proportionate basis having regard to the quantum of the exempted activity and taxable activity

Where the service provider opts for the second option, the calculation would be done in two stages i.e. Cenvat credits are first of all ascertained provisionally on a monthly basis during the relevant financial year by considering the credits arising during the month and splitting it up in the ratio the exempted activity bore to the total of taxable and exempted activity in the preceding financial year by taking the value of exempted services and taxable services provided in the preceding financial year. Needless to say, the value of exempted and taxable services considered here would be for the whole of the preceding financial year and would remain the same for all the months of the current

financial year for the purposes of such provisional calculation.

Next, the credits would have to be determined at the close of the current financial year on the basis of the values of taxable services and exempted services provided during the relevant financial year and by taking the total cenvat credits for the whole of the current financial year. The formula to be used here would be similar to the one used for provisional calculation and has been explained in notification 10/2008 CE (NT). Once the credits have been ascertained at the close of the financial year, the assessee would have to find out whether he has availed excess credits. If so, he shall have to pay the balance by 30th of June of the succeeding financial year. In case of delay beyond that date, interest at 24% p.a would have to be paid and in case credits have been short availed, he can claim the balance credits and intimate the SCE within 15 days from payment of amount or availment of credits as the case may be.

The assessee would have to exercise his option here and intimate the SCE regarding the method to be followed (either option 1 or 2) in advance and once opted, cannot be changed for the remainder of the financial year. One important factor to be remembered here is that the method would even cover a scenario where a service provider also happens to be a manufacturer or vice-a-versa.

Note - In the opinion of the authors, cess and SHE cess would have to be paid over and above the amount of 8% stipulated earlier. Where the assessee has substantial credits, it may be worthwhile to pay 8% plus applicable cess as the full credits can be availed in respect of input services. The method under option 2 would not include capital goods as the question of denial would only be in a case where the capital goods are exclusively used for providing exempted services. It is also important to note that credits would not be available on inputs used for manufacturing exempted goods and that the formula all the while talks of ascertaining the credits on inputs used for exempted services and input services used for exempted services and exempted goods as that portion would have to be deducted from the total credits available.

Exemption under the GTA scheme and the need for declaration from the Goods Transport Agency

Earlier there was a requirement for the consignor or the consignee (whoever paid the freight and the service tax thereon), to obtain a declaration from the Goods Transport Agency as to non-availment of cenvat credit and the benefit of notification 12/2003 ST. This had also been made of the important conditions for allowing the service tax payer to avail the benefit of deduction of 75% from the gross amount charged for the freight. Due to inconvenience experienced by the assesseees, this condition as to getting the declaration from the GTA has now been done away with. In other words, the benefit of 75% deduction from gross amount of freight would now be unconditionally available with effect from 01.03.08. The GTA has already been denied the benefit of availing credits.

Concept of Input Service Distributor extended with regard to credit on inputs and capital goods

At present, input service credits can be distributed to units engaged in manufacturing or providing taxable services, by an office of the enterprise by registering as an Input Service Distributor. Distribution is normally done on the basis of a bill/challan/invoice raised on the unit to which the credits are to be distributed. So far the credits of excise duty paid on inputs and capital goods could not be distributed and what could be distributed was credits of service tax paid on input services alone. With effect from 01.04.08, even the credits on inputs and capital goods can be distributed in accordance with new Rule 7A of Cenvat Credit Rules 2004 and the procedure to be notified thereunder. The provisions of Central excise as they pertain to a registered First Stage/Second Stage dealer have also been extended to such distributor of credits. This in the opinion of the authors could mean the distributor of credits ending up following the procedures prescribed for dealers as far as credits and documentation work is concerned.

Relaxation in a case where the service provider removes capital goods for providing output service

At present, where capital goods are removed outside the premises of the service provider for providing output service, the said goods are to be received back within a period of 180 days failing which the applicable cenvat credits would have to be reversed. The restriction of 180 days is being done away with effect from 01.04.08 as long as the removal is for providing output service. This would greatly facilitate carrying out of service at site/customers' premises as the assesseees would no longer have to worry about the time limit of 180 days for the capital goods removed to such site/premises.

Payment of amount in advance and adjusting towards service tax liable

Assesseees would have the option of paying an amount towards service tax in advance and then adjusting the amount paid in advance towards the actual liability on services provided, during the subsequent period. Once the advance is paid, the SCE would have to be intimated within 15 days. The details of the adjustments would have to be disclosed in the service tax returns. This facility would be available to all assesseees from 01.03.08 onwards. This is to be governed by new rule 6(1A) of Service Tax Rules 1994. However, there is no mention of any interest amount being involved for the amount paid in advance and whether the assessee would get one at all remains to be seen.

This budget has not addressed a number of issues, which have been brought before the TRU/ FM and has also armed the officers of the department with powers and enabling penalties for procedural violations which are draconian.

In this article some of the important measures have been highlighted. For full details regarding the changes, readers are advised to go through the relevant explanatory notes, notifications and memorandum. For any queries or text of the Bill / Notifications / Circulars mail to vssudhir@gmail.com.