Budget 2016-17: Service tax to be raised to 16% but with broader credit

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If the tax is hiked to 16%, it would mean a rate rise of over 3.5 percentage points in a short span of nine months. Since the tax's launch in 1994, at a rate of 5% on a small set of services, the steepest rate hike previously was in 2003-04. On June 1 last year, the rate went up from 12.36% to a flat 14% (in the process, eduction and higher-eduction cesses were subsumed in the rate) and 0.5% Swatch Bharat cess was levied on November 1.

Sources privy to the government's thinking in the matter told FE that the practice of disallowing credit to a clutch of input services on the grounds that these inputs haven't really been used for the relevant output services, would be discontinued. Spending on almost all intermediary services — those which are not consumed by end-consumers but by businesses for value addition — would be treated as legitimate business expenditure and allowed as credit, the sources added.

The enhanced opportunities for availing credit for the taxes paid on input services would help a whole range of industries including construction and professional services firms and taxi operators, analysts said, as these businesses are now suffering from an accumulation of input tax expenses. The Budget would also take forward the policy of integrating the tax on goods and services and extending credit of service tax and excise duty across goods and services, outlined in Budget 2004 by then finance minister P Chidambaram.

Finance minister Arun Jaitley may also extend the facility of refunds on special additional duty — levied at 4% — paid on imports, which is currently being made to importer-traders to the manufacturing industry as well. A large segment of the manufacturing industry is now unable to get full credit for the SAD paid on inputs because their value addition levels are not high enough for such set-offs. The SAD — which is levied on imports in lieu of the state VAT on domestic goods — could also be reduced on number of intermediate goods, the sources said.

The broadening of the credit system for taxes incurred on input services and the move to reduce the accumulation of CENVAT credit with manufacturing firms go in the direction of the proposed goods and services tax (GST). The Centre's idea is to increase the pressure on states to embrace the GST by setting example. A seamless input tax credit system for the CENVAT chain would amount to go a long way to achieving the chief objective of the GST, that is, removing the cascading of taxes in business-to-business transactions. The raising of the turnover threshold for the levy of service tax to R25 lakh is also in line with the GST, which could also be levied on businesses above that level, bringing several thousands of small manufacturing units into the tax net (excise duty is currently levied on firms with annual turnover of R1.5 crore and above).

The government had moved to the negative list approach for taxing services — which means all services except a select few are taxed — in July, 2012. With the tax being comprehensive and the rate hiked, it has budgeted for a 25% increase in service tax collections this fiscal to R2.1 lakh crore and this target seems about to be achieved.

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