

PRELIMINARY LEGAL PROVISIONS

2.1 EXTENT, COMMENCEMENT AND APPLICATION [SECTION 64]

The Finance Act, 1994 came into force from 1.7.1994. By section 64(1), the Act extends to the whole of India except the state of Jammu and Kashmir, and by section 64(3), the levy applies to “taxable services provided”. Thus, services provided in the State of Jammu and Kashmir are not liable to service tax.

As per Article 370 of the Constitution, any Act of Parliament applies to Jammu & Kashmir only with concurrence of State Government. Since, no such concurrence has been obtained in respect of Finance Act, 1994, service tax provisions are not applicable in Jammu and Kashmir.

Service tax will not be payable if service is provided in Jammu & Kashmir. However, if a person from Jammu & Kashmir provides the service outside Jammu & Kashmir in any other part of India, the service will be liable to service tax, as the location where service is provided is relevant. Merely because the office of the service provider is situated in Jammu & Kashmir, it does not mean that service is provided in Jammu & Kashmir.

Levy of service tax extends to services *provided to or from installations, structures and vessels in the entire continental shelf of India and exclusive economic zone of India*. The ‘exclusive economic zone’ extends upto 200 nautical miles inside the sea from base line.

Service provided within the territorial waters will be liable to service tax as levy of service tax extends to whole of India except Jammu and Kashmir and ‘India includes territorial waters. Indian territorial waters extend upto 12 nautical miles from the Indian land mass.

2.2 DEFINITIONS [SECTION 65]

This section contains definitions of various important terms used in the Finance Act, 1994. The adoption of selective coverage necessitates the definition of various service categories/service providers. These definitions are contained in section 65 of the Act. The Act defines the categories of services to which the Act applies by defining the term “taxable service” which is contained in section 65(105) of the Act. Further, various

2.2 Service tax & VAT

service providers like “stock brokers”, “advertisement agencies”, “courier agency”, etc. are also defined in this section. These definitions form the crux of the entire Act, and are analysed in Chapter 2 hereinafter.

2.3 CLASSIFICATION OF TAXABLE SERVICES [SECTION 65A]

Section 65A provides that classification of taxable services shall be determined according to the terms of the sub-clauses of clause (105) of section 65.

When for any reason, a taxable service is, prima facie, classifiable under two or more sub-clauses of clause (105) of section 65, classification shall be effected as follows:

- (a) the sub-clause which provides the most specific description shall be preferred to sub-clauses providing a more general description;
- (b) composite services consisting of a combination of different services which cannot be classified in the manner specified in clause (a), shall be classified as if they consisted of a service which gives them their essential character, in so far as this criterion is applicable;
- (c) when a service cannot be classified in the manner specified in clause (a) or clause (b), it shall be classified under the sub-clause which occurs first among the sub-clauses which equally merit consideration.

2.4 CHARGE OF SERVICE TAX [SECTION 66]

Section 66 is the charging section of the Act, which provides that there shall be levied a service tax @ 12% of the value of taxable services referred to in section 65(105) of the Act. *However, Notification No. 8/2009 ST dated 24.02.2009 has exempted all the taxable services specified in section 65(105) from so much of service tax leviable thereon under section 66 of the Finance Act, as is in excess of the rate of 10% of the value of taxable services. Therefore, the effective rate of service tax is 10%.*

Section 65(105) provides that taxable service shall not only include service provided but also the “service to be provided”. Thus, -

- (a) the charge is on the services provided or to be provided;
- (b) the services provided or to be provided must be the one which is covered in section 65(105);
- (c) the effective rate of tax is 10%;
- (d) the measure of tax is on “value of taxable services” provided which is defined in section 67 discussed later in this chapter.

2.5 EDUCATION CESS AND SECONDARY AND HIGHER EDUCATION CESS

An education cess is levied @ 2%, calculated on the service tax on all taxable services. The education cess so collected is utilized for providing and financing universalised quality basic education. Further, with effect from 11.05.2007 a secondary and higher education cess @ 1% is also being imposed on services liable to service tax. Thus, the effective rate of service tax becomes 10.3%. Service tax, education cess and secondary and higher education cess should be shown separately in the invoice.

These cesses paid on input services are available as credit for payment of cesses on output services or final products. The education cess and secondary and higher education cess on taxable services are in addition to the tax chargeable on such taxable services, under Chapter V of the Finance Act, 1994.

The provisions of Chapter V of the Finance Act, 1994 and the rules made thereunder, including those relating to refunds and exemptions from tax and imposition of penalty, apply in relation to the levy and collection of the education cess and secondary and higher education cess on taxable services, as they apply in relation to the levy and collection of tax on such taxable services under Chapter V of the Finance Act, 1994 or the rules, as the case may be.

The fully exempted taxable services would not be subjected to education cess and secondary and higher education cess. In case of a partial exemption, say by way of abatement, the cesses would be calculated on the net tax paid and not on the entire amount of tax that would have been payable, but for the exemption

2.6 NATURE OF SERVICE TAX

Service tax is a tax on services provided. This is not a tax on profession, trade, calling or employment but is in respect of service rendered. If there is no service, there is no tax. *[Addition Advertising vs. Union of India (1998) 98 ELT 14 (Guj)]*. Service tax like excise duty is an indirect tax.

2.7 VALUATION OF TAXABLE SERVICES FOR CHARGING SERVICE TAX [SECTION 67]

Section 67 provides for the valuation of taxable services. The provisions of this section are discussed below:

- (1) If the consideration for a taxable service is in terms of money, the value of such service shall be the gross amount charged by the service provider for such service provided or to be provided by him.
- (2) If the consideration for a taxable service is not wholly or partly in terms of money, then the value of such service shall be such amount in money, with the addition of service tax charged, is equivalent to the consideration.

2.4 Service tax & VAT

- (3) If the consideration for a taxable service is not ascertainable, the value of such service shall be the amount as may be determined in the prescribed manner.
- (4) Consideration includes any amount that is payable for the taxable services provided or to be provided.
- (5) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.
- (6) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.
- (7) Subject to the provisions mentioned in points (1), (2), (3), (5) and (6) above, the value of a taxable service shall be determined in such manner as may be prescribed.
- (8) Money includes any currency, cheque, promissory note, letter of credit, draft, pay order, travellers cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value.
- (9) "Gross amount charged" includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and book adjustment, and any amount credited or debited, as the case may be, to any account, whether called "suspense account" or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.

Here, "Associated enterprise" has the meaning assigned to it in section 92A of the Income tax Act, 1961."

2.8 SERVICE TAX (DETERMINATION OF VALUE) RULES, 2006

Notification No.12/2006-ST, dated 19.04.2006 has notified the Service Tax (Determination of Value) Rules, 2006. They have come into force from 19.04.2006.

Rule 2 – Definitions

Clause (c) defines "Value" to have the meaning to it in section 67.

The words and expressions used in these rules and not defined but defined in the Finance Act, 1994 shall have the meaning respectively assigned to them in the Act.

Rule 2A - Determination of value of services involved in the execution of a works contract

Subject to the provisions of section 67, the value of taxable service in relation to services involved in the execution of a works contract (hereinafter referred to as works contract service) shall be determined by the service provider in the following manner:-

- (i) Value of works contract service determined shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

The gross amount charged for the works contract shall not include value added tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract.

The value of works contract service shall include-

- (a) labour charges for execution of the works;
 - (b) amount paid to a sub-contractor for labour and services;
 - (c) charges for planning, designing and architect's fees;
 - (d) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;
 - (e) cost of consumables such as water, electricity, fuel, used in the execution of the works contract;
 - (f) cost of establishment of the contractor relatable to supply of labour and services;
 - (g) other similar expenses relatable to supply of labour and services; and
 - (h) profit earned by the service provider relatable to supply of labour and services.
- (ii) Where value added tax or sales tax, as the case may be, has been paid on the actual value of transfer of property in goods involved in the execution of the works contract, then such value adopted for the purposes of payment of value added tax or sales tax, as the case may be, shall be taken as the value of transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service under clause (i).

Rule 3 - Manner of determination of value

The value of taxable service, the consideration for which is not wholly or partly consisting of money, shall be determined by the service provider in the manner described below. However, the same is subject to the provisions of section 67.

- (a) the value of such taxable service shall be equivalent to the gross amount charged by the service provider to provide similar service to any other person in the ordinary course of trade. The gross amount charged is the sole consideration.
- (b) where the value cannot be determined in accordance with clause (a), the service provider shall determine the equivalent money value of such consideration. However, such value shall, in no case be less than the cost of provision of such taxable service.

2.6 Service tax & VAT

Rule 4 - Rejection of value

- (1) The Central Excise Officer shall have the power to satisfy himself as to the accuracy of any information furnished or document presented for valuation. In other words, where there are adequate reasons warranting verification of the value adopted by the service provider for payment of service tax, rule 4 specifically enables verification of records in such cases.
- (2) The provisions contained in rule 3 shall not restrict or put to question such power of the Central Excise Officer.
- (3) A show cause notice shall be issued to the service provider, if the Central Excise Officer is satisfied that the value determined by such service provider is not in accordance with the provisions of the Act or these rules.
- (4) Such show cause notice will specify the amount of service tax fixed by the Central Excise officer.
- (5) The Central Excise Officer shall provide a reasonable opportunity of being heard, to the service provider. Thereafter, he shall determine the value of such taxable service for the purpose of charging service tax in accordance with the provisions of the Act and these rules.

Rule 5 - Inclusion in or exclusion from value of certain expenditure or costs

- (1) The expenditure or costs incurred by the service provider in the course of providing taxable service forms integral part of the taxable value of the service provided or to be provided. Therefore, they shall be included in the value for the purpose of charging service tax on the said service. It shall not be relevant that various expenditure or costs are separately indicated in the invoice or bill issued by the service provider to his client.
- (2) There could be situations where the client of the service provider specifically engages the service provider, as his agent, to contract with the third party for supply of any goods or services on his behalf. In those cases, such goods or services so procured are treated as supplied to the client rather than to the contracting agent. The service provider in such cases incurs the expenditure purely on behalf of his client in his capacity as an agent, i.e. "pure agent" of the client. Amounts paid to the third party by the service provider as a pure agent of his client can be treated as reimbursable expenditure and shall not be included in the taxable value.
- (3) However, if the service provider acts as an undisclosed agent i.e. acts in his own name without disclosing that he is actually acting as an agent of his client, he cannot claim the expenditure incurred by him as reimbursable expenditure.
- (4) Subject to the provisions mentioned in point (1) above, the expenditure or costs incurred by the service provider as a pure agent of the recipient of service shall be

excluded from the value of the taxable service if all the following conditions are satisfied:

- (i) the service provider acts as a pure agent of the recipient of service when he makes payment to third party for the goods or services procured;
- (ii) the recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service;
- (iii) the recipient of service is liable to make payment to the third party;
- (iv) the recipient of service authorises the service provider to make payment on his behalf;
- (v) the recipient of service knows 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 has been 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; and
- (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.

“Pure agent” means a person who—

- (a) 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;
- (b) 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;
- (c) does not use such goods or services so procured; and
- (d) receives only the actual amount incurred to procure such goods or services.

It is clarified that the value of the taxable service is the total amount of consideration consisting of all components of the taxable service and it is immaterial that the details of individual components of the total consideration is indicated separately in the invoice.

Illustration 1.— X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement in television. Y billed X including charges for Television advertisement and paid service tax on the total consideration billed. In such a case, consideration for the service provided is what X pays to Y. Y does not act as an agent on behalf of X when obtaining the television advertisement even if the cost of television advertisement is mentioned separately in the invoice issued by X. Advertising service is an input service for the estate agent in order to enable or facilitate him to perform his services as an estate agent.

2.8 Service tax & VAT

Illustration 2.— In the course of providing a taxable service, a service provider incurs costs such as traveling expenses, postage, telephone, etc., and may indicate these items separately on the invoice issued to the recipient of service. In such a case, the service provider is not acting as an agent of the recipient of service but procures such inputs or input service on his own account for providing the taxable service. Such expenses do not become reimbursable expenditure merely because they are indicated separately in the invoice issued by the service provider to the recipient of service.

Illustration 3.— A contracts with B, an architect for building a house. During the course of providing the taxable service, B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., to enable him to effectively perform the provision of services to A. In such a case, in whatever form B recovers such expenditure from A, whether as a separately itemised expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B. Value of the taxable service for charging service tax is what A pays to B.

Illustration 4.— Company X provides a taxable service of rent-a-cab by providing chauffeur-driven cars for overseas visitors. The chauffeur is given a lump sum amount to cover his food and overnight accommodation and any other incidental expenses such as parking fees by the Company X during the tour. At the end of the tour, the chauffeur returns the balance of the amount with a statement of his expenses and the relevant bills. Company X charges these amounts from the recipients of service. The cost incurred by the chauffeur and billed to the recipient of service constitutes part of gross amount charged for the provision of services by the company X.

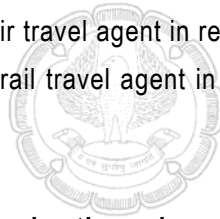
In view of the comprehensive provisions on value of taxable services, all the circulars issued relating to value of taxable services have been withdrawn.

Rule 6 - Cases in which the commission, costs, etc., will be included or excluded

- (1) Subject to the provisions of section 67, the value of the taxable services shall include,—
- (i) the commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker;
 - (ii) the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;
 - (iii) the amount of premium charged by the insurer from the policy holder;
 - (iv) the commission received by the air travel agent from the airline;
 - (v) the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;

Preliminary Legal Provisions 2.9

- (vi) the reimbursement received by the authorised service station, from manufacturer for carrying out any service of any motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer;
 - (vii) the commission or any amount received by the rail travel agent from the Railways or the customer;
 - (viii) the remuneration or commission, by whatever name called, paid to such agent by the client engaging such agent for the services provided by a clearing and forwarding agent to a client rendering services of clearing and forwarding operations in any manner; and
 - (ix) the commission, fee or any other sum, by whatever name called, paid to such agent by the insurer appointing such agent in relation to insurance auxiliary services provided by an insurance agent.
- (2) Subject to the provisions contained in sub-rule (1), the value of any taxable service, as the case may be, does not include–
- (i) initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;
 - (ii) the airfare collected by air travel agent in respect of service provided by him;
 - (iii) the rail fare collected by rail travel agent in respect of service provided by him; and
 - (iv) interest on loans.



Rule 7 - Actual consideration to be the value of taxable service provided from outside India

- (1) The value of taxable service received under the provisions of section 66A (i.e. the services which are provided from outside India and received in India) shall be such amount as is equal to the actual consideration charged for the services provided or to be provided.

- (2) The value of taxable services

- which are partly performed in India and are
- specified in clause (ii) of rule 3 of Taxation of Services (Provided from Outside India and Received in India) Rules, 2006,

shall be the total consideration paid by the recipient for such services including the value of service partly performed outside India. Nothing mentioned in point (1) above shall have any effect in this respect. Specified taxable services, which involve physical performance, fall under rule 3(ii) of Taxation of services (Provided from Outside India and Received in India) Rules, 2005. The same are treated as services provided from outside India and received in India if such services are partly or wholly performed in India.

2.10 Service tax & VAT

Self-examination questions

1. Whether a person, having a business in any of the Indian States other than the State of Jammu & Kashmir, who provides the services to the client in the State of Jammu & Kashmir be liable to pay service tax?
2. What is the extent and application of the provisions of the Finance Act, 1994 relating to service tax?
3. Discuss the provisions governing classification of taxable services.
4. Write short notes on education cess on service tax.
5. Briefly explain the concept of charge of service tax.
6. How will a taxable service be valued when the consideration thereof is not in wholly or partly in terms of money?
7. How will a taxable service be valued when the gross amount charged for it includes service tax payable?
8. Discuss whether the central excise officer has power to satisfy himself as to the accuracy of the furnished information/document presented for valuation.
9. Who is a pure agent? Discuss.
10. What shall be the value of taxable services which are partly performed in India and are specified in clause (ii) of rule 3 of Taxation of Services (Provided from Outside India and Received in India) Rules, 2006?