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Reimbursement of Expenses not subject to Service Tax

Dear Professional Colleague,

We are sharing with you an important analysis of judgment of Hon'ble Delhi High Court in the W.P. (C) 6370/2008 of **Intercontinental Consultants and Technocrats Pvt. Ltd. Vs. Union of India & ANR (2012-TIOL-966-HC-DEL-ST)** on the following issue:-

Issue:

- **Whether reimbursement of expenses includible in gross consideration for the chargeability of Service Tax?**
- **Whether Rule 5(1) of Service Tax (Determination of Value) Rules is ultra vires Sections 66 and 67 of Finance Act, 1994?**

Facts:

The Petitioner Company is engaged in providing consulting engineer services and receives payments not only for its service but also for reimbursed expenses incurred by it such as air travel, hotel stay, etc. It was paying service tax in respect of amounts received by it for services rendered to its clients. It was not paying any service tax in respect of the expenses incurred by it, which was reimbursed by the clients. Department issued Show Cause Notice demanding service tax on the expenses reimbursed by invoking the provisions of Rule 5(1) of the Service Tax (Determination of value) Rules 2006. The Petitioner Company has challenged Rule 5(1) in a Writ Petition.

The Service Tax (Determination of Value) Rules, 2006, (hereinafter referred to as "Rules"), was brought into effect from 01.06.2007. Rule 5 provided for "inclusion in or exclusion from value of certain expenditure or costs". Rule 5(1) of the Service Tax (Determination of Value) Rules, 2006, reads as:-

"(1) Where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service."

Illustration 3 to this Rule reads as: -

"Illustration 3: A contracts with B, an architect for building a house. During the course of providing the taxable service, B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., to enable him to effectively perform the provision of services to A. In such a case, in whatever form B recovers such expenditure from A, whether as a

separately itemised expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B. Value of the taxable service for charging service tax is what A pays to B."

Rule 5(2) of Rules state that Subject to the provisions of sub-rule (1), the expenditure or costs incurred by the service provider as a pure agent of the recipient of service, shall be excluded from the value of the taxable service if all the specified conditions are satisfied.

The contention of the Department was that as per the provisions of sub-rule (1) of Rule 5 of Rules, service tax was to be charged on the gross value including reimbursable and out of pocket expenses such as travelling, boarding and lodging, transportation, office rent, office supplies and utilities, testing charges, etc. which, were "essential expenses for providing the taxable service of consulting engineers".

Held:

It was held that Section 67 authorises the determination of the value of the taxable service for the purpose of charging service tax under Section 66 as the gross amount charged by the service provider for such service provided or to be provided by him, in a case where the consideration for the service is money. It is only the value of such service which is that of a consulting engineer, that can be brought to charge and nothing more. The quantification of the value of the service can therefore never exceed the gross amount charged by the service provider for the service provided by him.

The contention of the petitioner that Rule 5(1) of the Rules, in as much as it provides that all expenditure or costs incurred by the service provider in the course of providing the taxable service shall be treated as consideration for the taxable service and shall be included in the value for the purpose of charging service tax goes beyond the mandate of Section 67 merits acceptance. Section 67 as it stood both before 01.05.2006 and thereafter. This section quantifies the charge of service tax provided in Section 66 *(Replaced by Section 66B w.e.f 1-7-2012)*, which is the charging section. Section 67, both before and after 01.05.2006 authorises the determination of the value of the taxable service for the purpose of charging service tax under Section 66 as the gross amount charged by the service provider for such service provided or to be provided by him, in a case where the consideration for the service is money.

The underlined words i.e. ***"for such service" are important in the setting of Section 66 and 67***. The charge of service tax under Section 66 is on the value of taxable services. The taxable services are listed in Section 65(105). The service provided by the petitioner falls under clause (g). It is only the value of such service that is to say, the value of the service rendered by the petitioner to NHAI, which is that of a consulting engineer, that can be

brought to charge and nothing more. The quantification of the value of the service can therefore never exceed the gross amount charged by the service provider for the service provided by him. Even if the rule has been made under Section 94 of the Finance Act, which provides for delegated legislation and authorises the Central Government to make rules by notification in the official gazette, such rules can only be made ***"for carrying out the provisions of this Chapter" i.e. Chapter V of the Act*** which provides for the levy, quantification and collection of the service tax. The power to make rules can never exceed or go beyond the section which provides for the charge or collection of the service tax.

Rule 5(1) of Rules, which provides for inclusion of the expenditure or costs incurred by the service provider in the course of providing the taxable service in the value for the purpose of charging service tax is ultra vires Section 66 and 67 and travels much beyond the scope of those sections. The expenditure or costs incurred by the service provider in the course of providing the taxable service can never be considered as the gross amount charged by the service provider "for such service" provided by him.

Further, it was held that Section 66 levies service tax at a particular rate on the value of taxable services. Section 67(1) makes the provisions of the section subject to the provisions of Chapter V, which includes Section 66. This clarifies that the value of taxable services for charging service tax has to be in consonance with Section 66 which levies a tax only on the taxable service and nothing else. There is thus in built mechanism to ensure that only the taxable service shall be evaluated under the provisions of Section 67.

Furthermore, if the expenses such as on air travel tickets are already subject to service tax and is included in the bill, to charge service tax again on the expense would amount to double taxation.

Therefore, Hon'ble Delhi High Court, while allowing the petition, observed, "We have no hesitation in ruling that Rule 5 (1) which provides for inclusion of the expenditure or costs incurred by the service provider in the course of providing the taxable service in the value for the purpose of charging service tax is ultra vires Section 66 and 67 and travels much beyond the scope of those sections. To that extent it has to be struck down as bad in law. The expenditure or costs incurred by the service provider in the course of providing the taxable service can never be considered as the gross amount charged by the service provider "for such service" provided by him."

Food for Thought:

This judgement will open up new debate & litigation across the Country on following points:-

- Whether application of this judgement can travel beyond territorial jurisdiction of the High Court
- Whether the Govt. is going to accept this judgment in right spirit to extend benefits to the Trade and Commerce
- Retrospective Amendment: The Government would be tempted to retrospectively validate an invalid levy - Rule 5 (1) of the Rules runs counter and is repugnant to Sections 66 *(Replaced by Section 66B w.e.f 1-7-2012)* and 67 of the Finance Act and to that extent it is ultra vires – So many instances under the Direct Tax & Indirect Tax e.g. – Renting of immovable Properties, etc.

Hope the information will assist you in your Professional endeavours. In case of any query/ information, please do not hesitate to write back to us.

Thanks & Best Regards

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