



# Budget 2012: Changes in Service Tax

July 13, 2012

## **Disclaimer**

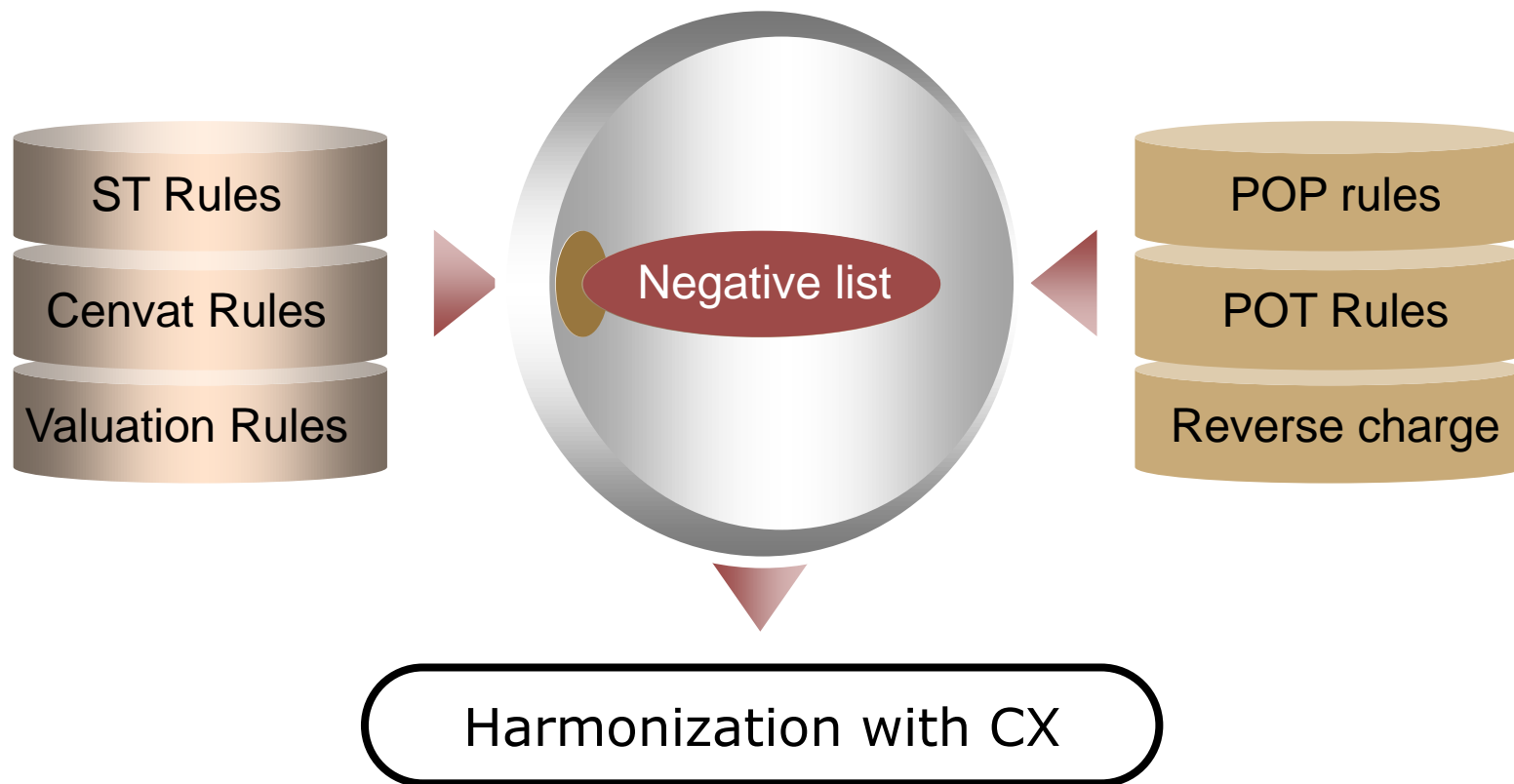
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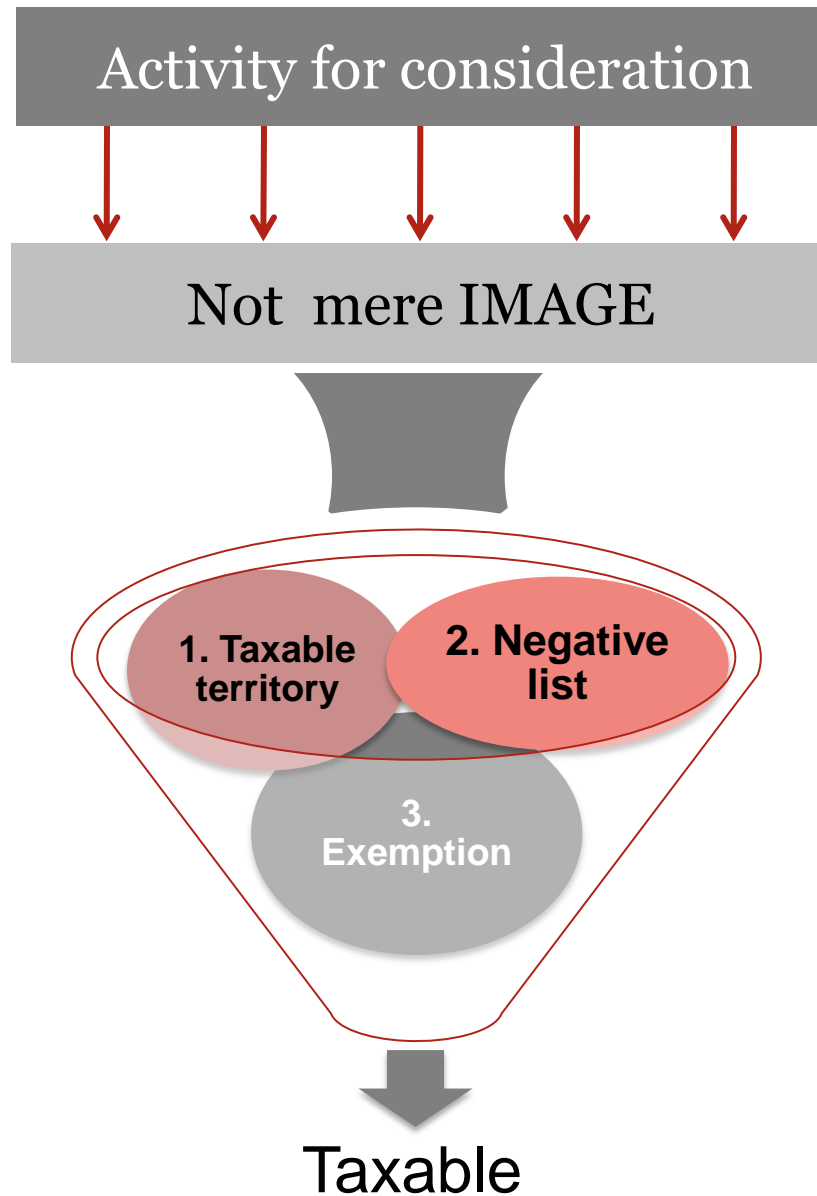
Budget at a glance	4
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# Budget at glance....



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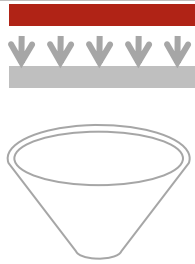
# Negative list: concept....



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

# Activity....

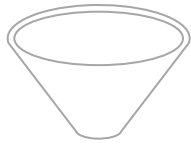
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- Legal obligation to do or not to do an act:
  - A beggar playing music on road not taxable even if soliciting money
  - But taxable if same beggar performs at a function for consideration
  
- May be active or passive i.e. forbearance to act
  - Non-compete agreements taxable;

# Activity....

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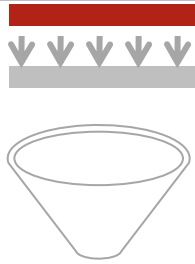


- “Direct” and “immediate” link between activity and consideration
  - Direct: no casual link
    - Services received from government against taxes paid not taxable per se;
    - Free seminar to educate about prudent investment indirectly promoting a mutual fund
    - Services received from a club against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



# Activity....

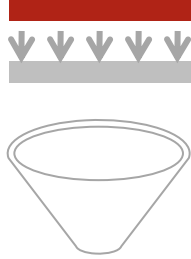
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- Immediate connection: not too remote
  - amount received in consideration for life time contribution not taxable e.g. Nobel Prize;
  - consideration may actually be payable at a later point of time but linkage should be immediate

# Activity....

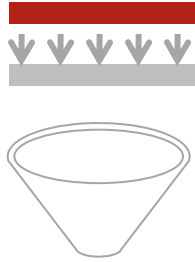
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- Not to include any activity where no such reciprocity:
  - Activity without consideration
    - ...Tourist information free of charge
  - But many activities may have indirect or deferred or disguised considerations; need careful study
    - ..Free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

# Activity....

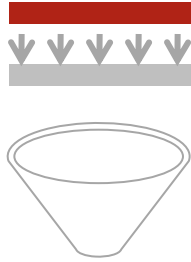
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- Not to include any activity where no such reciprocity:
  - Activity without consideration
    - Tourist information free of charge
    - Free TV channels
  - Consideration without activity:
    - Pure gifts
    - Tips and ex gratia payments
    -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

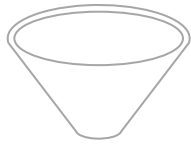
# Consideration....

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- 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

# Consideration....



## 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

### *Consideration*

## 3. Subsidies

Taxable when influence the unit price:  
price must change proportionate to  
amount given

Deficit subsidies not taxable

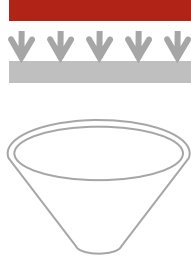
## 4. Amount received in court settlements

Consideration taxable;

Costs not taxable

# Persons....

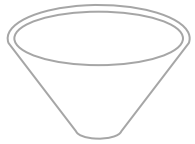
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- Two distinct entities – Service Receiver & Service Provider
  
- Two exceptions
  - Establishments in non-taxable territory and taxable territory are separate persons
  
  - Unincorporated association / body of individuals and their members:
    - Clubs or associations
    - Unincorporated JVs

# Not mere IMAGE...

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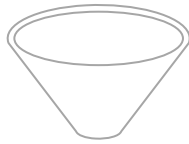


## 1. Immovable properties

- 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

# Not mere IMAGE...

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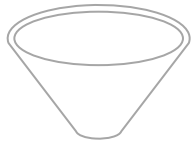
## 2. Money

- 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



# Not mere IMAGE...

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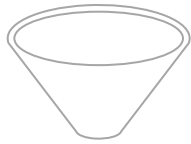


## 3. Actionable claims

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

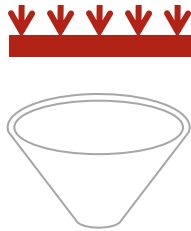
# Not mere IMAGE...



## 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

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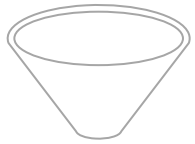


## 5. Employee to employer:

- 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

# Employer to employee..

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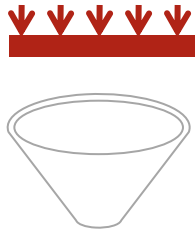


## Not excluded and thus taxable

- 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...

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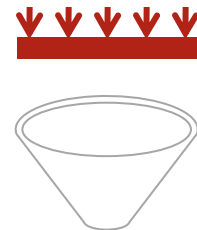


Not excluded and thus taxable:

- 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...

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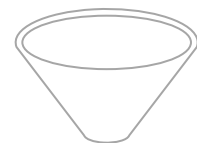
## **A. Similar to employees**

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**

# Includes declared services...

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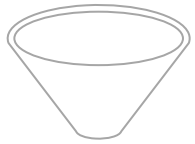


**A. Possibility of being **wrongly** considered as sale of goods or immovable property;** specified in the interest of uniform implementation of law:

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)

# Includes declared services...

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## **B. Services other than deemed sale transactions (Article 366(29A))**

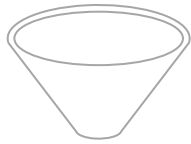
1. Hiring, leasing or licensing of goods without transfer of right to use (effective control & possession).
2. Activities 'related to' delivery of goods by hire purchase/ payment by installments.
3. Service portion of Works Contract
4. Service portion of Catering contract

## **C. Agreeing to act or not to act or tolerate an act: forbearance**



# Some declared services...

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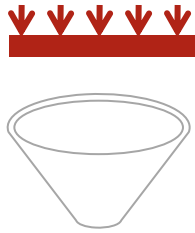


## Construction

- 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...

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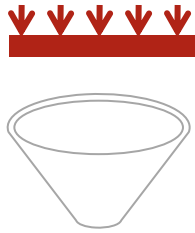


## Information technology

- 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...

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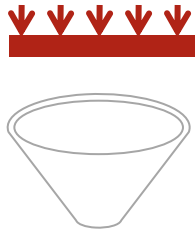


## Hire purchase

- 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...

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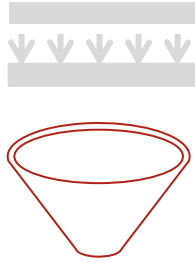


## Right to use

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

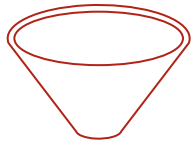
# Charging section

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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



## Criterion

## Services

1

Legal constraints

1. List II i.e. tolls, betting, gambling, entertainment & amusement, advertisement other than radio and TV, specified transportation
2. Services by diplomatic missions in India

2

Taxed as goods

1. Manufacture or production: both centre & state law: may not amount to transfer of title
2. Trading of goods: forward markets

3

Administrative difficulties

1. Margin-based financial services: interest
2. Services by Government or RBI

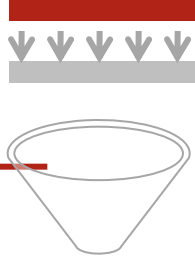
4

Lasting entries

1. Education
2. Agriculture
3. Renting of residential dwellings
4. Funeral



# Impact on major sectors



Area	Taxability
	Low ← → High
• Transportation	
• Construction	
• Real estate	
• Education	
• Govt. and community	
• Entertainment	
• Business	
• Miscellaneous	

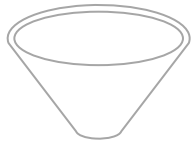
Changes
Railway by higher classes; repair of trucks/auto,
< 12 units and for personal use taxes, Repairs etc. of airports/ports/railways; Pvt. roads
Renting to govt., charities, > 90 days in hotels
Largely status quo, NSDC exempted; greater clarity provided: e.g. bundled services
To business entities reverse charged; regulators/autonomous bodies taxed
Film artists, sports commentary, IPL; reality shows; satellite hire
Director fee; non-compete, international calling cards, certification and cleaning
Marriage makers, couriers abroad, some services from J&K, demurrages as provision



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# Rules of interpretation



## Goods v services

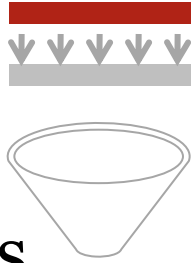
- ✓ Dominant nature or pith and substance test;
  - Rate same or higher
  - (Notification 12/2003 to be rescinded)

## Services v services

- ✓ Normally uniform rate
- ✓ When differential treatment:
  - Specific over general
  - Bundled services:
    - Natural bundle: essential character
    - Unnatural: highest liability

# Rules of interpretation...

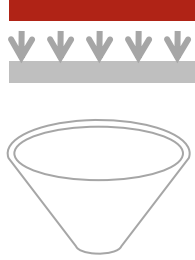
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- Reference to a service will not include reference to its input service:
  - Tolls and service used to collect tolls
  - A travel agent booking transportation by inland waterways
- Specific will prevail over a general description:
  - Real estate 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...

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- 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...

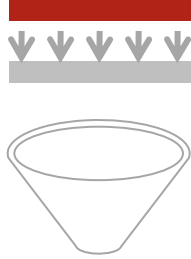
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- Service definable specifically as conglomerate of services
  - Convention in which organizer has been given stay, meals, access to health club, business centre, convention centre, pick-up and drop of delegates etc. as convention service
  - Freight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

# Rules of interpretation...

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## ➤ Naturally bundled

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

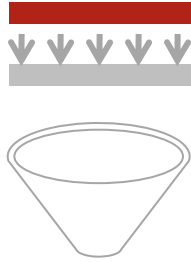
## ➤ Unnatural bundles

- 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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## ➤ Unnatural bundles

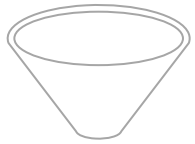
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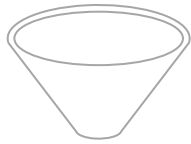
# Taxable territory



TT = India *minus* J & K;  
India defined in the Act  
to include EEZ

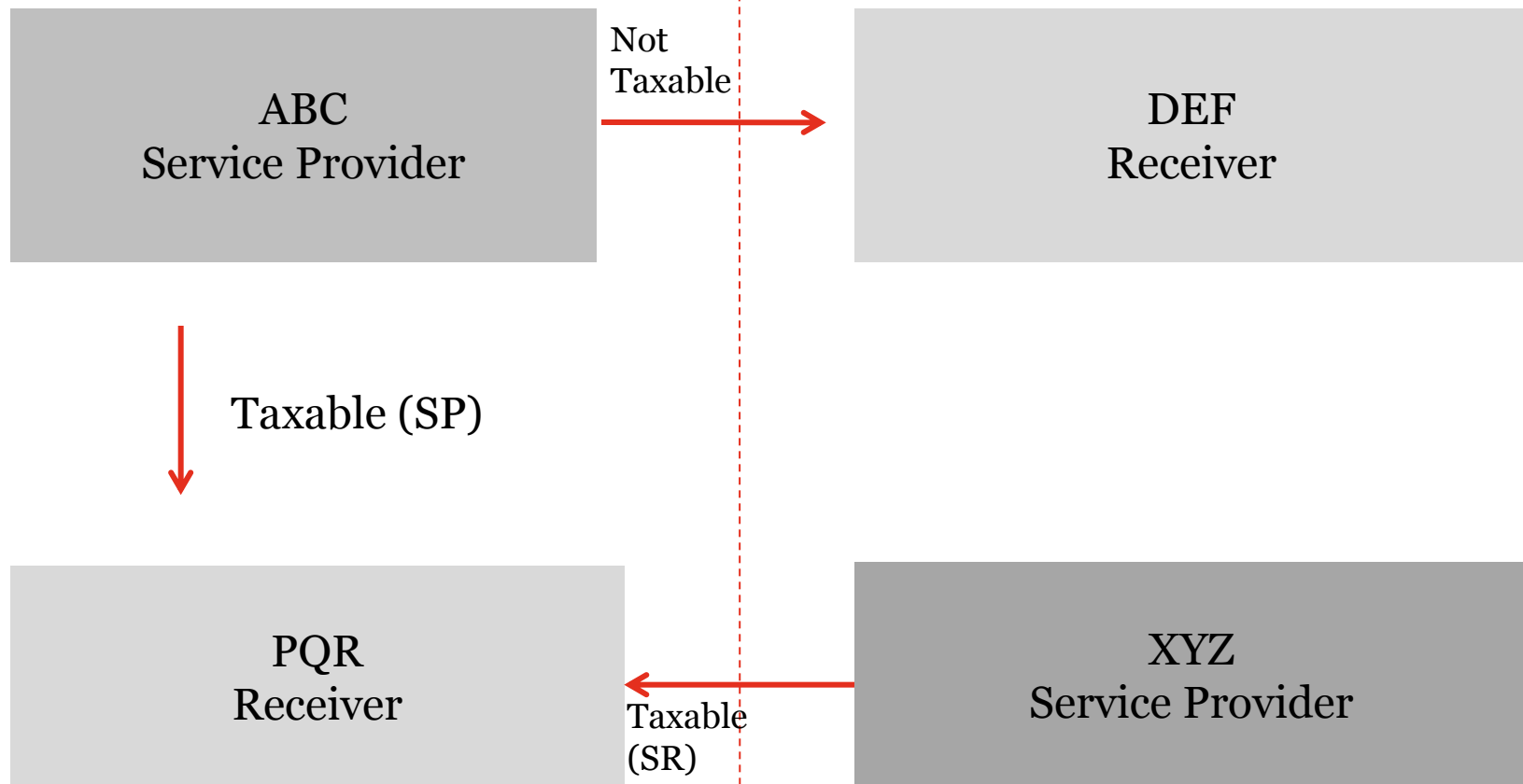


# Main rule

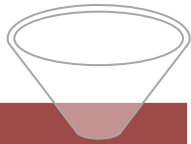


Taxable Territory

Non-taxable Territory



# Other rules



## Place of provision

- Location of performance
- Location of property
- Location of event
- Location of provider
- Embarkation
- Destination of goods

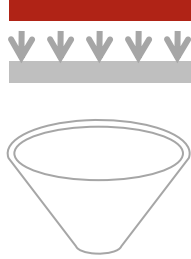
## Objectives

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...

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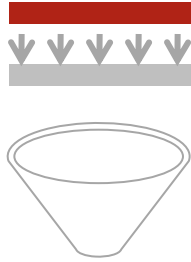
**Meaning:** person who arranges or facilitates a service between two persons but **does not include a person who provides the main service on his own account:**

➤ 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...

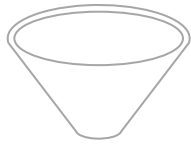
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- 1. Call centre:** There is only one service to a client
- 2. Stock Broker:** Not an intermediary; dealing in goods (securities)
- 3. Freight forwarder:** When books shipping space and resells: dealing in own account; not an intermediary
- 4. Money 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...

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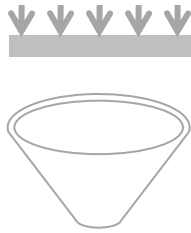


- 1. Partly in TT and partly outside:** Fully provided in TT; mainly an anti-avoidance rule; normally location specific services should be rendered by independent establishments (thus separate persons)
- 2. Both parties outside TT:** Exempted; Force of attraction and compulsory registration of foreign 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)

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# Point of taxation...

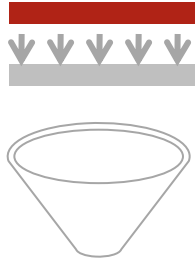
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- Rule changes from April 1, 2012:
  - Continuous supply made subordinate to Rule 4 & 5
  - Services by specified individuals and firms likewise
- Rate changes (Rule 4):
  - 10% to 12 % and a few others from 1.3.2012
  - Once again by way of abatements from 1.7.2012
  - Exemptions from 1.7.2012
- New services taxed (Rule 5): 1.7.2012

# Point of taxation principles...

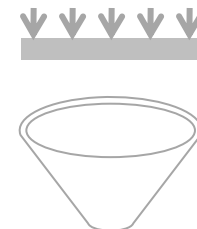
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- Once a POT is determined chargeability is decided; subsequent change will not change the chargeability
- If POT is not determined under an earlier rule then governed by new rule and consequences follow

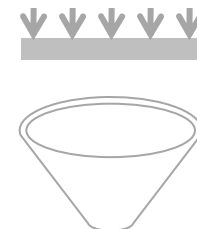


# POT in difficult cases...



Service	Payment	Invoice	Completion	POT
Works Contracts (WC)	20.3.2012	1.4.2012	10.4.2012	20.3.2012
Taxable WC with no effective rate change	20.6.2012	1.7.2012	10.7.2012	20.6.012
Taxable WC with effective rate change	20.6.2012	1.7.2012	10.7.2012	1.7.2012
Newly taxed WC	20.6.012	1.7.2012	10.7.2012	No Tax
-do- but invoice not issued in 14 days	20.6.2012	5.7.2012	10.7.2012	5.7.2012
Reverse charge	If POT of provider before 30.6.2012 no tax on RC			

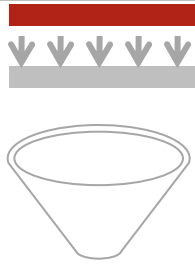
# POT in difficult cases...



Service	Payment	Invoice	Completion	POT
Mutual fund agents (reverse charged)	10.4.2012	1.4.2012	20.3.2012	10.4.2012
Mutual fund agents (exempted)	10.7.2012	1.7.2012	20.6.2012	?
Mutual fund agents (exempted)	10.7.2012	30.6.2012	20.6.2012	?
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.....				
Mutual fund agents (exempted)	10.7.2012	1.7.2012	20.6.2012	1.7.2012 (?)
Mutual fund agents (exempted)	10.7.2012	30.6.2012	20.6.2012	30.6.2012(?)

# Point of taxation ...

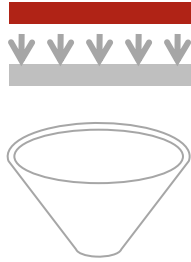
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- Once a POT is determined chargeability is decided; subsequent change will not change the chargeability
- POT in the previous example will remain the date of payment i.e. 10.7.2012

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# Works contracts



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

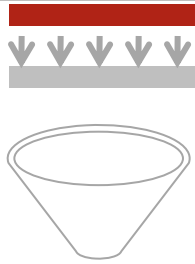
- Value of materials for the purpose of VAT to be such value
- When VAT not paid on such value option to pay on actual cost or as follows:

## Abatement

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

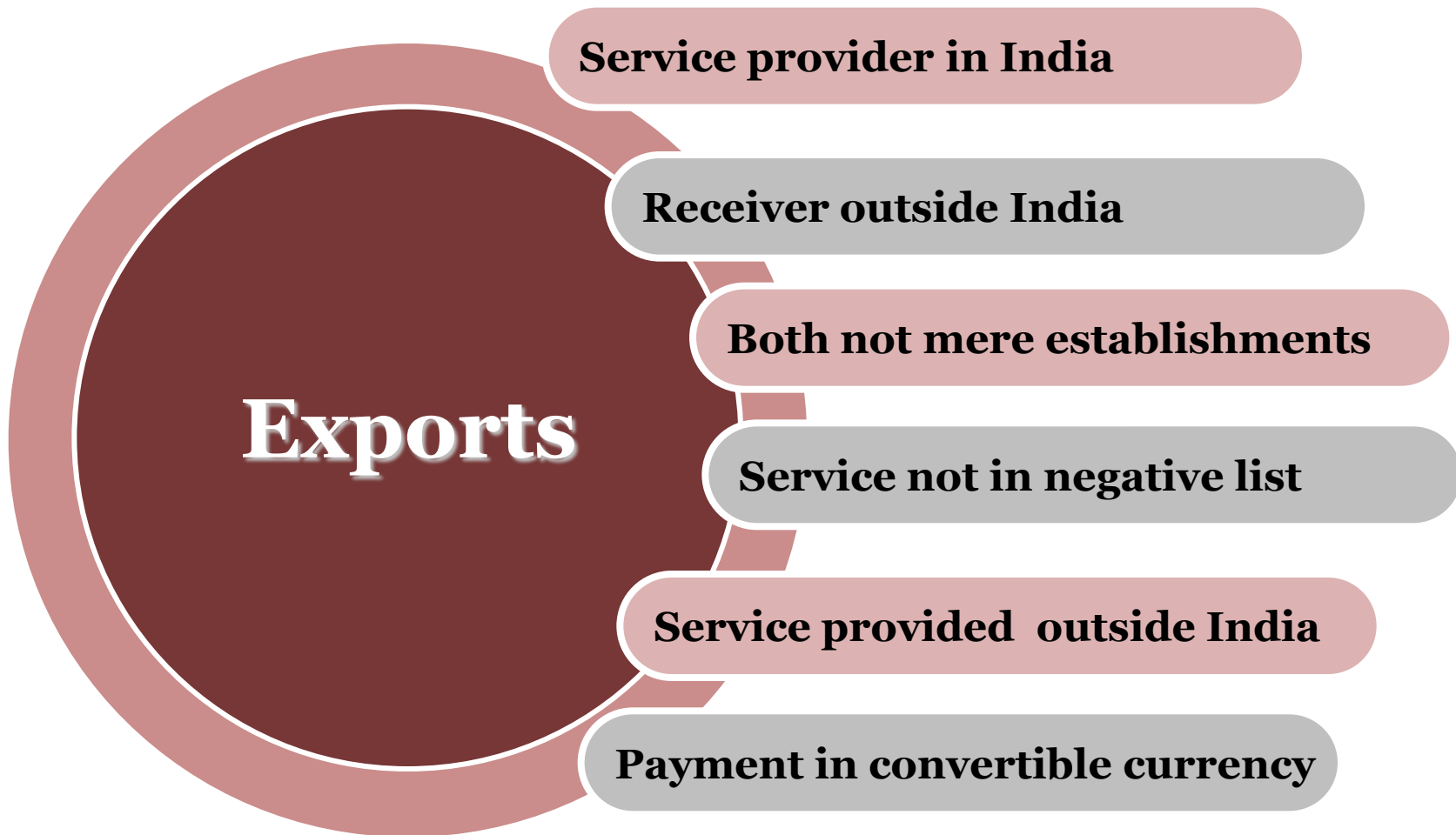
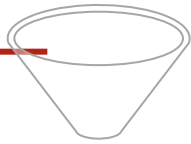
# Total amount

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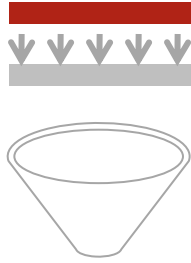
- Where some materials supplied by receiver same to be added to FMV less amount charged for such materials by the receiver;
  - FMV to be determined as per GAAP
  
- Cenvat credits available on materials to receiver but not to service provider

# Transaction to comprise exports if...



# If payment not received in 6 months...

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

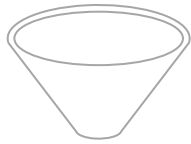
...but input tax credits will need to be reversed

.....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

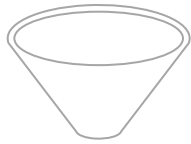
**2**

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

**3**

Service-specific descriptions removed with further liberalization

# Reverse charge



Liability to pay

Service provider:

➤ Portion specified:

- Transport: 60%;
- Manpower : 25%
- Construction: 50%

➤ Avail ITC

➤ Refund if necessary

Service receiver:

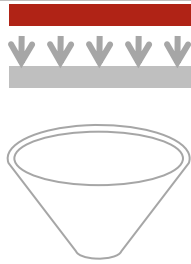
➤ Portion payable:

- Transport: 40%
- Manpower: 75%
- Construction: 50%

➤ Independent liability

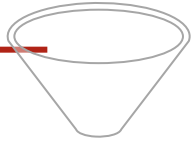
# Reverse charge

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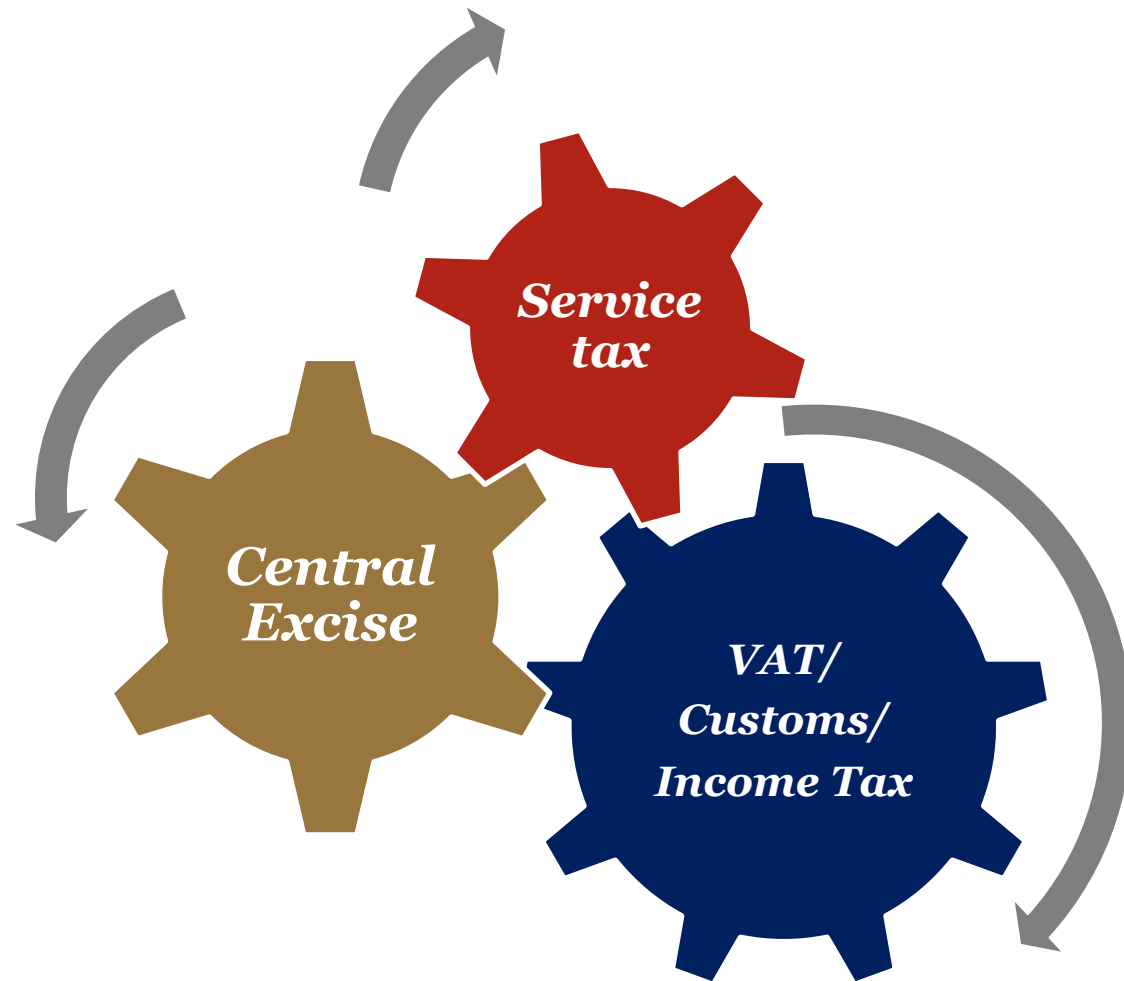


- Liabilities of both the service provider and service receiver are independent of each other:
- Small scale benefit available only to the service provider, if entitled
  - Unlikely for the listed services
- Valuation of service receiver and service provider can be on different principles, if permitted 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

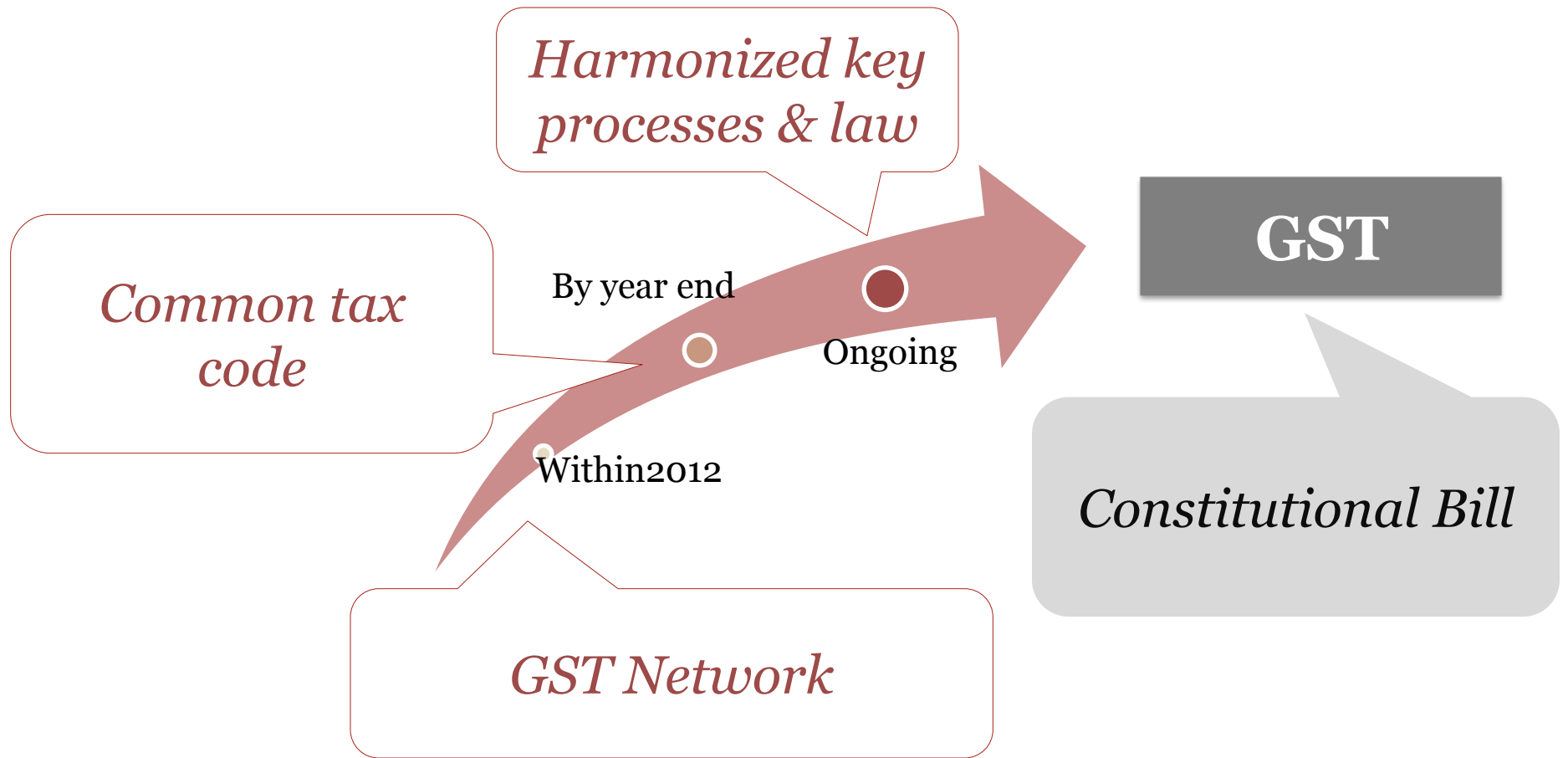
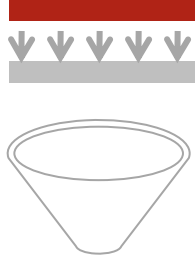


## Commonalities

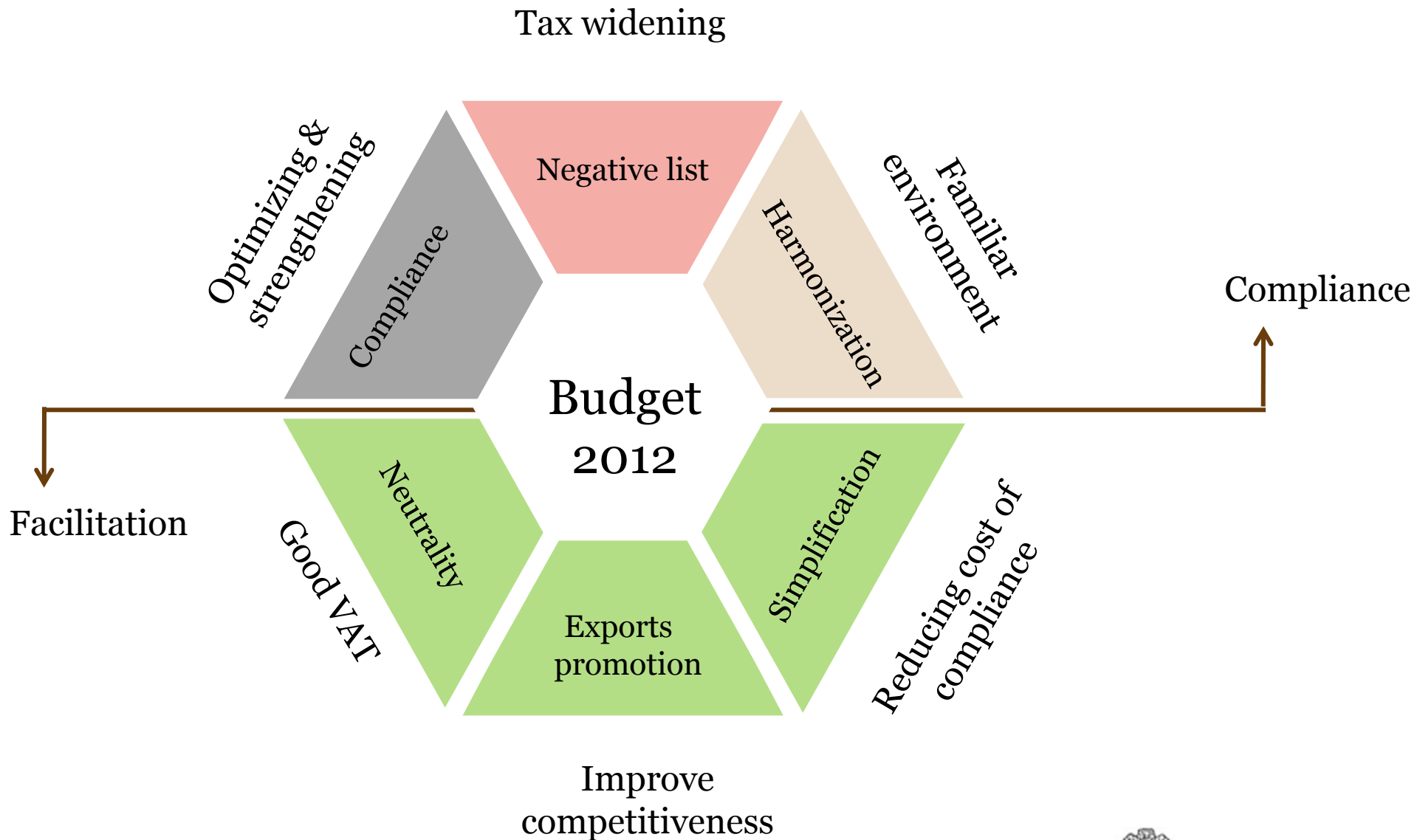
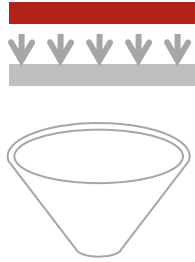
- **Already common:** Cenvat credit, many provisions incorporated in section 83 of FA 1994 e.g. Settlement Commission, appellate matters etc.
- **Can be easily common:** Essential processes like registration, return, assessment compliance.
- **Difficult areas:** Charging section and one common law
- **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



# Balancing budget





Ministry of Finance  
North Block, New Delhi India-110002  
E-mail: [garg.vk@nic.in](mailto:garg.vk@nic.in) Tel: 9111-23093027;  
Fax: 011-23093037