

IMPORTANT CONCEPTS IN INDIRECT TAX

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The tax is the price which we pay for a Civilised Society- Justice Holmes of US Supreme Court. In a civilised society a citizen demands law and order, basic infrastructure, social/health services etc., and for meeting his demands Government collects funds in various forms from various sources and indirect taxes is one of the main source of such revenue to the Government.

Constitutional background

Constitution of India is the foundation and source of power to all laws in India and all laws and Government actions are subordinate to our Constitution. If it is found that any Act, Rule, Notification or Government order is not according to the Constitution, it is illegal and void and it is called *ultra vires* the Constitution. Hence the Government or even Parliament for that matter cannot levy and collect any taxes or duties from the public without the authority of the Constitution.

Article 246 (1) of the Constitution of India States that Parliament has exclusive powers to make laws with respect to any of matters enumerated in List I in the Seventh Schedule to Constitution (Called 'Union List). As per Article 246 (3), State Government has exclusive powers to make laws for State with respect to any matter enumerated in List II of Seventh Schedule to Constitution. List III is a concurrent list, which includes matters where both Central Government and State Government can make laws. If GST has to be implemented, it would require the amendment to the constitution to enable the centre to tax the sale and states to tax services.

List I called the 'Union List', contains entries like Defence of India, Foreign affairs, War and Peace, Banking etc., Entries in this list relevant to the indirect taxation provisions are as follows,

1. Entry No. 83 – duties of customs including export duties
2. Entry No. 84 – duties of excise on tobacco and other goods manufactured or produced in India except alcoholic liquors for human consumption, opium, narcotic drugs, but including medicinal and toilet preparations containing alcoholic liquor, opium or narcotics.
3. Entry No. 92A – taxes on sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of interstate trade or commerce.
4. Entry No. 92C – taxes on *services*

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5. Entry No. 97 – any other matter not included in List II, list III and any tax not mentioned in list II or list III (these are called ‘residual powers’)

List II called as the ‘State list’, where State Government has exclusive powers to make laws, contains entries like, Police, Public health, Agriculture, Land etc., Entries in this list relevant to indirect taxations are as follows,

1. Entry No. 51 – excise duty on alcoholic liquors, opium and narcotics
2. Entry No. 52 – tax on entry of goods into a local area for consumption, use or sale therein (usually called ‘Octroi’)
3. Entry No. 54 – tax on sale or purchase of goods other than newspapers except tax on interstate sale or purchase.

List III called as the ‘concurrent list’, includes entries like Criminal law and procedure, Trust and Trustees, Civil procedures, economic and social planning etc., In case of entries included in the concurrent list, in case of conflict, law made by union Government prevails.

Further Article 265 of the Constitution states that ‘no tax shall be levied or collected except by authority of law’. Thus, whenever it has been found that Government has collected tax without proper authority of law, courts have held that the illegally collected taxes must be refunded, subject to provisions of ‘Unjust Enrichment’ in respect of Indirect Taxes.

Nature of indirect taxes

Even though some of the taxes and duties are levied on the revenue outflows, broadly it can be laid down that in majority of the cases taxes and duties are levied on the revenue inflows of the public.

Taxes are conventionally classified as direct taxes and indirect taxes. As the name suggests direct taxes are paid by the assessee directly from their income, but whereas indirect taxes are paid by the assessee by collecting the same from others who uses their services, products etc., Some of the principal direct taxes are income tax, wealth tax, gift tax etc., and whereas some of the principal indirect taxes are excise duty, customs, service tax, tax on sale of goods (VAT) etc.,

In case of indirect taxes, the responsibility is on the assessee to collect the amount from others and remit it to the Government and if the assessee has not collected the same from others, he shall still be liable to pay the same to Government from his pocket.

Merits and De-merits of indirect taxes compared to direct taxes

Merits	De-merits
<ul style="list-style-type: none">✓ Psychological advantage to the taxpayer✓ Easier to collect✓ Tax evasion comparatively less✓ Lower collection cost✓ Control over wasteful expenditure✓ High revenue inflow from these	<ul style="list-style-type: none">✓ Reduces Demand✓ Increases project cost✓ Safeguards inefficient industry✓ Modern technology costlier✓ Levy makes no distinction between income levels of the taxpayer

GOODS AND SERVICE TAX- Precursor

Introduction

GST is proposed to be introduced for sometime now. It could be introduced sometime from April, 2013. GST rates around the world are typically at between 16 percent and 20 percent, and India is likely to see a tax rate within this bracket. India is a federal republic and therefore the GST will be implemented simultaneously by the central and state governments as CGST and SGST respectively. The objective will be to maintain a commonality between the basic structure and design of the CGST, SGST and SGST between states.

What is meant by GST?

Goods & Service Tax (GST) as the name suggests, is a tax on supply of goods or services. Any person, providing or supplying goods or services will be liable to charge GST. The person supplying the goods or services is allowed to take credit for taxes paid on purchases, consequent to which, GST becomes a tax on the value added by the supplier. Further GST would be levied by both the Central Government and State Government on the same transaction, making GST a dual transaction tax structure.

What would be the Applicability of Levy?

Under GST, every specified transaction would be subject to tax.

- a) **Supply within State:** In case the supply of goods or services is done locally i.e. the place of consumption rules provide that local GST needs to be applied for the transaction, then the supplier would charge dual GST i.e. SGST and CGST at specified rates on the supply.

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- b) **Supply from One State to Another:** In case the supply of goods or services is done interstate i.e. the place of consumption rules provide that interstate GST (or integrated GST) needs to be applied for the transaction, then the supplier would charge IGST at specified rates on the supply. The IGST charged on the customer for supply of goods or services will be remitted by the seller into the appropriate account of the Central Government.
- c) **Exports:** In case the supply of goods or services are exported out of India i.e. the place of consumption rules provide that regard the transaction as 'exported', then the transaction would be zero rate. In other words, the supplier will be allowed to export the goods or services without charging any tax.

The important features of GST are given below:

- ⇒ **Dual GST:** Dual GST signifies that GST will be levied by both, the Central Government and the State, on supply of goods or services. In certain cases, such as the interstate transactions, the power to tax will be vested with the Central Government, while the revenue will in some appropriate manner, get distributed to the States. Considering the dual taxation power to tax transactions under GST, the structure is referred to as Dual GST. Considering the basic framework of the constitution and keeping its structure intact, Dual GST appears to be implementable solution for India scenario.
- ⇒ **Subsuming all Taxes:** GST should subsume all major indirect taxes levied by the Central Government i.e. central excise, customs and service tax and majority of the taxes levied by the State Government i.e. VAT, luxury tax, entertainment tax, etc. In this regard, tax on petroleum products and alcohol are intended to be kept either outside or tax additionally under GST. The following taxes would be absorbed/ subsumed into GST:

The following indirect taxes would be subsumed under GST:

Particulars	Levied By
Duty of excise on manufacture	Centre
CVD & SAD (component of customs duties)	Centre
Service tax	Centre
Taxes when sale or purchase takes place in the course of inter-State trade	Centre
Taxes on consignments that take place in the course of inter-State trade	Centre

Particulars	Levied By
Duty of excise on manufacture	Centre
Taxes on the entry of goods into a local area for consumption, use or sale therein (other than that in lieu of octroi).	State
Taxes on sale/purchase of goods within state	State

⇒ **Rate Structure:** It is expected that GST will be levied on the transaction value i.e. price actually paid or payable for supply of goods and services. The GST for local supplies will be split into SGST and CGST. The Task Force on GST of Thirteenth Finance Commission (TFC) has worked out a Revenue-Neutral Rate (RNR) of 12% (5% CGST and 7% SGST) assuming there is a single GST rate and stamp duty & electricity duty are also subsumed in the GST.

GST would have a 4 rate structure with standard rate, concessional rate, special rate for bullion & jewellery and exempted/ nil rated. It is not clear whether services and goods will have the same rate or be subjected to tax at different rates. Further, the Government is yet to specify the rate of taxes proposed for each of these categories.

The discussion paper mentions that the empowered committee has decided to adopt the following SGST rate structure for taxing goods and services:

- Exempted goods: The current list under the State VAT law-0%
- Special rate: Precious metals- could be 1-2%
- Concessional rate: Necessities and goods of basic importance-could be 5%
- Standard rate: For all other goods- could be 10%
- Specified rate: Services- could be 10%

The discussion paper has recommend a uniform State GST threshold of INR 10 Lakhs for both goods and services and INR 150 Lakhs for Central GST threshold limit for goods. The discussion paper has not recommended the threshold amount for taxing CGST on services, though it has recommended to be kept appropriately high.

The discussion paper has recommended for upper ceiling of gross annual turnover of INR 50 Lakhs with a floor tax rate of 0.50% across the States for composition scheme.

⇒ **Credit Scheme:** GST will be levied on supply of goods and services and the supplier will be allowed credit for the GST paid on purchases. The credit would be seamless except that the credit of CGST paid will not be allowed for set-off against SGST payable and vice versa.

How would this work?

The assessee dealer will be entitled to avail credit of GST paid on purchases. In this regard, the dealer may purchase the goods or services locally or interstate or as imported. The following taxes paid on purchases when made locally, interstate or imported, would be available as credit in the hands of the dealer:

The assessee is required to account for CGST, SGST and IGST separately.

Extent of Cross Utilisation:

Nature of tax paid on purchase	Can be utilized for payment of
CGST	CGST IGST
SGST	SGST IGST
IGST	CGST SGST IGST

⇒ **IGST:** Under this model the Centre will levy the IGST which will be CGST plus SGST on all inter-State transactions of taxable goods and services. Inter-State seller would pay the IGST on value addition after adjusting of IGST, CGST and SGST on purchases. The Exporting state will transfer to the Centre the credit of SGST used on payment of IGST.

⇒ **Administrative Mechanism:** Both the Central Government and State Government will have the authority and control over the assessee as follows.

- (i) The administration of the Central GST would be with the Centre and for State GST with the States.
- (ii) Each taxpayer could be allotted a PAN linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-

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based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department.

(iii) Keeping in mind the need of tax payers convenience, functions such as assessment, enforcement, scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States.

(iv) Accordingly, the assessee dealer would be required to pay GST into the specified account of the State/ Centre and file periodic returns separately with the State/ Central Government.

Central Excise Law and Procedures

Introduction

The taxable event for the purpose of Central Excise is Manufacture and the liability to pay Central Excise arises as soon as the goods are manufactured. Thus even though central excise is a duty on manufacture of the goods and it is collected at the time of removal only for convenience. The powers to levy Central excise duty are derived from entry 84 of union list of seventh schedule.

What is taxable event

Manufacture: The excise duty can be levied only when the **goods** which are movable and marketable, emerged as a result of manufacture. The term manufacture as understood in common parlance is different from what is defined under Central Excise Law as many of the process which is not manufacture in common understanding is construed as manufacture for the purpose of levy. The test that is commonly used to determine whether the activity of manufacture has taken place or not is that whether the activity has lead into emergence of a product which is different from the one with which the process started and the new product should have *different name, character and use*.

Determination of the Excisability of Product

Step 1: Whether Goods?: Examine whether “goods” exist. Under the Sale of Goods Act 1930 items that are movable are said to be goods. Movable property is anything that is not immovable. Immovable property has been defined as anything that is permanently embedded/ fastened to the earth, or anything permanently attached to such embedded item. Marketability is an equally important criterion. Most items, which are known are marketable with the exception of damaged machinery, transient chemicals, intermediate goods which are not known to be

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sold, garbage and few exceptional products. Practically only in process materials maybe said to be not marketable or those, which are in the process of Research and Development.

However Section 2(d) of Central Excise Act, 1944(which before 1996, was known as the Central Excises and Salt Act 1944) provides an explanation to the definition of “excisable goods” wherein it states that ‘goods’ include any article, material or substance which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable. It is important to note that there is no requirement of actual sale or actual market for the manufactured goods as long as the goods are capable of being brought to the market.

The transactions which are purely trading and which do not even fall into the deemed manufacture concept and transactions of service would not be considered as covered under manufacture in normal circumstances. They are mutually exclusive.

Step 2: Whether in State List or Central? : The Products under List II (State List) or List III(Concurrent List) of the VII schedule of the Constitution of India are not covered by Central Excise. The products like opium, narcotic drugs, alcoholic liquors for human consumption are outside the scope of Central Excise. The excise duty on medicinal and toilet items which contain alcohol though covered by central excise would be collected by the State Government.

Step 3: What is the Classification?: Classify the product with reference to the broad category and then specific coverage within the broad entry of the Central Excise Tariff 1985. Where the entry is not clear or more than one classification appears to be correct then reference is to be made to the rules of interpretation of the First Schedule contained in the Central Excise Tariff Act 1985. Even when this is not helpful the recourse to the Harmonised System of Nomenclature maybe made. The confirmation of such classification could also be done by reference to the case laws with regard to the products if any, which could be a valuable indicator. Where an alternative with a lower rate is chosen, the justification of the choice should be clear and legally defensible including the fulfillment of the conditions.

The gist of the classification rules are provided below:

- ✓ Rule 1: The classification of the goods should be on the basis of heading and relevant notes and not on the basis of chapter notes as they are provided for reference only.
- ✓ Rule 2(a): The goods should be classified under the particular heading even though the said article is incomplete, unfinished, the condition to be satisfied is that the incomplete or unfinished product reflects the character of the finished article.

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- ✓ Rule 2(b): According to this rule heading in which there is a reference to a material or substance also apply to that material or substance mixed or combined with other materials or substance as this rule relates to mixtures or combination of materials or substances and for the goods consisting of two or more materials or substances.
- ✓ Rule 3(a): The description by name is more specific than the description by character.
- ✓ Rule 3 (b): This rule is to be adopted only when classification cannot be classified following the above rule. The goods should be classified as if the material or component which gives them their essential character.
- ✓ Rule 3©: this rule should be followed only when the classification cannot be determined according to the above rule, according to the said rule the heading which occurs last in numerical order among those which will equal merit consideration.
- ✓ Rule 4: When goods cannot be classified in accordance with the above rules, then they are to be classified in a heading of a product which is most akin to the goods in question.

Step 4: Whether Process is Deemed Manufacture?: Section 2 (f) (ii)& (iii) set out the processes which are considered to be manufacture though the same may not be understood in common parlance to be manufacture. The chapter notes to the chapter under which the product falls should be perused to ensure that deemed manufacture concept does not apply. In the case of such products even if process/ activity (like packing, labeling, repacking etc) NOT amounting to manufacture are undertaken, the activity is DEEMED to be manufacture and the central excise provisions would apply. Where for the product the processes carried out are not specifically set out, they will not be covered by the deeming fiction. This would require to know the list of activities chapter wise to which deemed manufacture concept applies.

Further in case of products in Third Schedule the process of packing, repacking, relabeling including the declaration or alteration of retail sale price would amount to manufacture. However, it is interesting to know that the deemed manufacture introduced under clause (iii) of Section 2(f) of Central Excise Act, 1944 would essentially be applicable to those goods which are valued on the basis of MRP under Section 4A of the Act.

This leads to a situation where the trader of certain goods may be liable for payment of central excise duty. Consequently they would also be eligible for the credit on the incoming products and input services and the exemptions provided under law for a manufacturer.

Step 5: What is Manufacture?: In case the product is not covered by the deemed manufacture concept, the process should be examined whether amounting to manufacture. Since the

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definition is not very clear, the meaning is to be understood by referring to the judicial pronouncements. The tests which can be applied are that the incoming material and the final outgoing material are to be compared with respect to their name, character or use. If the final product is distinct and different with regard to the three criterion then manufacture has taken place as understood under central excise. The name refers to what is the product called in common parlance (generic) and does not refer to the brand name. The condition of use is to be applied in a broad manner as every change will bring about some restriction to the use. If the use has not altered, then it would be advisable to seek an opinion from experts in the field or err on the side of revenue. There have been a large number of decisions of the Tribunal and the courts with regard to manufacture of innumerable products, which may shed light. However it should be ensured that processes not amounting to manufacture are not described as manufacture as the department may at a later date take the view that there is no manufacture. This could result in denial of credit along with consequent demand for interest and penalty.

Step 6: Should Exemption be Availed?: We now have an excisable product manufactured in India. The next examination is whether the manufacturer wishes to avail the exemption if any, which is available. This should depend on the type of product/ customers orders. If the final product is being sent to the consumer then exemption should be claimed. If the item were an intermediate product then availing credit on the inputs and paying duty on the finished goods would be preferable as long as the customer is eligible for credit. The orders if generally received as basic + taxes as applicable would mean that the manufacturer would benefit by opting for duty payment. A comparative analysis of the two situations (opting for registration and opting for exemption) would highlight to the benefit to the client. The manufacturer doing very low value addition may also find opting for registration preferable.

Here it should be noted that vide changes brought in by Finance Act 2011, exemptions to about 130 entries is being withdrawn. These would also include cases where the duty was nil by Tariff. A Notification No.1/2011-CE dated 1.3.2011 is being introduced, which prescribes a concessional rate of 1% ad-valorem, on excisable goods set out therein, with the condition that the manufacturer should not avail cenvat credits on inputs and input services used in relation to manufacture and clearance of such goods upto the place of removal.

Here it should also be noted that out of the said 130 entries, 76 entries are also set out in Notification 2/2011-CE dated 01.03.2011 wherein the rate of duty is set out at 5% with the benefit of CENVAT Credit.

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Step 7: Whether to claim the SSI Exemption?: The exemption notification if any is to be examined carefully as non following of the substantive conditions could lead to a denial of the benefit. The exemption based on the value of clearances for units who have had clearances not exceeding Rs. 400 Lakhs also called the SSI Exemption is available for specified products, which maybe confirmed by reference to the Notification 8/2003 dt. 1.3.2003 as amended. Here it has to be noted that this exemption is not available for Branded Goods of **another**. Therefore a manufacturer of branded goods of another would be required to register and pay duty from day one. However if such a manufacturer is situated in a rural area, manufactures for Khadi Board or is an Original Equipment Supplier then the exemption would still be available. The notification also sets out that the exemption is applicable to :-

- ✓ A manufacturer from one or more factories
- ✓ A factory of one or more manufacturers

Manufacturers who set up new concerns by splitting the company, setting up one more company with financial, managerial, production, marketing dependence would attract the clubbing provisions where the whole group would be considered as one entity. Generally the start of the litigation is due to proximity and the decision on clubbing due to establishment of financial flowback.

If the manufacturer is eligible for the exemption he can claim the exemption upto a clearance value of Rs.150 Lakhs. Clearance has to be differentiated from turnover as the former is the value of removals whereas the latter is the sale/ transfer of property.

Step 8: Registration Decision: The person manufacturing excisable goods or deals with excisable goods with some exceptions are required to get their premises registered and this registration is required to facilitate the administration of Central Excise Act and Central Excise Rules. Separate registration is required for each premise.

The following are the person requiring registration:

- ✓ Every manufacturer of excisable goods.
- ✓ First and second stage dealers intending to issue cenvatable invoices.
- ✓ Persons holding warehouses for storing non duty paid goods.
- ✓ Person who obtains excisable goods for availing end use based exemption.
- ✓ Exporter-manufacturers under rebate/bond procedure.

The following are the persons who are not required to obtain registration:

- ✓ The manufacturers who manufacture goods liable to nil rate of duty or are fully exempt.

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- ✓ The manufactures who are availing the benefit of notification 8/2003 i.e. exempted on the basis of value of clearances.
- ✓ Persons who outsource their manufacturing activity
- ✓ Wholesale traders and dealers not intending to issue cenvatable invoices.

Step 9: Dealers Registration Under Central Excise?: The trader who wishes to pass on the duty paid on goods traded by him to customers who can avail the credit for the same could also be registered. Now that the service providers are also eligible for input credit the registration as dealer makes more economic sense.

Service tax law and procedure

Introduction

While the Finance Act does not define the word “service”, Black’s Law Dictionary defines the term “service” to mean an intangible commodity in the form of human effort such as use of labour, skill or knowledge for the benefit of another. Webster’s dictionary gives various meanings of the term “service” and one such meaning goes thus – “performance of any duties or work for another; helpful or professional activity”. Thus, generally, until and unless the activity undertaken by a person can actually be called a service, there would be no service tax liability.

Concept of taxable service

Once a service is provided, the question as to its taxability can be resolved by going through the clauses of Section 65 (105) of the Finance Act, which define the term “taxable service”. The definition of “taxable service” has to be seen in relation to each category of service that is liable to service tax. Only when a particular service is covered by section 65 (105) would it be regarded as a “taxable service” for the purpose of payment of service tax. Once we ascertain that the “taxable service” has been provided, we should see whether the same has been provided by a defined “service provider”. It is to be noted that if the person providing the service were not the one defined then there would be no service tax.

Concept of service provider

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The definition of “service provider” is not the same for the various categories of services that have been made liable. An analysis of the various definitions given with regard to the various categories of services liable to tax, would reveal that words such as “commercial concerns”, “professionally qualified”, “specified authorities”, “any person” have been used to describe the service provider. Where the word “any person” has been used in any definition, the liability to pay service tax would extend to all persons/assesseees who provide the concerned taxable service. But where other words have been used to define a “service provider” in relation to a particular category of service, the liability to pay service tax would extend only to those types of service providers covered by the relevant definition and not to others.

Thus, for service tax to be applicable, there should be a “service” and the same should be provided by a defined “service provider” and the service should be covered by section 65 (105) of the Finance Act as a “taxable service”.

Concept of Classification

The service provider should ensure that he classifies the service properly as this would enable him to ascertain his liability correctly. Correct classification is critical as the exemptions under service tax barring the general exemptions are based on specified categories and if the classification is wrong, the service provider may either end up paying more than required or even face a liability. For the purposes of classification, the category which gives the most specific description of the service, should be adopted. Where composite services (combination of different services) are provided, the classification should be on the basis of the service which gives them their essential character. Where the aforesaid two principles cannot be followed for classification, the classification shall be under the sub-clause which occurs first among the sub-clauses which equally merit consideration as per section 65A.

Classification of services and exemptions

Classification of a service would determine whether the service is liable to tax and whether specific exemptions/ abatements are eligible for the service. It would also determine from which date the service became taxable.

As per section 65A of Chapter V of the Finance Act, which deals with the classification of services, the classification of taxable services shall be determined in accordance with the terms of the various sub-clauses of clause (105) of section 65. Where the taxable service in question

is classifiable under more than one sub-clause, the classification shall be determined as follows

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- ✓ The sub-clause which provides the most specific description shall be preferred over sub-clauses which provide a more general description
- ✓ Where there are composite services (services consisting of a combination of different services) which cannot be classified as per the aforesaid clause, the classification shall be determined on the basis of the classification of a service which gives them their essential character
- ✓ Where a service cannot be classified as per any of the aforesaid clauses, it shall be classified under the sub-clause which occurs first among the sub-clauses which equally merit consideration

Importance of correct classification: -

An improper classification could have serious effect on the assessee's image (both in the department and elsewhere) and his business and may also have the potential to sour his relations with the customers. The effects have been stated below -

- ✓ There could be an additional liability at a later stage on correctly classifying the service and the service provider might be saddled with a huge demand from the department and his customer may not be willing to pay for the same.
- ✓ As a result of wrong classification, the service provider might have claimed some deductions/exemptions which he would not have been entitled to in the normal course had he correctly classified his services.
- ✓ The dispute with the department would also add to the transaction cost by way of cost of litigation, interest and penalty that cannot be recovered from anyone else.
- ✓ There is also a possibility of denial of cenvat credit on inputs, capital goods and input services.
- ✓ In case of erring on the side of revenue, competitors could become more cost effective. (Where services, which are not liable, are preferred to be covered voluntarily).
- ✓ The image of a tax compliant assessee would also be tarnished to a certain extent if there is protracted litigation.

Registration

Every person liable to pay service tax is required to register himself by making an application to SCE as per section 69. The service provider before registering himself shall ensure that he has

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crossed the exemption limit of registration for the small service provider which is Rs. 10 lakhs, specified by notification 6/2005 ST dated 01.03.05 as amended from time to time. Branded service providers i.e providing services under brand name or trade name of others, would not be admissible for the exemption. An illustration could be the commercial coaching franchisees. The exemption from registration would not be available for a person who is liable to pay service tax as receiver of services

As per Rule 4 of Service Tax Rules 1994, an application in Form ST 1 would have to be filed within thirty days from the date on which the taxable service is provided/tax is levied on such service. The assessee would also have the option of going in for centralised registration where the accounting and billing activities are centralised.

Centralized Registration

In case the service provider is having more than one premises or place of providing output service, and either the accounting or billing for more than one premise is centralized, then he will be having an option of centralized registration for all such premises.

The centralized registration may be obtained in any of the following circumstances where assessee—

- Provides such service from more than one premises or offices;
- Receives such service in more than one premises or offices;
- Having more than one premises or offices, which are engaged in relation to such service in any other manner, making such person liable for paying service tax,

and has centralized billing system or centralized accounting system in respect of such service, and such centralized billing or centralized accounting systems are located in one or more premises, he may, at his option, register such premises or offices from where centralized billing or centralized accounting systems are located.

The assessee has to make an application to the Commissioner of Central Excise who has a jurisdiction over the premises or offices for which centralised registration is sought.

Input Service Distributor Registration

There can be situations where service provider is having more than one premises or having an office different from the premises from where the services are being provided. All these premises also need not be covered by a single registration. In such a scenario, if the bills are sent to office or other place (other than registered premises) then it would be difficult to avail the credit in the registered premises as there will not be proper document as set out in CENVAT

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Credit Rules, to avail credit. Therefore to facilitate the registered premises to avail credit, the concept of 'Input Service Distributor' (ISD) is coined.

In the said concept the office or other place where the invoice/bill/challan is received for the services received at other premises where the said services is used and eligible for taking credit, the said office or other place would be registered as Input Service Distributor and issue invoice/bill/challan to the premises where such input services are used mentioning the credits pertaining to that unit.

Assessee intending to make use of ISD concept has to get register in the same manner as that of service provider who is liable to pay service tax.

Further every ISD distributing credit of taxable services shall, in respect of credit distributed, issue an invoice, a bill or, as the case may be, a challan signed by such person or a person authorized by him, for each of the recipient of the credit distributed, and such invoice, bill or, as the case may be, challan shall be serially numbered and shall contain the following, namely:—

- The name, address and registration number of the person providing input services and the serial number and date of invoice, bill, or as the case may be, challan
- The name, and address of the said input services distributor;
- The name and address of the recipient of the credit distributed;
- The amount of the credit distributed

Concept of consideration and valuation

The service provided should be for a consideration. As per section 67, where the consideration is wholly in money, the gross amount charged for the service would be liable. Even reimbursements of expenses shall be liable as per Service Tax (Determination of Value) Rules 2006 unless the same is incurred by the service provider as a pure agent of the service receiver. The conditions to be satisfied for this are explained in the chapter on valuation. The gross amount charged shall include payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment. One would have to refer the Rules on valuation to ascertain the value where the consideration is not wholly or partly in monetary terms or where the same is not ascertainable.

Payment of service tax

The service provider providing taxable services shall be required to pay service tax under

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section 68(1).

There has been a change in the event attracting service tax liability wef 1.4.2011 with the introduction of Point of Taxation Rules, 2011.

At the outset, we would be examining the law as it stood prior to the introduction of the Point of Taxation Rules. The service tax levy would be attracted at the time of provision of taxable services and crystallize at the time of receipt of the consideration either in full or in part. However where any advance was received for the service to be provided in future, the point of levy and crystallization of levy happened at a single point of time. This is because the taxable service definition as per Section 65(105) read as under-“taxable service” *means any service to be provided or to be provided*. The services to be provided were included within scope of taxable service by the Finance Act, 2005 wef 16.6.2005. Thus the levy covered even the services to be provided within its scope.

As a procedural requirement, there was a requirement of preparing a bill or invoice or challan within 14 days from the date of completion of service. However at the time of receipt of such advance itself, bill or invoice or challan had to be raised. There was a legal question of whether the levy on future contingent event could be called a service at all without even the service commencing, which continues even today.

Further the service tax was to be paid in accordance with Rule 6 of Service tax Rules, 1994 which stated that Service tax to be paid when the receipt of gross amount charged took place.

Now the earliest of the following is deemed to be taxable event for purpose of attracting service tax levy:

- (i) Date of invoice
- (ii) Date of completion of service
- (iii) Date of receipt of advance

The service tax shall be paid by the 5th of the month following the month in which the service is deemed to be provided in accordance with the POT Rules, 2011. However, in respect of the month of March, the payment would have to be made by the 31st of March and not by 5th of April. Where the payment is made electronically, the due date is 6th of the following month instead of 5th.

Payment u/s 68(2) by the service receiver

Generally it is the service provider who provides the taxable services who is called upon to collect service tax from his customer/client and pay the same to the government. But section

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68(2) empowers the government to notify the services with regard to which the service receiver would be held liable to pay service tax to the government. The government has consequently notified the following services in this regard through notification 36/2004 ST dated 31.12.2004 as amended from time to time –

- Goods Transport Agency service – specified person paying the freight
- Business auxiliary service of distribution of mutual fund by a mutual fund distributor or agent – mutual fund or asset management company receiving such service
- Sponsorship service provided to any body corporate/firm in which case, the body corporate or firm receiving such sponsorship service would be liable
- Taxable services received by any person in India from abroad – the recipient of such service in India.
- Insurance auxiliary service by an insurance agent – person carrying the general insurance business or life insurance business

Cenvat Credits

There has been a change in the definition of inputs, input services and capital goods definition under Cenvat credit Rules, 2004 wef 1.4.2011. The changes are as follows:

The definition of ‘input’ contained in rule 2(k) has been revised.

For better understanding of the definition of input, inclusions and exclusions which has been tabled below

<u>Inclusions</u>	<u>Exclusions</u>
All goods used in the factory by the manufacturer of the final product	Light diesel oil, high speed diesel oil, Motor spirit commonly known as petrol
Any goods including accessories cleared along with the final product and goods used for providing free warranty.	Any goods used for the construction of a building or a civil structure or laying of foundation or making of structure for support of capital goods.
Similarly, goods used for generation of electricity or steam for captive use also constitute inputs.	Capital goods except when used as parts and components in manufacture of final products and also does not include the motor vehicles.
	Goods used primarily for personal use or

	consumption of any employee including food articles etc.
	Goods having no relationship with whatsoever with the manufacture of final product.

Definition of input service

For better understanding of the definition of input services, inclusions and exclusions which has been tabled below

<u>Inclusions</u>	<u>Exclusions</u>
Any service used by the provider of taxable service for providing output service or Used by a manufacturer whether directly or indirectly in relation to manufacture of final product and clearance of final product upto the place of removal	Architect service, port service, air port service, other port services, commercial or industrial construction service, works contract service and construction of residential complex when they are used in construction of building or civil structure or even when used for laying foundation or making structure for support of capital goods.
Services in relation to <ul style="list-style-type: none"> • Modernization or renovation or repairs of the premises of provider of output service or an office relating to such premises • Advertisement or sales promotion • Market research • Storage up to the place of removal • Procurement of inputs • Accounting, auditing, financing, recruitment and quality control, coaching and training, computer 	Services such as rent a cab service, general insurance service, authorised service station service and supply of tangible goods service shall not be available as credits, unless they are used by service providers who have been allowed to take Cenvat credit of duty paid on capital goods

<p>networking, credit rating, share registry and security, business exhibition, legal service)</p> <ul style="list-style-type: none"> • Inward transportation of inputs or capital goods and • Outward transportation up to the place of removal 	
	<p>Services such as those provided in relation to outdoor catering, beauty treatment, health service, cosmetic and plastic surgery, membership of a club, health and fitness centre, life insurance, health insurance and travel benefit extended to employees on vacation such as leave or home travel concession, when such services are used primarily for personal use or consumption of any employee.</p>

Note : The limb "such as activities in relation business" have been deleted in this budget.

The service provider providing taxable services is entitled to avail cenvat credit of the service tax on input services as well as excise duty charged on inputs and capital goods used for providing such taxable service. This credit can be used by him to pay off his liability on his services. This would reduce his outflow in cash on account of service tax. Eg – If his liability is Rs. 10000/- and he has credits of Rs. 4500/-, he utilizes this and pays only Rs. 5500/- in cash. The credit of service tax on input services (eg. Telephone service, management consultancy, professional services, security service etc) would be available once the payment has been made to the input service provider for the value of services including the service tax amount.

Further there is a change in time of availment of cenvat credit on input services: Earlier to 1.4.2011, the credits could be availed making payment of invoice.

- ✓ The Cenvat Credit on input services can be availed on receipt of invoice. However the payment has to be made within three months. This is effective from 01.04.2011 irrespective of the fact that the service provider may be continuing to pay service tax on payment basis.
- ✓ If the payment is not made within three months, then the credit availed has to be reversed/paid. However the same can be taken back as credit on making payment.
- ✓ If subsequent to payment made or invoice received, a amount is received back or credit note is received, when the value of service is renegotiated or altered for any reason the credit availed to that extent requires to be reversed/paid.
- ✓ Credit on the invoices issued prior to 01.04.2011 by the service provider would continue to be eligible only on payment basis and not on receipt of invoice.

Utilisation of Cenvat credits: -

One important aspect the service provider has to be careful about is the taxability of the service he provides. The term “output service” has been defined to mean taxable service. By virtue of Rule 3(4) of CCR 2004, the service provider who avails Cenvat Credit on inputs, capital goods or on input services is supposed to utilize the credits either for –

- ✓ Payment of excise duty on any final product or
- ✓ Payment of service tax on output service (as defined above). (In other words, he can use it for payment of service tax on taxable service provided) or
- ✓ Reversal of Cenvat credit availed on inputs when the inputs are removed as such or after partial processing or
- ✓ Reversal of Cenvat credit on capital goods where the capital goods have been removed as such or
- ✓ Payment of amount as required u/r 16(2) of Central Excise Rules 2002 (reversal of Cenvat or payment on transaction value in case of clearance of goods, which had been brought back to the factory for repairs, etc.)

The credit of education cess (whether on input services or excisable goods) is to be used for payment of education cess and also the credit of SHE cess (whether on input services or excisable goods) is to be used for payment of SHE cess.

Refund of Cenvat credit (Rule 5 of CCR 2004): -

Where any input or input service is used in providing output service which is exported, the Cenvat credit in respect of that input or input service can be utilized by the provider of output service towards payment of service tax on output service. In case such utilization is not

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possible, the provider of output service shall be allowed a refund of such amount subject to conditions set forth in the notification. The relevant notifications are 11/2005-SST and 12/2005-ST.

This refund shall not be allowed where the provider of output service avails of drawback under the Customs and Central Excise Duties drawback rules 1995 or claims rebate of duty under Central Excise Rules 2002 or claims rebate of service tax under Export of Services Rules 2005 in respect of such duty/tax as the case may be.

Document for availing cenvat credit: -

The document for availing Cenvat credit on inputs or input services shall be as per the requirements of Rule 9 of Cenvat Credit Rules 2004. The document could be an invoice issued by a manufacturer (including clearances from depot or premises of consignment agent), importer or a registered first stage or second stage dealer, bill/challan of Input Service Distributor, bill of input service provider, a supplementary invoice, bill of entry, challan evidencing payment of service tax in case of specified services, a certificate issued by appraiser of customs.

Supplementary invoice, bill or challan issued by a provider of output service, which should be in terms of the Service Tax Rules, 1994 is also added as one of the documents on which credit can be availed. However if such invoice is raised by the service provider in cases where such additional amount of tax became payable by him on account of fraud or collusion or wilful mis-statement or suppression of facts or contravention of any of the provisions of the Finance Act or of the rules made thereunder with the intent to evade payment of service tax, then it would not be considered as eligible document for credit

Transfer of Cenvat credit: -

Where a provider of output service shifts or transfers his business on account of change in ownership or on account of sale, merger, amalgamation, lease or transfer of business to a joint venture, Rule 10(2) of Cenvat Credit Rules 2004 allows him to transfer the credit lying unutilized in his books, to such transferred, sold, merged, leased or amalgamated business provided such transfer as aforesaid also includes a transfer of liabilities of the business. Where the credit on inputs (in stock) or capital goods are sought to be transferred, even such inputs in stock or capital goods as the case may be are to be transferred to the new site/business and accounted properly to the satisfaction of DCCE/ACCE.

Recovery of Cenvat credit wrongly taken or refunded: -

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Where the cenvat credit has been taken wrongly or wrongly utilized by the service provider or has been wrongly refunded to him, the same can be recovered from him by virtue of Rule 14 of CCR 2004 and the provisions of section 73 (recovery) and 75 (interest on delayed payment) of the Finance Act shall also apply. Such interest has to be paid from date of availing the cenvat credit and not from date of utilizing same. This has also been held in UOI vs. Ind-Swift Laboratories Ltd (2011 (265) ELT 003(SC)).

Other changes in Cenvat Credit Rules

- A. Rule 3(5B) is also amended and now the rule requires that the Cenvat credit availed to be paid back even if the Cenvat availed inputs or capital goods are partially written off. Earlier it was required only when the goods are fully written off. This change is effective from 1st March 2011.
- B. Rule 4 is amended to state that the Cenvat credit would be allowed even on capital goods which is received outside the factory and used for generation of electricity for captive used in factory. Earlier Cenvat Credit is available only on capital goods which are used in the factory

Receipt of services from outside India

Where any service covered by section 65(105) is –

- ✓ Provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and
- ✓ Received by a person (hereafter referred to as the recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India,

Then, such service shall, for the purposes of this section, be the taxable service and such taxable service shall be treated as if the recipient had himself provided the service in India (unless such recipient is an individual and the service is received for purposes other than for use in any business or commerce).

Where the service provider has his business establishment both in that country as well as in some other country, the country where the establishment concerned directly with the provision of service is located, shall be treated as the country from where the service is provided or to be provided.

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Where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section.

Where a person carries on a business through a branch or agency in any country he shall be treated as having a business establishment in that country.

Usual place of residence in relation to a body corporate means the place where it is incorporated or otherwise legally constituted.

The central government has notified the Taxation of Services (Provided from outside India and Received In India) Rules 2006 vide notification 11/2006-ST dated 19.04.2006 by virtue of the power granted by section 94 read with section 66A of the Finance Act.

TAXATION OF SERVICES (PROVIDED FROM OUTSIDE INDIA AND RECEIVED IN INDIA) RULES 2006

As per the Taxation of Services(Provided from Outside India and Received in India) Rules, 2006, the import of services has been structured by breaking up the services into three groups/sectors with a condition attached to such group as under.

- based on the situation of immovable property – If the property is situated inside India;
- based on the performance of service – If the performance is either fully or partially performed inside India; and
- based on the location the recipient of service. – If the recipient of service is located inside India.

Rule 3: - Taxable services received from outside India

The following services (illustrative) shall be treated as taxable services in the hands of the receiver if such services are provided or to be provided in relation to an immovable property situated in India –

- ✓ General Insurance business provided by an insurer under section 65(105)(d)
- ✓ Architectural service u/s 65(105)(p)
- ✓ Interior decorator's service u/s 65(105)(q)
- ✓ Real estate agent's service u/s 65(105)(v)
- ✓ Commercial or industrial construction service u/s 65(105)(zzq)

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- ✓ Site formation, clearance, excavation and earthmoving and demolition services u/s 65(105)(zzza)
- ✓ Dredging services u/s 65(105)(zzzb)

The following services (illustrative) shall be treated as taxable services in the hands of the receiver if such services are performed in India. Even where the service is partly performed in India, it shall be treated as performed in India.

- ✓ Services by a stock broker in connection with sale or purchase of listed securities u/s 65(105)(a)
- ✓ Services by a courier agency in relation to door to door transportation of time sensitive documents, goods or articles u/s 65(105)(f)
- ✓ Services by a customs house agent in relation to entry or departure of conveyances or the import or export of goods u/s 65(105)(h)
- ✓ Services by a steamer agent in relation to a ship's husbandry or dispatch or any administrative work related thereto as well as the booking, advertising, canvassing of cargo u/s 65(105)(i)
- ✓ Clearing and forwarding agent's services u/s 65(105)(j)

In respect of other services not covered in any of the aforesaid categories, the service shall be a taxable service in the hands of the recipient if such services are received by a recipient located in India for use in relation to business or commerce.

However, under this clause, the following services are excluded -

- ✓ Services in relation to sponsorship (not being sponsorship of sports events) to any body corporate or firm u/s 65(105)(zzzo)
- ✓ Services in relation to transport of persons by a cruise ship, embarking from any port or other port in India u/s 65(105)(zzzv)
- ✓ General Insurance business provided by an insurer under section 65(105)(d) so far as it does not relate to immovable property
- ✓ Survey and map making services u/s 65(105)(zzzc) so far as it does not relate to immovable property
- ✓ Auction of property u/s 65(105)(zzzr) so far as it does not relate to immovable property

Rule 4: - Registration

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The person who receives taxable services in India from outside India shall be required to make an application for registration and the provisions regarding registration as covered earlier would be applicable here.

Rule 5: - Treatment of such services received from outside India

The taxable services provided from outside India and received in India shall not be treated as output services and the receiver would not be entitled to avail credit of excise duty paid on input or service tax paid on any input services, as per Cenvat Credit Rules 2004.

Export of services

The central government has been granted powers to make rules by virtue of section 94 of the Finance Act. These rules may provide for –

- ✓ Determining export of taxable services
- ✓ Exemption to/granting rebate of service tax paid on taxable services exported out of India
- ✓ Rebate of service tax paid or payable on the taxable services consumed or duties paid or deemed to have been paid on goods used for providing taxable services which are exported out of India
- ✓ Rebate of service tax paid or payable on the taxable services used as input services in the manufacturing or processing of goods exported out of India u/s 93A

Power to grant rebate

Section 93A of the Finance Act has granted powers to the central government to grant rebate of service tax paid on taxable services which are used as input services for the manufacturing or processing of goods which are exported or for providing taxable services which are exported. Rebate shall be granted to the extent and in the manner prescribed.

Where rebate is granted under this section and the sale proceeds/consideration is not received by the exporter in India within the time allowed by RBI, the rebate shall be deemed never to have been allowed. The government shall then go about the task of recovering such rebate.

By virtue of the powers granted by section 94, the central government has notified vide notification 9/2005-ST dated 03.03.2005, the Export of Services Rules 2005. These rules have been in force from 15.03.2005

Export of services rules 2005

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Rule 3: - Export of taxable services

When the service will be considered as Export of Service

As per the Export of Service Rules, 2005, the export of services has been structured by breaking up the services into three groups/sectors with a condition attached to such group as under.

- based on the situation of immovable property – If the property is situated outside India;
- based on the performance of service – If the performance is either fully or partially performed outside India; and
- based on the location the recipient of service. – If the recipient of service is located outside India.

Presently in addition to the above condition depending upon the category of services, the service provider has to additionally fulfill one more condition i.e. for such service the consideration should be received in convertible foreign exchange.

However prior to 28.02.2010, there was one more additional condition that such services should be provided from India and used outside India. (earlier to that the said condition was such services should be delivered outside India and used outside India)

The following services (illustrative) shall be regarded to have been exported if such services are provided in relation to an immovable property situated outside India –

- ✓ General Insurance business provided by an insurer under section 65(105)(d)
- ✓ Architectural service u/s 65(105)(p)
- ✓ Interior decorator's service u/s 65(105)(q)
- ✓ Real estate agent's service u/s 65(105)(v)
- ✓ Commercial or industrial construction service u/s 65(105)(zzq)

In the following cases (illustrative), the services shall be treated as having been exported if the services are performed outside India. Where the service is partly performed outside India, the service shall be treated as performed outside India.

- ✓ Services by a stock broker in connection with sale or purchase of listed securities u/s 65(105)(a)
- ✓ Services by a courier agency in relation to door to door transportation of time sensitive documents, goods or articles u/s 65(105)(f)

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- ✓ Services by a customs house agent in relation to entry or departure of conveyances or the import or export of goods u/s 65(105)(h)
- ✓ Services by a steamer agent in relation to a ship's husbandry or dispatch or any administrative work related thereto as well as the booking, advertising, canvassing of cargo u/s 65(105)(i)
- ✓ Clearing and forwarding agent's services u/s 65(105)(j)

Rule 4: - Export without payment of service tax

Any taxable service may be exported without payment of service tax. Thus, by virtue of Rule 4, no payment of service tax is needed where the taxable service is exported in accordance with these rules.

Rule 5: - Rebate of service tax

The central government can grant rebate of service tax paid on taxable service exported or service tax or duty paid on input services or inputs used in providing such taxable service. This rebate shall be granted through a notification and the rebate shall be subject to such conditions or limitations specified in the notification.

The central government has therefore come out with two notifications regarding rebate of service tax. The notifications are 11/2005-ST dated 19.04.2005 and 12/2005-ST dated 19.04.2005

Important Exemptions

Exemption on value of materials sold –

The Notification No.12/2003-ST dated 1.3.2003, provides for an exemption of value of goods and materials sold by the service provider to the recipient of service, from the service tax. Where the materials are consumed in providing the service and not sold as goods to the service recipient, it cannot be said to be sold, within section 2(h) of the Central Excise Act, 1944. section 2(h) of The Central Excise Act,1944 defines sale and purchase means any transfer of possession of goods by one person to another in the ordinary course of trade or business for cash or deferred payment or other valuable consideration.

Even if the inputs are not indicated in bills and invoices raised the benefit cannot be denied. The goods sold while providing service are not liable to service tax as that would amount to Sales tax, which constitutionally is State subject and not that of Union. The service tax can be levied

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only on the taxable event of service and sales tax on sale. Therefore the aspect of sales would be exempted from service tax.

In fact the Tribunal in case of Adlabs v. Commissioner — 2006 (2) S.T.R. 121 (Tribunal) and in case of Shilpa Color Lab. v. Commissioner — 2007 (5) S.T.R. 423 (Tribunal) [upheld by Supreme Court] has held that the benefit of exemption of value of materials cannot be denied on the ground that invoice does not contain such value.

Small Service Provider Exemption

Notification 6/2005-ST dated 01.03.2005 as amended provided an exemption on aggregate value of taxable services upto rupees 10 lakhs. This exemption does not extend to the taxable services provided by a person under a brand name or a trade name (whether registered or not) of another person as well as to a case where tax is payable u/s 68(2) of the Finance Act by a person (who may not be the service provider) notified by the Central Government.

The said exemption is governed by the Notification No. 6/2005-ST dated 01.03.2005, wherein it gives exemption for service providers who provide taxable services of a value not exceeding the specified limit (presently Rs. 10 Lakhs) in the previous financial year. The exemption that would be available is the amount of taxable value received in the current financial year upto the specified limit mentioned above. **It is relevant to note that for considering the eligibility the value of taxable services provided is to be considered, whereas for the purpose of availing exemption it is the value of taxable services received in the current financial year.**

Following are some of the issues which are raised while the said exemption is availed:

- (a) The billing is done on accrual basis- The billing could be done without charging service tax, while availing exemption in the current year. A question may arise, whether when receipts happens in current year after exceeding Rs 10 Lakhs (may be inclusive of previous year's billings received in current year), could lead to a situation which could result into the service provider has to make payment of service tax out of his pocket. As the receipt happens after crossing the exemption limit.
- (b) Even when the service tax is charged to customer by mistake while availing exemption, there is a possibility that the same would be considered as opting out of exemption. After such charging, the benefit of exemption would not be available for the rest of financial year.
- (c) Does the service tax collected by mistake while availing exemption, to be remitted? Here it should be noted that section 73A provides that service tax collected has to be remitted/deposited to the Central Government Treasury.

- (d) Does aggregate amount for exemption include payments which are exempted from service tax? The aggregate value not exceeding Ten Lakh rupees means the sum total of first consecutive payments received during a financial year towards the taxable services charged, irrespective of the fact that the said services are provided in the current financial year or earlier financial year. **However the aggregate amount does not include payments received towards such gross amount, which is exempt from whole of service tax leviable.** Therefore any amount received which is exempt from whole of service tax should not be included.
- (e) Can the abatement claimed under any other notification should be excluded as exempt as mentioned above? In the opinion of the paper writers what is excluded is payments received towards such **gross amount which is exempt from WHOLE OF SERVICE TAX leviable.** When the abatement is being availed the **gross amount** is not **wholly exempt from service tax leviable.** Therefore the same cannot be excluded while computing the aggregate value for exemption limit.
- (f) Whether the value of exports needs to be included in the value of exemption limit? IN the opinion of the paper writers, the same are exempt wholly from payment of service tax leviable on the same. Therefore the same should not be included.

Other specified exemptions

- ✓ Services provided to United nations or an International Organization
- ✓ Exemption on services provided to a developer of Special Economic Zone or a Unit of a Special Economic Zone (Notification 11/2011 ST dated 1.03.2011)
- ✓ Exemption to services provided by or to the Reserve Bank of India (22/2006-ST dated 31.05.2006)
- ✓ Specific Concessions by way of Abatement in Notification No.1/2006-ST

VALUATION-Section 67

Where service tax is to be charged on any taxable service with reference to its value, then such value shall –

- ✓ Be the gross amount charged by the service provider for such service provided or to be provided by him (where the provision of service is for a consideration in money)
- ✓ Be such amount, as with the addition of service tax charged, be equivalent to the consideration (where the provision of service is for a consideration not wholly or partly consisting of money)

- ✓ In a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

Where the gross amount charged is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, be equal to the gross amount charged.

One important changes which brought out from the date of introduction of Service Tax (Determination of Value) Rules, 2006 is that by virtue of Section 67 (4), subject to the provisions of Section 67(1), 67(2) and 67(3), the value for taxable services shall be determined in such manner as is prescribed in Service Tax (Determination of Value) Rules, 2006.

Now the question arises whether the provisions set out in Service Tax (Determination of Value) Rules, 2006 can go beyond the provisions of Sub-Sections (1),(2) & (3) of Section 67 which all speak only about gross amount charged for such i.e. taxable service. In my view, there is no deeming fiction created in Section 67 to say all the cost and expenditure incurred by the service provider in the course of providing services should be included in the term consideration.

Whether re-imburements are includable within the value of taxable services after to 18.04.2006

After 18.04.2006, the centre of dispute lies with introduction of Rule 5 of the Service Tax (Determination of Value) Rules, 2006, wherein it says “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.”

The primary aspect to be examined is when service provider is paying any amount on behalf of service receiver, can it be said that service provider has incurred “Expenditure” or “Cost”. In view of paper writer, there is a possibility to argue that such amounts paid on behalf of service receiver cannot be considered as either cost or expenditure. The same would be a capital expenditure as it is current asset recoverable from the service receiver and not a revenue item.

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Also it is relevant to note that if the same payments are made by the service recipients, it is expenditure or costs by them but not cost or expenditure for the service provider. But if the said amount is paid by the service recipient, the same would not become part of taxable value (as there is no specific provision for the same). Therefore for the same service there cannot be different value merely by the fact that the person paying for the same is different. However the above arguments are subject to judicial scrutiny and are yet to conclude in judicial forum.

Without getting into legal entangles, if the assessee wants to comply with the provisions, then as per the present interpretation being placed by the revenue authorities, all amounts collected by the service provider from the service receiver is subject matter of service tax except in case where the amounts are received as pure agent and fulfill the specified conditions. Accordingly the service tax has to be charged including the amounts collected as reimbursements unless it can be established that such amounts are received as pure agent and also fulfill the specified conditions.

What is the concept of Pure Agent

As per Explanation (1) to Rule 5(2) of Service Tax (Determination of Value) Rules 2006, pure agent means a person who-

- i. Enters into a contractual agreement with the recipient of service to act as his pure agent to incur expenditure or costs in the course of providing taxable service
- ii. Neither intends to hold nor holds any title to the goods or services so procured or provided as pure agent of the recipient of service
- iii. Does not use such goods or services so procured and
- iv. Receives only the actual amount incurred to procure such goods or services

From the above provision it can be seen practically there will be difficulty in fulfilling the above conditions. As an sample it is explained as follows:

- a. There may not be written agreement in most of the cases. Even if there is one, it will not be so specific to mention this aspect.
- b. Title to goods can be understood. But title to services is very difficult. For example, if a chartered Accountant is travelling for auditing by train, whether he holds the title to such service or the client holds the title to such service.
- c. Further if the invoice for the goods are services are in the name of service provider, then the title can be said to have been held by the service provider and the condition is violated.

- d. The usage condition is again would create lot of difficulty. In the same example above the travelling services is being used by the Chartered Accountant. Similarly when a stay in hotel the services are being used by the Chartered Accountant. Therefore the condition is violated.

What are the additional conditions which are to be fulfilled by the pure agent.

As per Rule 5(2) of Service Tax Determination of Value Rules, 2006 following are the additional conditions which are required to be fulfilled to claim exclusion from the taxable value.-

- i. Service provider to act as a pure agent of the recipient of service while making payment to third party for the goods or services procured
- ii. Service receiver to receive and use the goods or services procured by the service provider on his behalf
- iii. Service receiver to be liable to make payment to the third party
- iv. Service receiver to authorise the service provider to make payment on his behalf
- v. Service receiver to know that the goods and services, for which payment has been made by the service provider, shall be provided by the third party
- vi. The payment made by the service provider on behalf of the recipient of service is to be separately indicated in the invoice issued by the service provider to the recipient of service
- vii. The service provider recovers from the recipient of service only such amount as has been paid by him to the third party
- viii. The goods or services procured by the service provider from the third party as a pure agent of the recipient of service are in addition to the services he provides on his own account

Again as can be seen from the above conditions, practically it is difficult to fulfill all the above conditions simultaneously. If one of the conditions is not fulfilled, then the benefit of exclusion is not available.

Any person who is willing to claim the benefit of the above exclusion as a pure agent, then it is advisable to have appropriate documentation to establish all the factors mentioned above.

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Rule 7: - Consideration where the service is provided from outside India

Rule 7 (1) of Service Tax (Determination of Value) Rules 2006 states that the value of taxable service received under section 66A shall be the amount of **actual consideration** charged for the service.

This principle when applied to Valuation Rules can lead to an inference that when there was a Rule 5(1) providing for expenses to be included in consideration, by enacting Rule 7 in the same Rules, the intent of the legislature is for actual consideration to be value of taxable service when a service is provided from outside India.

Filing of returns by a service provider

The obligation to furnish returns has been imposed on persons liable to pay service tax, by section 70 of the Finance Act 1994.

As per rule 7 of Service Tax Rules 1994, every assessee is required to submit half-yearly returns in Form ST-3 or Form ST-3A (as the case may be) with relevant copies of Form GAR 7, in triplicate by the 25th day of the month following the end of the relevant half-year. Form ST-3A is to be used in addition to the service tax return where a deposit is to be made provisionally (i.e. the assessee has opted for provisional assessment). The returns are to be filed for the half year ending September and for the half year ending on 31st March.

Wef 1.10.2011 all assessees irrespective of the amount of service tax paid in cash by them in preceding financial year is required to file the returns electronically. (Notification no.43/2011-ST).

Show Cause Notice and demand

Section 73 of the Finance Act 1994 has given powers to the CEO (Central Excise Officer) to serve a SCN (Show Cause Notice) on the person chargeable with service tax as to why he should not pay the amount specified in the notice. This can be done where the service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded. Generally, the time limit to issue SCN is one year from the relevant date unless such short payment/ non-levy/refund was by reason of fraud or collusion or willful mis-statement or suppression of facts or contravention of the provisions of Chapter V or rules made thereunder with the intent to evade payment of service tax. In such cases, the time limit would be five years. Where the service of the SCN has been stayed by a court order, the period of such stay will be excluded in computing the aforesaid period of one year or five years as the case may be.

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The CEO shall consider the representation from the assessee's (person on whom notice is served) side and determine the amount of service tax due. Once the amount is determined, the same shall be paid.

Determination of demand after issue of notice. Section 73(2) The provisos to this sub-section have been omitted. The provisos had set out that where the service tax was paid in full together with interest and 25% penalty within 30 days, u/s73 (1A) the proceedings were deemed to be completed. Where part payment was made, the officer would determine the amount of service tax or interest in excess of such amount that was partly due.

Relevant date" has the following meaning –

- ✓ Where the service tax has been short levied or short paid or not levied and a return has been filed, the date on which the return is filed
- ✓ Where the service tax has been short levied or short paid or not levied and a return has not been filed, the last date on which return was to be filed
- ✓ Where the service tax has been short levied or short paid or not levied and the aforesaid two cases are not attracted, the date on which service tax is to be paid
- ✓ Where the service tax is provisionally assessed, the date of adjustment of service tax after final assessment
- ✓ Where any service tax has been erroneously refunded, the date of such refund

New section 73(4A) is inserted wef 1.4.2011

This is inserted by the Finance Act, 2011 setting out that where in course of audit or investigation or verification, it is found there is short levy/non-levy/short paid/not paid service tax or erroneous refund but transactions are in records, the service tax paid fully or partly, along with interest and penalty at 1% of such tax, for each month where default continues, upto 25% of tax amount before notice is issued and inform the CE officer in writing of same. After receipt of same, the notice would not be served u/s73(1) and such proceedings in respect of such amount shall be concluded. Any additional amounts could be collected as determined is payable by the CE officer.

Interest for delayed payment

Section 75 of the Finance Act requires a person liable to pay service tax, to pay interest where there is a delay in payment of tax and the interest shall be at a rate notified by the central government not below 10% but not exceeding 36% per annum. The rate fixed for the present is 13% w.e.f.10.9.2004. This rate is increased to 18% wef 1.4.2011.

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In case the assessee has provided taxable service not exceeding Rs.60 lakhs during any financial year covered under the notice or in the preceding financial year then the interest would be at the rate of 15%. This is by a proviso inserted to section 73B.

Service tax collected in excess: -

The Finance Act 2006 has introduced section 73A which deals with cases where the person liable to pay service tax has collected service tax in excess of the amount he is liable to pay. Even where service tax is collected by a person who is not required to pay service tax, the same has to be deposited to the credit of the Central government.

Where any such amount as aforesaid is to be credited to the government and such amount has not been paid, the Central Excise officer is empowered to serve a notice (SCN) on the concerned person. After hearing the representation from the assessee's side, he shall determine the amount due and it shall be payable by the assessee. Where he has already paid any amount, the same shall be adjusted against his liability at the time of final assessment.

In case any amount is paid in surplus, the same shall be credited to the consumer welfare fund referred to in section 12C of the Central Excise Act 1944. Where a refund is sought, the same shall be in accordance with section 11B of the Central Excise Act 1944.

Provisional attachment Sec. 73C

The central excise officer is empowered to attach provisionally any property belonging to the person on whom notice is served u/s 73 or 73A for the purpose of protecting the interests of revenue. This attachment can be done after approval has been obtained from the Commissioner of Central Excise in this regard and can be done during the pendency of proceedings under the aforesaid sections. An order is to be passed in writing for this purpose. The provisional attachment order shall be in force for six months and this can be extended by the Chief Commissioner of Central Excise in such a way that the total period of extension does not exceed two years.

Recovery of amounts: -

1. The Finance Act 2006 has given additional powers to the Central Excise Officer (CEO) through section 87 to deduct or to require any other Central Excise Officer or officer of customs to deduct the amount payable to the government from any other amount due to such person who has not paid any amount due to the government. This can be done if such other central excise officer or officer of customs is in possession of amounts due to such person.

2. The CEO can even require any other person from whom money is due or may become due to such person who has defaulted, to pay to the credit of the government such amount as may be required to meet the liability. A notice is served on the person for this purpose. Where the notice is issued to a bank, post office or an insurer, it would not be necessary to produce any pass book, deposit receipt, policy or any other document for the purpose of making an entry or endorsement before payment.
3. Where the person to whom a notice is issued fails to make the payment, he himself shall be deemed to be an assessee in default.
4. Under section 87(c) of the Finance Act, the CEO on an authorisation of the CCE may detain any movable or immovable property belonging to or under the control of such person and detain the same until the amount payable is paid along with the cost of distress or keeping of the property. Where any such amount is due for more than 30 days from the date of distress, the property may be sold and the amount due realised. The balance left over after adjusting the cost incurred in making sales, will be paid to such person.
5. The CEO is also empowered to prepare a certificate specifying the amount due from such person and send it to the collector of the district in which such person owns any property or resides or carries on his business and such collector can proceed to recover the amount specified as arrears of land revenue.

Penalty

Section 76:

The penalty prescribed here is higher of:

- Amount not less than Rs. 100 per day for each day of delay continues. (However higher amount may be ordered)
- 1% p.m. on the tax payable from the first day after the due date till the actual date of payment.

No penalty under this section shall be imposed if the entire amount of service tax along with the interest has been paid before issue of show cause notice, in circumstances where the payment has aroused not for the reason of fraud, collusion etc,

Conditions: Amount payable under this section shall not exceed 50% the actual amount of service tax payable.

Section 77:

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Provisions of Section 77 provides for a general penalty where a person contravenes any of the provisions set out in the Finance Act, 1994 or rules made hereunder, for which no penalty has been specifically mentioned as a penalty not exceeding Rs.10,000. The minimum penalty here may be nil and the maximum may be Rs. 10,000.

Penalty which may extend up to Rs. 5000 or Rs. 200 for every day during which such failure continues from the due date to actual date of compliance, whichever is higher in the following cases:-

- Liable to take registration in terms of Service Tax Law but fails to do so.
- Failure to furnish information called by the office in accordance with the provisions of service tax.
- Failure to produce documents called for by the Central Excise Officer in accordance with provisions of service tax.
- Failure to appear before the Central Excise Officer when issued with summons for appearance to give evidence or to produce a document in an enquiry.

Penalty which may extend up to Rs. 10,000 in the following cases

- Failure to keep, maintain or retain books of account and other documents as required in accordance with the provisions of service tax law.
- Failure to pay tax electronically through internet banking, fails to do so.
- Issues invoice in accordance with the provisions of the Act or Rules made there under with incorrect or incomplete details or fails to account for an invoice in his books of account.
- Contravenes any of the provisions of Chapter V of Finance Act, 1994 or rules made there under for which no penalty is separately provided.

In any other case not specifically indicated the penalty shall not exceed Rs. 10,000

Section 78:

Where any service tax was not paid/short paid/not levied or short levied or erroneously refunded by reason of fraud, collusion or willful mis-statement or suppression of facts or contravention of provisions of this chapter or rules made thereunder, the person liable to pay would have to pay a penalty by virtue of section 78. as follows

⇒ Penalty:—Amount equal to service tax, which was not levied not levied or paid or short-levied or short-paid or erroneously refunded.(Section 78(1) 1st proviso)

- ⇒ However where the books provide all the details of the transaction, penalty would be reduced to 50% of service tax, which was not levied or paid or short-levied or short-paid or erroneously refunded.
- ⇒ Where the service tax and interest payable is paid within 30 days of communication of order of CE officer determining such service tax, the amount of penalty liable to be paid shall be reduced to 25% of service tax as determined. Where any amount is paid prior to communication of order the same would be adjusted against the total amount due from such person.
- ⇒ The benefit of such reduced penalty would be available only where the penalty so determined has also been paid within 30 days as aforesaid.
- ⇒ Where in case of a service provider the value of taxable services does not exceed 60 Lakhs during last preceding financial year or any of years covered by notice , the 30 days period set out above would extend to 90 days. Such 90 days would be computed from date of communication of order.
- ⇒ Where penalty is payable under this section , the provisions of section 76 would not be applicable.
- ⇒ Where any amount is paid prior to communication of order the same would be adjusted against the total amount due from such person.

First Charge on the Property: Section 88 Any amount of Duty, penalty, interest or any other sum payable by an assessee or any other person under the service tax provision shall have the first charge on the property of the assessee or the person as the case may be. However this is subject to the provision of

- 529A of the Companies Act, 1956
- Recovery of Debts due to Banks and the Financial Institution Act, 1993
- Securitisation and Reconstitution of the Financial Assets and the Enforcement of Security Interest Act, 2002.

Prosecution Section 89(1) This is introduced wef 1.4.2011

Any person committing the following offence would be liable for prosecution

- (a) provides any taxable service chargeable to service tax under sub-section (1) of section 68 or receives any taxable service chargeable to tax under sub-section (2) of said section, 20

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without an invoice issued in accordance with the provisions of this Chapter or the rules made thereunder; or

- (b) avails and utilizes credit of taxes or duty without actual receipt of taxable service or excisable goods either fully or partially in violation of the rules made under the provisions of this chapter; or
- (c) maintains false books of account or fails to supply any information which he is required to supply under this chapter or the rules made thereunder or (unless with a reasonable belief, the burden of proving which shall be upon him, that the information supplied by him is true) supplies false information; or
- (d) collects any amount as service tax but fails to pay the amount so collected to the credit of Central Government beyond a period of six months from the date on which such payment becomes due

The punishment would be as follows:

- a. Where the amount exceeds Rs 50 Lakhs with imprisonment for a term which can extend to 3 years. Where there is no specific reason to contrary to be recorded in judgment of court, such imprisonment shall not be less than for 6 months. In other case, such imprisonment may extend to one year.
- b. Where convicted person under this section once again is convicted of an offence then for each subsequent offence the imprisonment for a term which may extend to 3 years. Where there is no specific reason to contrary to be recorded in judgment of court, such imprisonment shall not be less than for 6 months.
- c. The following would not be considered as special and adequate reasons:
 - i. The fact that accused was convicted for the first time of an offence under this Chapter.
 - ii. The fact that in any other proceeding under this Act, other than prosecution the accused was ordered to pay penalty or any other action has been taken for same act which constitutes offence.
 - iii. The fact that accused was not principal offender and was acting as a secondary party in commissioning the offence.
 - iv. The age of accused.

A person can be prosecuted only with prior permission of Chief Commissioner of Central Excise.

OVERVIEW OF KVAT LAW

Introduction

Karnataka Value Added Tax is a tax on sale of goods. The KVAT law provides for setting off of the tax paid on inputs (goods purchased) against the tax payable on sale of goods to avoid the cascading effect of taxes. This concept was earlier used in Central Excise.

This can be explained with the help of an example. Suppose a dealer purchases goods worth Rs. 100 with a tax rate of 14.0% and makes a value addition of Rs. 50, in the absence of set off, he would sell the product to his customer at Rs. 164.00. If the tax rate on sale is 14.0%, the total value would be Rs. 186.96 with the tax payable being Rs. 22.96. If the set off is available, the price would be Rs. 150 with the tax on input being available for set off. The net tax payable being Rs. 8.96. This can be used for setting off by the customer where he himself happens to be a dealer. This in effect is the tax on his value addition alone.

Under KVAT Act, the set off available is of tax paid under this Act and not under any other Act. In other words, where CST is paid on interstate purchase, the same will not be available for set off though KVAT paid on inputs used in interstate sales can be set off against CST payable on such interstate sales.

Under this law, the concept of sale, dealer and goods assume importance.

Goods generally include movable property with the exception of newspaper, actionable claims, stocks and shares and securities. It includes articles involved in the execution of works contract as well.

As per Section 2 (29) of the VAT Act, "sale" with all its grammatical variations and cognate expressions means every transfer of the property in goods (other than by way of a mortgage, hypothecation, charge or pledge) by one person to another in the course of trade or business for cash or for deferred payment or other valuable consideration. This includes transfer of rights to use goods as well as delivery of goods on hire purchase basis. Even where goods are transferred during the execution of works contract the same would be covered under this

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definition. Transfer of property in goods by government/local authorities/statutory bodies would be covered even if such transfers are not in course of business.

Even distribution of goods by clubs or associations to members would be covered.

“Dealer” means any person who carries on the business of buying, selling, supplying or distributing goods, directly or otherwise, whether for cash or for deferred payment, or for commission, remuneration or other valuable consideration. Even a casual trader would be covered. The definition also covers government undertakings. Clubs/associations/societies would be dealers if they distribute goods to members (whether or not in course of business). Once the dealer ascertains as to whether the transaction amounts to a sale or not as aforesaid, he has to find out whether it is a sale within the state of Karnataka. Where the transfer of right to use goods is involved, sale is said to be within the state if the goods are for use within the state. The sale is normally said to have taken place at the time of transfer of title or possession or incorporation of goods in the course of execution of works contract whether or not there is receipt of payment.

Where an invoice is raised within 14 days from the date of sale, the sale shall be deemed to have taken place at the time the invoice is raised.

The dealer will have to pay applicable taxes on sales to 100% EOU or to a SEZ unit. SEZ unit or a developer of SEZ would be entitled to refund of tax paid by them on their inputs as section 20 has been amended in this year’s budget. The 100% EOU if it desires has to go in for refund under normal scheme under KVAT. Further, input tax on goods used for exports is not restricted under the law.

The importance of this definition stems from the fact that i

Registration under KVAT Act

Who is liable to register?

A dealer is liable to register under the KVAT Act when -

- ✓ His taxable turnover is likely to exceed rupees five lakhs during any year
- ✓ His taxable turnover exceeds twenty five thousand rupees in any one month
- ✓ A business or part of a business is transferred to him by another dealer liable to register but who has not registered
- ✓ He obtains or brings goods from outside the state whether as a result of purchase or otherwise
- ✓ He exports goods outside the country

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- ✓ He effects a sale in the course of interstate trade or commerce or dispatches goods to a place outside the state
- ✓ He is a casual trader or a non-resident dealer or his agent
- ✓ He is involved in the execution of works contract

The registration is granted only from the date of application or from the date of commencement of business whichever is later.

Cancellation of registration may be needed where -

- ✓ Any business has been discontinued, transferred or disposed off or
- ✓ There is a change in the status of the ownership of the business or
- ✓ The taxable turnover during twelve months does not exceed rupees two lakhs or
- ✓ Death of a proprietor (legal heirs can apply for cancellation)

Dealers not registered

Where a dealer purchases his inputs from another dealer who is not registered under the Act, the purchasing dealer will be liable to pay tax on his purchases.

Tax invoice under KVAT

A dealer making a taxable sale is required to issue a tax invoice for such sale. In case of sale of exempt goods or if the dealer pays tax under composition scheme, he is to issue a bill of sale. The tax invoice like the invoice under Central Excise is a valuable document based on which the buyer is admissible for input/ capital goods set off. Even computerized invoices can be issued subject to safeguards. The amendments have even made usage of digital signatures possible.

Stock transfer notes

Where goods are not sold and are transferred, they should be accompanied by a stock transfer note in the prescribed form (VAT 515/505 as the case may be depending on the items involved). It is also the responsibility of every carrier of goods to ensure that valid documents in respect of such goods exist. This may be either a tax invoice or bill of sale or a stock transfer note in the prescribed form. Failure to follow this could result in goods being held up at check posts.

Now it is required for a registered dealer who transports goods either as a result of sale or otherwise to obtain the delivery note electronically. It is to be obtained following the instruction contained in the web site. This is called as e-sugam module. The details of the goods to be

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transported is to be entered in specified format appearing in the departmental website before the movement of goods commences.

This has been notified in No.Adcom(I&C)/AC/CR-22/2010-11 dt 25.1.2011.

Filing of return

The dealer shall submit the return in Form VAT 100 along with the document showing the proof of payment of tax, to the jurisdictional local VAT officer or sub-officer on or before the twentieth day from the end of the month pertaining to which the return relates. The return has to compulsorily filed electronically by every dealer paying tax commencing from the month ending 31st July, 2010 vide notification no.KSA/CR-60/2010-11 dated 5.8.2010.

Revised return under KVAT

Where the registered dealer having filed the return in the normal course, finds any omission or incorrect statement therein, other than as a result of an inspection or receipt of any other information or evidence by the prescribed authority, he can file a revised return within six months from the end of the relevant tax period.

This is however, subject to sub-section (2) of section 72 which states that the dealer shall be liable to penalty where he understates his liability or overstates his entitlement to tax credit by more than five percent of his actual tax liability.

Audit requirement

Where the turnover exceeds Rs. 60 lakhs, the accounts will have to be audited in accordance with section 31.

Input tax set off scheme

“Input” means any goods including capital goods purchased by a dealer in the course of his business for re-sale or for use in the manufacture or processing or packing or storing of other goods or any other use in business.

“Capital goods” means plant, including cold storage and similar plant, machinery, goods vehicles, equipments, moulds, tools and jigs whose total cost is not less than an amount to be notified by the government or the commissioner, and used in the course of business other than for sale.

Dealer is entitled to deduct input tax from the turnover. However, input tax is not deductible in the following cases –

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- ✓ Input tax paid on purchases attributable to the sale of goods exempted u/s 5 unless such goods are sold in the course of export out of the territory of India.
- ✓ Input tax paid by an agent purchasing or selling goods on behalf of any other person other than a non-resident principal.
- ✓ Input tax paid on goods specified in the Fifth Schedule and subject to such conditions as may be specified, purchased and put to use for purposes other than for resale or manufacture or any other process of other goods for sale.
- ✓ Tax paid on purchase of goods as may be notified by the Govt. or the Commissioner subject to specified conditions.
- ✓ Input tax paid on purchases attributable to naphtha, liquefied petroleum gas, furnace oil, superior kerosene oil, kerosene and any other petroleum product, when used as a fuel in motor vehicles.
- ✓ Input tax paid on purchase of fuel from unregistered dealers.
- ✓ Input tax on goods purchased by a dealer who is required to be registered under the Act, but has failed to register.

As per Section 14 of the Act, the deduction of input tax shall be allowed to the extent of the input tax charged at a rate higher than four percent or any other lower rate notified by the government in respect of the following purchases (this is presently 2%)–

- ✓ Purchases of goods that are dispatched outside the state (other than through sale), or are used as inputs in the manufacture, processing or packing of other taxable goods, which are dispatched to a place outside the state other than as a direct result of sale or purchase in the course of inter-state trade.
- ✓ Purchases of naphtha, liquefied petroleum gas, furnace oil, superior kerosene oil, kerosene and any other petroleum product used as fuel in the production of any goods for sale in the course of export out of the territory of India or taxable goods or captive power.

With regard to the capital goods input tax, the following may be noted as per Section 12–

- ✓ The input tax deduction is available in respect of the purchase of capital goods for use in the business of sale of any goods in the course of export out of the territory of India in case of registered dealer.
- ✓ Input tax deduction is also available in respect of purchase of capital goods wholly or partly for use in the business of taxable goods. In such cases the set off will be in the manner prescribed.

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- ✓ Deduction is available only after commencement of production, or sale of taxable goods or sale of any goods in the course of export out of the territory of India by the registered dealer.
- ✓ The deduction shall be available in one lump sum. The taxable turnover of the dealer should not be less than the limit fixed u/s 22(2) in the year of purchase in order to avoid a situation where set off is not available on capital goods. (Limit is Rs. 5 lakhs)

The rule deals with finding out the non-deductible input tax as follows -

(Sales of exempt goods + non taxable transactions) X total input tax

Total sales (including non-taxable transactions)

This amount has to be deducted from the total input tax to arrive at the deductible amount of input tax.

Note: - All input tax directly relating to sale of exempt goods is non-taxable. All input tax directly relating to taxable sales may be deducted, subject to provisions of Section 11. Purchase of petroleum items/fuel items specified u/s 11(6) shall be subjected to special rebating u/s 14 and if used towards both taxable as well as exempted activity/stock transfers outside state, to partial rebating u/s 17 as well.

Payment of VAT

The tax or any other amount under the Act or these Rules shall be paid by the dealer or any other person either in cash or by postal order, money order, crossed cheque or crossed demand draft which shall be drawn in favour of either the Registering authority, Jurisdictional local VAT officer or VAT sub-officer or any other authorized officer or by remittance into the Govt. treasury or SBI or its associate bank or any other bank approved by RBI (payment can be even by electronic remittance). The payment shall be along with a tax challan in Form VAT 152.

The tax is payable at the rates specified in the schedules with regard to the goods in question after setting of the input tax set off available.

Belated payment of VAT

Where the dealer having filed the return, fails to pay the tax declared on the return, he shall be liable for payment of interest u/s 37 at the rate of one and a quarter percent per month simple interest for the period of default.

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Adjusting VAT set off

Rules 127 (1) and 127 (2) provide for the adjustment of excess amounts of input tax towards tax payable for any other month or quarter in arrears under the KST Act 1957, CST Act 1956 or the KTEG Act 1979, Karnataka Special Tax on Entry of Certain Goods Act 2004.

- ✓ The input tax deductible should exceed the output tax payable u/s 10(5) or as per final return submitted at the time of cancellation of return (where the dealer is liable to pay tax).
- ✓ The adjustment can be made against the liability for any other month or quarter under this Act or under CST Act.
- ✓ Where adjustment is to be made against liability under the other Acts specified above, the dealer can apply to the LVO
- ✓ Even the LVO is empowered to make adjustment and issue notice in Form VAT 250.
- ✓ Where eligible, the dealer can get a refund u/r 128 after such adjustment as long as he complies with the requirements as to furnishing of details of purchases on website as notified by commissioner in certain cases.

Refund of VAT

The provisions pertaining to refund under KVAT can be examined in two ways -

- ✓ Rule 128(1) read with section 10(5) allows the dealer to get a refund where the input tax set off exceeds the output tax payable as per the return furnished and the adjustments as laid out under Rule 127 have been carried out as applicable. The law does not provide for a separate refund application in this case.
- ✓ In addition to the aforesaid provision section 47 of the Act read with rule 129 provides for filing a refund claim where amounts are wrongly collected from a dealer. This refund would not be available where the dealer from whom it has been wrongly collected has availed input tax deduction of the amount of tax paid.

Records

Every registered dealer and every dealer liable to pay tax under this Act, shall keep and maintain a true and correct account of all his purchases, receipts, sales, other disposals, production, manufacture and stock showing the values of goods subject to each rate of tax under this Act including the input tax paid and output tax payable.

VAT set off/credit ledger (Register of purchases)

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Rule 33(2) of KVAT Rules requires every dealer to maintain a register of purchases made within the state in Form VAT 170. This form has details of - Serial number, Date of entry, Input supplier name, TIN number of the supplier, Description of the goods. Tax invoice number and date, Value of the goods with rate wise segregation, Input tax amount with rate wise segregation.

Record keeping - Production

Rule 33 (1) requires every registered dealer and every person liable to be registered under the Act to keep and maintain a true and correct account of his daily transactions showing the goods produced, manufactured, bought and sold by him and the value thereof separately together with invoices and bills.

VAT account

Rule 33 (3) of KVAT Rules (Rule 33(3a) as per latest draft rules) requires a dealer to maintain a VAT account containing details as to the input and output tax together with the debit and credit notes issued during any tax period.

Debit notes and credit notes

Section 10 (4) of the VAT Act, allows the dealer to avail input tax deduction on the basis of a debit note or credit note, in relation to a sale, provided it is issued in accordance with Section 30 and is with the registered dealer taking the deduction at the time any return in respect of the sale is furnished. As per Section 30, these notes are to be issued containing the particulars as may be prescribed. As per Rule 31, a credit note or a debit note can be issued by a registered dealer who has given a tax invoice in respect of sale of goods and thereafter, the goods or any part thereof are returned, the sale is cancelled or the value of the sale is altered whether due to a discount or otherwise.

CST LAW AND PROCEDURE

Introduction

The provisions of K-Vat Act 2003 and the Rules made thereunder concentrates on the sale or purchase of goods within the State, whereas the provisions of C.S.T Act 1956 and the Rules made thereunder formulates the principles for determining,

- ✓ when a sale or purchase of goods takes place in the course of inter-state sales or purchases
- ✓ when a sale or purchase of goods takes place outside a State
- ✓ when a sale or purchase of goods takes place in the course of import into India
- ✓ when a sale or purchase of goods takes place in the course of export out of India

The CST law also,

- ✓ provides for the levy, collection and distribution of taxes on inter-state sale of goods.
- ✓ declare certain goods to be of special importance in the case of inter-state sales or purchases
- ✓ specify the restrictions and conditions to which the state laws imposing taxes on the sale or purchase of such goods of special importance shall be subject.

Registration of dealers

The dealers liable to pay tax under the C.S.T Act 1956 shall get themselves registered under the said Act. Further any changes in the information provided in the application for registration shall be intimated by the dealer, so that the prescribed authority may amend the registration certificate to reflect such changes.

Inter-state sales or purchases

A sale or purchase is considered as inter-state sales or purchases, if the sale or purchase,-

- ✓ results in the movement of goods from one state to another; or
- ✓ is effected by transfer of documents of title to the goods during their movement from one state to another.

Hence movement of goods from one state to another is must and should, for attracting levy under CST law. However where the movement of goods commences and terminates in the same state it shall not be deemed to be a movement of goods from one state to another by

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reason merely of the fact that in the course of such movement the goods pass through the territory of any other state.

Sale or purchase of goods outside the state

So far we have seen cases where goods are purchase and sold within the state (where provisions of K-Vat law is applicable) and purchase and sale of goods from our state to other state or from other state to our state. It may be noted that only in the aforesaid two categories of sales or purchases the Government of Karnataka can collect the revenue (directly or by way of allocation by the Central Government towards the share of CST). In other cases, that is where the sales or purchase of goods takes place outside the state, where there is no movement of goods from or to our state, the taxes are collected by the Central Government under the CST law and our State Government is not entitled to share of such tax. Thus it becomes critical to know when the sale or purchase of goods takes place outside the state.

As per Section 4 of the C.S.T Act 1956, when a sale or purchase of goods is determined to take place inside a state, then such sale or purchase shall be deemed to have taken place outside all other states.

A sale or purchase of goods shall be deemed to take place inside a state if the goods are within the state-

- ✓ in the case of specific or ascertained goods, at the time the contract of sale is made; and
- ✓ in the case of unascertained or future goods, at the time of their appropriation to the contract of sale by the seller or by the buyer.

Sale or purchase of goods in the course of exports

A sale or purchase of goods shall be deemed to take place in the course of export of goods only if the sale or purchase either occasions such export or is effected by a transfer of documents of title to the goods after the goods have crossed the customs frontiers of India.

Even the last sale or purchase of any goods preceding the sale or purchase occasioning the export of those goods shall also be deemed to be in the course of such exports, if such last sale or purchase took place after, and was for the purpose of complying with, the agreement or order for or in relation to such export.

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Sale of purchase of goods in the course of imports

A sale or purchase of goods shall be deemed to take place in the course of the import of the goods only if the sale or purchase either occasions such import or is effected by a transfer of documents of title to the goods before the goods have crossed the customs frontiers of India.

Liability to tax on inter-state sales

Every dealer shall be liable to pay tax under the C.S.T Act 1956, on all sales of goods effected by him in the course of inter-state sales. The CST is payable even though such goods are exempted under the local VAT laws of the state, if such goods are sold within the state. Exports are not taxed even under this Act.

Concept of subsequent sales in CST: However exemption is available to the 2nd & subsequent inter state sale provided such sale is effected by transfer of documents of title during the movement from one State to another.

The conditions to be fulfilled for availing this exemption are as follows:

- a. There must be an ISS by a registered dealer to another registered dealer/Government.
- b. During the movement of such goods from one state to another, a 2nd inter-State sale by transfer of documents of title should take place.
- c. Such transfer of documents should be either to the Government or to a registered dealer other than Government.
- d. The dealer who makes the first inter state sale should give Form E-I to the purchasing registered dealer /Govt. and obtain Form C/D as the case may be, from him.
- e. The registered purchasing dealer, who made the subsequent sale by transfer of documents of title, will issue Form E-II to the subsequent registered purchasing dealer / Government and must obtain C/D form from them.
- f. Similar procedure will be followed for any subsequent sale which may take place during the movement of such goods.

However no such certificate requires to be produced in the following cases,

- ✓ where such sale or purchase of goods is exempt from tax or subject to tax at a rate which is lower than two percent or such other rate as may be prescribed by the Government; or
- ✓ the dealer effecting such second time sale proves to the satisfaction of the prescribed authority that such sale is in the nature of second time sales.

No tax on inter-state stock transfer

As per Section 6 of the C.S.T Act 1956, no tax is payable in case of inter-state stock transfer if the dealer effecting such inter-state stock transfer furnishes to the prescribed authority a declaration in Form-F.

Rates of tax

The rate of CST prescribed under Section 8 of the C.S.T Act 1956 is as follows,

- ✓ two percent of his turnover; or
- ✓ at the rate applicable to the sale or purchase of such goods inside the state under the sales tax law of that state.

whichever is lower, subject to the satisfaction of the prescribed conditions and procedures.

Where the prescribed conditions and procedure is not satisfied then the rate of tax shall be the rate applicable to the sale or purchase of such goods inside the state under the sales tax law of that state. The Government can also prescribe the different rates for different products by way of a Notification. Further no tax is payable for sale of goods to SEZ units or to the Developer of SEZ.

Determination of turnover

As per Section 2 (j) of the C.S.T Act 1956, turnover means the aggregate of the sale prices received and receivable by the dealer in respect of inter-state sales of any goods, made during any prescribed period. However the following shall be deducted from the aggregate of the sale prices received and receivable by the dealer,

- ✓ amount of CST, if the aggregate of sale prices comprises of the same.
- ✓ value of goods returned to the dealer from the buyers, within six months from the date of sales
- ✓ such other deductions as the Government may prescribe.

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In case the dealer is registered under the local VAT laws of the state, then the tax period is same as that applicable under the local VAT laws, and in other cases, it is a 'quarter'.

Levy and collection of tax and penalties

The tax will be levied and collected by the Central Government from the state from which the movement of goods commenced. Even though the authority to collect CST is the Central Government, the authorities of the VAT law of the state are empowered to assess, collect and enforce payment of the CST. For this purpose the authorities of the VAT laws of the state are bestowed with the required powers of administration under the CST law. Hence the provisions relating to invoicing, record keeping, assessment, etc., as discussed under K-Vat chapter may be referred to.

Goods of special importance in inter-state trade

The Central Government has declared the following category of goods to be of special importance in the inter-state trade.

The following goods are declared as goods of special importance in inter-State trade:

Cereals (paddy, rice, wheat, ragi, barley.)	Oil seeds (Peanut, Til, Castor).
Coal.	Pulses (Black Gram, Green Gram)
Cotton, Cotton fabrics, Cotton yarn	Man-made fabrics
Crude oil	Sugar
Hides and skins (Both raw & Dressed).	Tobacco and its products
Iron and steel.	Woven fabrics of wool
Jute.	

The aforesaid items indicate the broad categories of goods declared and hence please refer Section 14 of the CST for the details of the goods declared. The following are the main restrictions and conditions imposed on such goods.

- ✓ No state shall levy tax on such goods above 4%, even on sales within the state
- ✓ In case any local VAT of the state is levied on such goods, the same will be reimbursed to the dealer, if such goods are sold in inter-state trade with payment of CST.

Important
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Concepts

in

Indirect

Taxes

WORKS CONTRACT

Introduction to Works Contract

The definition of sale under the constitution did not include goods incorporated in an indivisible works contract. Therefore the transfer of property in goods involved in the execution of the works contract was not liable for sales tax. After the 46th amendment, it has become possible for the states to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of goods and materials. This was because Article 366 (29A) specifically talked about taxing the transfer of property in goods involved in the execution of the said works contract as a deemed sale. This amendment created a legal fiction making the position of works contract on par with sale. Even the composite contract embodied in a single document would be deemed to be divisible for the purpose of levying sales tax.

The definition of dealer now includes a person engaged in the transfer of property in goods involved in the execution of works contract. The definition of goods includes goods as goods or in some other form involved in the execution of works contract. The definition of sale includes a transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract.

Where from the terms of the contract it is clear that the scope for execution is composite i.e. the contract involves the use of both materials and labour. The materials which are in use for the contract are in addition to the issue of materials free of cost if any. In our view, such contract is that of works contract liable to VAT on the goods involved in the execution of contract.

In the case of Hindustan Shipyard Ltd Vs State of Andhra Pradesh 119 STC 533, wherein it was observed that a contract to stitch suit as per cloth supplied by the customer is a contract for work and labour. However, if tailor promises to stitch and deliver a suit for a price agreed upon, investing his own cloth and stitching material, it will be sale even if customer might have chosen piece of cloth.

Further the Honorable Supreme Court in the case of Kone Elevators (I) Ltd 2005 (181) ELT 156 has observed that if the main object of contract is transfer of finished chattel at time of its delivery, it is contract of sale - If main object is work and labour and property passing by accession during the process of work on fusion to the movable property of customer, it is works-

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contract. Substance and terms of contract, customs of trade and circumstances/facts of each case are important to determine the nature of contract.

Therefore it is clear that the subject contract is works contract liable to VAT, as the said contract involves both labour and goods. The following are the options available for discharge of VAT:

- a. **Under composition:** Under this scheme, dealer would be liable to VAT at 4% on the gross amount of the contract. The dealer opting to discharge VAT on composition scheme would not be eligible for claiming input set off. It is also important to note that the department of commercial tax is also demanding to include the value of free supply materials for computing the liability, which in our view is not proper. The rate of 4% would not be applicable on the goods used in the contract which are procured from a place outside the state of Karnataka. On these goods, in the first instance, the dealer has to discharge the tax at applicable rates applicable in the state of Karnataka and reduce the same out of total turnover for the purpose of composition tax.
- b. **Under Regular Scheme (Actual Labour):** Under this scheme the assessee is eligible to deduct the actual labour, service and like charges, which are ascertainable from his records in terms of Rule 3(2)(l) of KVAT Rules 2005. The rate would be 14.0% as per Schedule VI to the KVAT Act 2003 on the value of materials transferred during the course of execution of the contract. The dealer opting to discharge VAT under this scheme would be eligible to claim input set off.
- c. **Under Regular Scheme (standard deduction):** Under this scheme the assessee is eligible to deduct a standard rate specified where he is unable to arrive at the actual labour, services etc. This situation would arise when the contractor is not able to quantify the value of materials involved in the execution of the contract. The rates are set out under Rule 3(2)(m) of KVAT Rules 2005. Even under this scheme, the set offs of input tax paid on purchases of materials for construction would be available to the contractor. Presently for civil construction it is 30%. That is to say VAT is payable on 70 % of the value of the contract.

Discussion under Service Tax on Works Contract:

The taxable service definition in this context Section 65(105)(zzzza) states – any service provided or to be provided, to any person, by any other person in relation to the execution of

works contract, excluding works contract in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams.

Explanation – For the purposes of this clause, “works contract means” means a contract wherein, -

- (i) Transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods, and
- (ii) Such contract is for the purpose of carrying out,-
 - (a) Erection, commissioning or installation of plant, machinery equipment or structures, whether prefabricated or otherwise, installation of electrical or electronic devises, plumbing, drain laying or other installations for transport of fluids, heating, ventilation or air conditioning including related pipe work, duct work and sheet metal work, thermal insulation, sound insulation, fire proofing or water proofing, lift and escalator, fire escape staircases or elevators; or
 - (b) Construction of a new building or a civil structure or a part thereof, or of a pipeline or conduit, primarily for the purposes of commerce or industry; or
 - (c) Construction of new residential complex or a part thereof, or
 - (d) Completion and finishing services, repair, alteration, renovation or restoration of, similar services, in relation to (b) and (c); or
 - (e) Turnkey projects including engineering, procurement and construction or commissioning (EPC) projects.

For works contract, the contract should be one for execution of work (with emphasis being on such execution) where transfer of property in goods happens by way of accession during progression of work. In case of sale, possession and ownership of goods is passed on to the buyer at the time of delivery.

The following are the options available for discharge of service tax under the category of Works Contract:

- (i) The gross amount charged less the VAT/sales tax paid on transfer of property in goods involved in the execution of works contract, would be the value on which the service tax would be paid at 4.12%. The credit on inputs used in the execution of works contract is not available **however there is no restriction for availment of**

credit on input services and capital goods. Further the value of materials supplied free of cost if any is also required to be considered.

- (ii) Calculating service tax at normal rate after taking deduction of materials used as per the records maintained. The benefit of cenvat credit of inputs used in the execution of contract will not be available; **however there is no restriction for availment of credit on input services and capital goods.**
- (iii) The company may also opt for payment of service tax on the gross amount of the contract despite the payment of VAT on the value of goods transferred. In such a case the duty of excise paid on the materials used for the service would be available for the payment of service tax. This option is not implicitly stated in the rules but is in our opinion available under Section 67 which is the valuation section which would override the rules.