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Import of Services - Disputes carrying on

By Bimal Jain, CA

DISPUTES unlike wine, do not improve by ageing. Many things happen to a cause and to parties in a dispute by the simple passage of time and almost none of them are good. Delay in settlement or disposal of conflicting claims is a primary enemy of justice and peace in the community.

Recently the Supreme Court of India has issued notice vide order dated 04.09.2009 in the matter of **Ankit Exim Pvt. Ltd. Vs. Union of India & Anr. in SLP (C) NO. 21190/2009** challenging the legality and validity of Section 66A of the Finance Act 1994 and Taxation of Services (Provided from Outside India and Received in India) Rules, 2006 ('the Import of Service Rules'). Further the Supreme Court of India in SLP (C) NO. 10981/2009 through order dated 09.07.2009 has also issued notice challenging the legality and validity of rule 2(1)(d)(iv) of Service Tax Rules 1994 and Explanation to section 65 (105) of the Finance Act 1994.

Further these notices are very important when the Delhi High Court had dismissed the petition filed in the case of **Orient Craft Ltd. Vs. UOI** (2006-TIOL-271-HC-DEL-ST) wherein it was held that "Taxable service provided from outside India and received in India liable to Service tax - Rules framed by Central Government clear - Nothing unconstitutional in the scheme of things under Section 66A of Finance Act, 1994 and Rule 3 of the Import of Service Rules."

Thus, we can now expect that the Supreme Court of India will clear the doubts on the levy of Service Tax on "Import of Services".

As well there is recent judgments came in the matter of **Toyota Kirloskar Motors Pvt. Ltd. Vs. CCE (LTU), Bangalore** (2009-TIOL-1437-CESTAT-BANG) wherein it was held that the Service Tax on services received from outside India can be discharged from CENVAT Credit A/c and no exclusion provided in the scope of 'output service' defined in Rule 2(p) of the CENVAT Credit Rules, 2004 other than GTA prior to 01.03.2008 and Pre-deposit of Rs. 3.3 crores waived and stay granted.

Hence it is important to:

++ Examine legality and validity of levy of the Service Tax on "Import of Services" in terms of the Section 66A of the Finance Act 1994 and the Import of Service Rules and Rule 2(1)(d)(iv)of the Service Tax Rules 1994 and explanation to the Section 65 (105) of the Finance Act 1994.

++ Further if at all, levy of Service tax on import of Services is held valid by the Supreme Court then what would be date of chargeability of Service tax.

++ Examine whether the payment of the Service Tax on import of Services can be made from Cenvat Credit Account prior to 1 March 2008.

Commencement of levy of the Service tax on import of Services:

The Finance Act 2006 inserted the Section 66A w.e.f 18 April 2006 to levy the Service tax under reverse charge method on taxable services provided from outside India to a recipient in India. The service tax was levied on taxable services specified under Section 65(105) 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 who has his place of business, fixed establishment, permanent address or usual place of residence, in India.

Further earlier explanation to section 65(105) by the Finance Act, 2005 existing prior to 18 April 2006 was omitted and paving the way to the clear legislative intention of the Government on the taxation of taxable services rendered by non-resident persons from outside India to a person in India.

Section 66A imposes two conditions which need to be satisfied for the levy of service tax on import of Services i.e.

++ Service must be received by a person in India

++ Service provider must be situated outside India i.e. does not have permanent address or place of residence in India.

If both the above conditions are fulfilled, then the question of levy of service tax arises. Further, for determination of a service to have been provided from outside India and received in India, the Import of Service Rules have been framed vide Notification No. 11/2006-ST dated 19 April 2006 w.e.f. 19 April 2006.

Legality and Validity of levy of the Service Tax under Section 66A and the Import of Service Rules:

We can discuss the above issue on following parameters; namely

I. Can the Act have extra territorial jurisdiction

Section 64(1) of the Finance Act, 1994 reads as follows; "This Chapter i.e. Chapter V which contains provisions relating to Service tax, extends whole of India except the State of Jammu and Kashmir. It means the Act does not have any extra-territorial jurisdictions as decided in the case of **Poppat Lal Shah Vs. State of Madras 1953 SCR 677** .

However the Article 245(2) of the Constitution of India reads as follows; 'No law made by the Parliament shall be invalid on the ground that it will have extra-territorial operation. Thus constitutionally, there is no bar in the Act having extra-territorial jurisdiction.

Further it is decided in the case of **Fatma Bibi Ahmed Patel Vs. State of Gujarat (2008) 6 SCC 789** that Parliament may enact a legislation having extra-territorial application.

II. Constitutional Validity of levy of Service tax on Import of Services

There seems no difficulty in imposing Service tax on Import of Service either covered under Entry No. 83 or Entry No.97 of List I i.e. Union List of Seventh Schedule to the Constitution of India.

III. Can tax be levied when Service provider is outside jurisdiction of India

What cannot be done directly can also not be done indirectly. It means charging Service tax on Services provided by person who does not have place of business in India tantamount to indirectly imposing a tax on his income.

In the case of **Ishikawajma-Harima Heavy Industries Ltd. Vs. Dir. IT (**2007-TIOL-03-SC-IT), it was held that offshore services must have sufficient territorial nexus with India so as to impose tax ie. it must require to have direct link for services rendered in India.

IV. Applicability of Double Tax avoidance agreement ('DTAA') and it's essence on the Service tax

India has entered into DTAA with major countries like USA, UK, Japan, China, Germany, etc., and provides important relief either by way exemption method or by way of tax credit method.

Further DTAA applies to income tax and also to any other tax which is identical or substantially similar to tax on income, by whatever name called.

Now question comes can additional tax namely Service tax be collected on same income/ gross receipt of Services provided say on royalty and/ or technical services under DTAA on which Indian Govt has already collected tax by the name of income tax.

It is a broader issue and has multiple effects in terms of growth and development of Service sector for overall GDP of the Country and to align norms as per the WTO guidelines and principles where by all the member countries are required to ensure free trade and commerce among them.

V. Legal Validity of the import of Service Rules

The import of Service Rules have been issued under Section 93 and 94 read with Section 66A of the Finance Act but Section 66A does not contain any authority to make rules for determining "Import of Services".

Hence, if the provisions of the Act itself are not valid then any rules framed to enforce such provisions cannot be held good.

Who is liable to pay Service Tax and from which date:

Section 68 of the Finance Act, 1994 provides for payment of service tax. Accordingly, every person providing taxable service to any person shall pay service tax at the specified rate in prescribed manner and Sub-section (2) provides that Central Government is empowered to notify any taxable service on which service tax shall be paid by such person in prescribed manner as notified and such person shall be the person liable for paying service tax in relation to such services.

In this regard Rule 2(1) (d) (iv) of the Service tax Rules as amended vide Notification No. 12/2002 dated 16 August 2002 initially provided that the person receiving the taxable Services will be liable to pay the Service tax

But corresponding Notification No. 36/2004-ST under Section 68 (2) of the Finance Act, 1994 made effective only from 1 January 2005 which was further amended by Notification No. 9/2006-ST dated 19 April 2006 notifying that service recipient shall be the person liable for any taxable service provided or to be provided from a country other than India and received in India under section 66A .

In the matter of **Hindustan Zinc Ltd Vs. CCE, Jaipur [2008-TIOL-1149-CESTAT-DEL-LB]**, it was held that levy of service tax is on rendering to taxable service and not on person. Definition clause can not be read as substantive. The manner of collection of tax is not extendable to include person liable to pay service tax. It was held that service recipient of consulting engineering service provided from outside India was not liable to pay service tax prior to 1.1.2005. Since the liability to pay service tax is generally on the provider of service, where liability is to be fastened on any other person, the services in relation to which liability is to be so fastened, has also to be identified and specified. The services were notified w.e.f. 1.1.2005 vide Notification No 36/2004 and departmental appeal is dismissed by the Supreme Court on merits vide Order dated 23 January 2009 and same decisions were followed in the following judgments; namely

Further in the case of **Indian National Shipowners Association Vs. UOI (2009-TIOL-150-HC-MUM-ST)**, the Hon'ble DB of Bombay High Court held that before enactment of Section 66A, there was no authority vested by law in revenue to levy service tax on person who was resident in India and received services outside India. In the case of **Foster Wheeler Energy Vs. CCE (2007-TIOL-785-CESTAT-AHM)** it was held that Service provided by Service provider who has no office in India became taxable only w.e.f 18 April 2006 – same decisions were followed in many other judgments.

Examining whether the payment of the Service Tax on import of Service can be made from Cenvat Credit Account prior to 1 March 2008:

Rule 5 of the Import of Service Rule states that the taxable Services provided under this Rule will not be considered as Output Services of the recipient for the purpose of availing Cenvat Credit of duty of excise paid on inputs or service tax paid on any input services. Thus the recipient of Service has to pay the Service tax in cash by GAR -7 Challan and cannot utilize his Cenvat Credit A/C for payment of this amount as it is not his 'Output Service' though he is liable to pay Service tax on Import of Service.

But in the matter of **Toyota Kirloskar Motors Pvt Ltd Vs CCE (LTU), Bangalore** **2009-TIOL-1437-CESTAT-BANG** it was held that the Service Tax on services received from outside India can be discharged from CENVAT Credit A/c as there is no exclusion provided in the scope of 'output service' defined in Rule 2(p) of the Cenvat Credit Rules, 2004 other than GTA prior to 01.03.2008.

Let us see changes made in Rule 2(p) of the Cenvat Credit Rules 2004 prior to and after 1 March 2008 to understand the importance of above judgment and way forward in the stated case.

"Output Service" (after 1 March 2008) means any taxable service, excluding the taxable service referred to in sub-clause (zzp) of clause (105) of section 65 of the Finance Act, provided by the provider of taxable service.

"Output Service" (prior to 1 March 2008) means any taxable service provided by the provider of taxable service, to a customer, client, subscriber, policy holder or any other person, as the case may be, and the expressions 'provider' and 'provided' shall be construed accordingly.

Hence in brief, the provisions pertaining to Output Services are overlapping each-other under different rules framed in this regard and it seems that intention of legislation would be playing a decisive role to conclude the disputes.

Conclusion:

Prima facie, it seems that the levy of Service tax on Import of Services may be held valid as the Finance Act can have extra-territorial jurisdictions in terms of the Article 245(2) of the Constitution of India and such chargeability may also be covered under the Union List of the Seventh Schedule to the Constitution of India.

Further, if at all, the levy of Service tax on import of Services is held valid by the Supreme Court then effective date should be 18 April 2006 i.e. only after enactment of Section 66A of the Finance Act and the Import of Service Rules.