<u>What is Service Tax</u>

Service tax is a tax on service. This is not tax on profession, trade. Calling or employment but is in respect of service rendered . If there is no service, there is no tax. As per Webster's Concise Dictionary 'service' means a useful result or product of labor, which is not a tangible commodity.

Thus basically service is a value addition that can be perceived but cannot be seen, as it's tangible. However, usage of some goods during the course of rendering the service would not mean that there is no 'service' .It is the predominant factor in each case, which is to be studied to arrive at a conclusion.

Service tax is a tax levied on service providers in India, except the State of Jammu and Kashmir.

Service Tax, introduced from the financial year 1994-95 now covers as many as 41 services within its ambit. Service sector, which has an average annual growth rate of value addition of 7.9%, contributes nearly 50% of the GDP. The Economic Survey 2001-2002 observed that bringing more services under the tax net can offset the likely revenue loss through lower custom tariff. Finance Act, 2001 added 15 new services to the list of taxable services with effect from 16-7-2001 & it is expected that coming budget will add further services under the tax net. We are moving towards a total value added tax regime which was partially expected to come into force with effect from 1st April, 2002 replacing the local sales tax in about 17 states.

However due to failure of reconciliation between the center & the states regarding some key issues, like amendment in Central Sales Tax regarding vat ability of Central Sales Tax against liability of local sales tax & loss of revenue to the state exchequer due to introduction of value added tax, it could not be introduced. However it is expected to come into force with effect from 1st April, 2003 & by that time service tax may also be made vat able.

Vat ability of service tax will compel the reduction in loss of revenue through tax evasion. To reduce the tax evasion in respect of service tax government has already taken some significant steps like introduction of service tax audit in the mode of Canadian system of excise audit introduced in India from financial year 2000 & collection of data from various associations of service tax providers like ICAI, ICSI, ICWAI, Internet Service Provider Association of India, Stock Exchanges, Council of architecture etc. Now let us discuss about some basic concepts of service tax regarding taxability, exemptions, payment, assessment, etc.

The services provided by goods transport operators, out door caterers and pandal shamiana contractors were brought under the tax net in the budget 1997-98, but abolished vide Notification No.49/98, 2 June,1998.

Government of India has notified imposition of service Tax on twelve new services in 1998-99 union Budget. These services listed below were notified on 7 October, 1998 and were subjected to levy of Service

Charge of Service Tax and Alternative rates of Service Tax

Section 66 is the charging section of the ACT which deals with the levy and collection of service tax. It prescribes the applicable rate of service tax which is to be levied on the value of various taxable services. For collection of service tax, it provides that the 'prescribed manner 'needs to be followed. Applicable rate is provided in the section itself whereas the prescribed manner for collection and payment of tax is provided in the Service Tax Rules,1994 .With effect from 18.04.2006 , the rate of service tax prescribed by section 66 is 12% of the value of taxable services referred to in section 65(105) of the Act . Section 65(105) provides that taxable service shall not only include service provided but also the "services to be provided"

- The charge is on the services provided or to be provided
- The services provided or to be provided must be the one which is covered in section 65(105)
- The rate is 12%
- The measure of tax is on 'value of taxable services 'provided which is defined in section 67

Education Cess :

With effect from 10.09.2004 an education cess has been levied @2%, calculated on service tax on all taxable services. Education cess collected is utilized for providing and financing universalized quality basic education.

Fully exempted taxable services are not subject to education cess. In case of a partial exemption, say by way of abatement, the cess is calculated on the net tax paid and not on the amount of tax that would have been payable, but for exemption

Secondary and Higher Education Cess:

With effect from 11.05.2007, a secondary & higher education cess@1% has been imposed on services liable to service tax. It is levied on service tax payable on such services . The secondary & higher education cess is additional to the Educational cess of 2% . Thus the effective rate of service tax works out to be 12.36% **[12%+3%(2-1) of 12%]**

Although service tax is levied at the basic rate of 12% but in case of certain services, an alternate rate is also provided. Some of these are under

- Specified immovable properties an optional composition tax rate of 4% of gross value has been provided

- In case of life insurance service alternate mode of discharge of service tax liabilities has been provided and rate of service tax in this case is 1% of total premium

Exemptions :

There is no minimum limit or basic exemption limit to small service providers on the basis of value of taxable services rendered as yet. Following exemptions are available to the service tax providers :-

1) Taxable services rendered in India by an assessee to a client in respect of overseas projects for which payment is received in non repatriable convertible foreign exchange are exempt from levy of service tax.

2) Serive tax is fully exempt in respect of payments of which is received in India in non repatriable convertible foreign exchange whether the service is received in India or abroad.

3) In certain cases like insurance, telephone, telegraph, air travel, courier, advertisement etc. services provided to UN, notified international organizations or notified diplomatic missions, service tax is exempt.

4) Software engineering enjoys a complete exemption from service tax.

History of service tax

The provisions relating to Service Tax were brought into force with effect from 1 July 1994. The services, brought under the tax net in the year1994-95, are as below: (1) Telephone

(2) Stockbroker

(3) General Insurance

The Finance Act (2) 1996 enlarged the scope of levy of Service Tax covering three more services, viz.,

(4) Advertising agencies,

(5) Courier agencies

(6) Radio pager services. But tax on these services was made applicable from 1 November, 1996.

The Finance Acts of 1997 and 1998 further extended the scope of service tax to cover a larger number of services rendered by the following service providers, from the dates indicated against each of them.

(7) Consulting engineers (7 July, 1997)

(8) Custom house agents (15 June, 1997)

(9) Steamer agents (15 June, 1997)

(10) Clearing & forwarding agents (16 July, 1997)

(11) Air travel agents --- (1 July, 1997)

(12) Tour operators (exempted up to 31.3.2000 Notification No.52/98, 8 July, 1998, reintroduced w.e.f. 1.4.2000)

(13) Rent-a-Cab Operators (exempted up to 31.3.2000 Vide Notification No.3/99 Dt.28.2.99, reintroduced w.e.f. 1.4.2000)

(14) Manpower recruitment Agency (1 July, 1997)

(15) Mandap Keepers (1 July, 1997)

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(16) Architects

(17) Interior Decorators

(18) Management Consultants

(19) Practicing Chartered Accountants

(20) Practicing Company Secretaries

(21) Practicing Cost Accountants

(22) Real Estates Agents/Consultants

(23) Credit Rating Agencies

(24) Private Security Agencies

(25) Market Research Agencies

(26) Underwriters Agencies

In case of mechanized slaughter houses, since exempted, vide Notification No.58/98 dtd. 07.10.1998, the rate of Service Tax was used to be a specific rate based on per animal slaughtered. In the Finance Act'2001, the levy of service tax has been extended to 14 more services, which are listed below. This levy is effective from 16.07.2001.

(27) Scientific and technical consultancy services

(28) Photography

(29) Convention

(30) Telegraph

(31) Telex

(32) Facsimile (fax)

(33) Online information and database access or retrieval

(34) Video-tape production

(35) Sound recording

(36) Broadcasting

(37) Insurance auxiliary activity

(38) Banking and other financial services

(39) Port

(40) Authorised Service Stations

(41) Leased circuits Services

In the Budget 2002-2003, 10 more services have been added to the tax net which are listed below. This levy is effective from 16.08.2002.

(42) Auxiliary services to life insurance

(43) Cargo handling

(44) Storage and warehousing services

(45) Event Management

(46) Cable operators

(47) Beauty parlours

(48) Health and fitness centers

(49) Fashion designer

(50) Rail travel agents.

(51) Dry cleaning services. and these services have been notified on 1-8-2002 and were subject to levy of Service Tax w.e.f. 16-8-2002. It is expected that in view of more & more services brought under the Service Tax net, the service tax revenue would now form a major part in Govt. Revenue earnings. In the Budget 2003-04 seven more services along with extension to three existing services have been added to the

tax net which are listed below. The levy of service tax on these services is effective from 1 July, 2003.

(52). Commercial vocational institute, coaching centre and private tutorials

(53). Technical testing and analysis (excluding health & diagnostic testing) technical inspection and certification service.

(54). Maintenance & repair services

(55). Commission and Installation Services

(56). Business auxiliary services, namely business promotion and Support services (excluding on information technology services)

(57). Internet café

(58). Franchise Services the rate of Service Tax was increased from 5% to 8% on all the taxable services w.e.f. 14.5.2003.

In the Budget 2004-05, 10 more services have been introduced in the service tax net along with reintroduction of three existing services as follows:

(59) Transport of goods by road (earlier Goods Transport Operators service re- introduced).

(60) Out door Caterer's service (re-introduced)

(61) Pandal or Shamiana service (re-introduced)

(62) Airport Services

(63) Transport of Goods by Air Services

(64) Business Exhibition Services

(65) Construction Services in relation to Commercial or Industrial Building Construction Services in relation to Commercial or Industrial Building The levy of service tax on

these services is effective from 10 September, 2004 and the rate of service tax has been enhanced to 10% from 8%. Besides this 2% Education Cess on the amount of service tax has also been introduced. Thereafter Service Tax is increased up to 12.24% and now currently the effective service tax rate is 12.36% including Education Cess.

In the Budget 2005-06, 9 more services have been introduced in the service tax net as follows with effect from 16.06.2005:
(66) Intellectual Property Services

(67) Opinion Poll Services

(68) TV or Radio Programme Services

(69) Survey and Exploration of Minerals Services

(70) Travel Agent's Services other than Rail and Air travel agents

(71) Forward Contract Services

(72) Transport of goods through pipe line or other conduit Services.

(73) Site preparation & clearance Services

(74) Dredging Services

(75) Survey & Mapmaking Services

(76) Cleaning Services

(77) Membership of Clubs & Associations

(78) Packaging Services

(79) Mailing list compilation & Mailing Services

(80) Construction Services in relation to Residential Complexes.

On February 24, 2009 Government reduced by two percent rates of excise duty and service tax. While the general excise duty has been reduced from 10 percent to 8 percent, the rate of service tax cut is from 12 percent to 10 percent. Including the 2% Education Cess, Effective Service Tax in India now stands at 10.3%

CONSTITUTIONAL BACK GROUND OF INDIA

Constitutional Background: According to Article 265 of the constitution India, no tax of any nature can be levied or collected by Central or State Governments expect by the Authority of Law.

According to Article 246, law can be enacted by Parliament or the State Legislature, if such power is given by the Constitution of India.

List – I – Union list – Parliament has the exclusive right to make in respect of that entry.
List – II – State list – Any state has exclusive power to make law for such state or any part thereof with respect to such entry.
List – III – Concurrent list – The parliament or the legislature of a state has power to make loss with respect to any matter enumerated in List III.

- There are various matters enumerated in each list. Each matter in the list is known as an entry.
- Entry 97 of the Union list is the residuary entry and empowers the Central Government to levy tax on any matters not enumerated in List II (State List) or List III.
- In 1994 the Service Tax was levied by the Central Government under the powers granted under the said Entry 97 of List I.
- Entry 92C has been inserted to the 1 stList in the VIIth Schedule (so as to make the enactment a subject matter of Union List.
- Although the Government has amended the Constitution and inserted entry No.92C the List 1 of Schedule VII but no separate Act has been passed yet and service tax is still being governed by entry 97 i.e. residuary entry.

WHAT IS THE NEED OF INTRODUCTION OF SERVICE TAX:

Need for Taxation of Services: It is the prime responsibility of the Government to fulfill the increasing development needs of the country and its people, by way of public expenditure. The

Government's primary sources of revenue are direct and indirect taxes. Central Excise Duty on the goods manufactured and produced in India and Customs Duties on imported goods constitute the two major sources of indirect taxes in India.Due to WTO commitments and rationalization of commodity duties. Therefore the revenue receipts from customs and excise duties are low. The largest component of GDP in the country comes from the service sector,

- To introduce value added tax in Indirect taxation as a whole

- To widen the taxation base.

- To merge tax on goods & services for eliminating multiple levels and for bringing about single levels called Goods & Service tax through out country

Features of Service Tax:

The salient features of levy of service tax are:

1. Scope: It is leviable on taxable services 'provided' or 'to be provided' by a service provider. The services 'to be provided' in future are taxed only if payment in its respect is received in advance.

Two separate persons required Payment to employees not covered: For charge of service tax, it is necessary that the service provider and service recipient should be two separate persons acting on 'principal to principal basis'. Services provided by an employee to his employer are not covered service tax and, therefore, salaries or allowances paid to them cannot be charged to service tax.

2. Rate: It is leviable @ 12% of the value of taxable services. Education Cess @ 2% and Secondary and Higher Education Cess @ 1 % are chargeable on the amount of service tax, thus, making the effective rate of service tax at 12.36% of the value of taxable service.

3. Taxable services: Service tax is leviable only on the taxable services. Taxable services mean the services taxable under section 65(105) of the Finance Act, 1994. The taxable services with their scope, inclusions/ exclusions and specific exemptions are discussed in the next chapter.

4. Value: For the levy of the service tax, the value shall be computed in accordance with section 67 read with Service Tax (Determination of Value) Rules, 2006.

5. Free services not taxable ***:*** No service tax is leviable upon the services provided free of cost.

6. Payment of service tax : The person providing the service (i.e. the service provider) has to pay service tax in such manner and within such period as is prescribed in the Service

Tax Rules, 1994. The service tax is to be paid only on the receipt of payment towards the value of taxable services.

7. **<u>Procedures</u>:** Provisions have been made for registration, assessment including self assessment, rectifications, revisions, appeals and penalties on the service provider.

8. **<u>CENVAT credit</u>:** The credit of service tax and excise duty across goods and services is allowable in accordance with the CENVAT Credit Rules, 2004.

Accordingly, output service provider (i.e. provider of any taxable service) can avail credit not only of the service tax paid on any input service consumed for rendering any output service but also of the excise duty paid on any inputs and capital goods used for rendering output service. CENVAT credit so availed can be utilized for payment of service tax on taxable output service.

9. **<u>Services provided by an unincorporated association/body to its members also taxable</u>**
[Explanation to Sec. 65] : 'Taxable service' includes any taxable service provided or to be provided by any unincorporated association or body of persons to a member thereof, for cash, deferred payment or any other valuable consideration. Hence, the services (falling under any category of taxable service) provided or to be provided by any unincorporated association/body to member thereof shall be liable to service tax. **This provision is an exception to the 'principle of mutuality'.**

10. **<u>Performance of statutory activities/duties, not 'service'</u>:** An activity performed by a sovereign /public

authority under provisions of law does not constitute provision of taxable service to a person and, therefore, no service tax is leviable on such entities.

11. Import/Export of services: While import of services is chargeable to tax u/s 66A, the export of services has been made exempt from tax. Import/export provisions are discussed separately.

Nature of service tax

As per section 65 (95) of finance act , 1994 ,'sevice tax ' means tax leviable under the provision. Section 66 of Finance Act, 1994 is the charing section of service tax. Section 66 provides that there shall be levied a tax (service tax) @12% of

the value of taxable service referred to in various clauses of section 65(105).It will be collected in a manner as may be prescribed. Though the tariff rate is 12%, the effective rate is 10% w.e.f 24-2-2009.Thus; total service tax payable is 10.30%w.e.f.24-2-2009.
In respect of each type of service , it is necessary to determine two things namely
(a) Taxable Service and
(b) Value of taxable service.

Taxable Service – As per section 66 of Finance Act, 1994, service tax is payable on taxable service. Service 65(105) of Finance Act 1994 defines what “taxable service” is. The definition is different for each class of service, e.g. in case of stock broker, any service provided by stock broker to investor in connection with sale or purchase of securities listed on a recognized stock exchange will be “taxable service”.

Service tax can be collected by service provider from service recever – Service tax is on indirect tax. Though liability is on provider, the tax can be collected by him from service receiver.

Excise and service tax are independent taxes- Though excise and service tax are administered by same department ,both are independent taxes. Payment of excise is not same thing as paying service tax . ,it was held that service tax is payable on charges of erection and commissioning even if assessee has paid excise duty on entire value of contract including erection and commissioning charges.

Service tax is destination –based consumption tax – Service is a destination based consumption tax, as per CBE & C circular No. 56/5/2003 dated 25-4-2003.

No service tax if transaction is sale of goods –Service tax is not leviable on a transaction treated as sale of goods and subjected to levy of sales tax/VAT . Its has been held that service tax and VAT (sales tax) are mutually exclusive , In case of composite contract , VAT cannot be imposed on portion relating to value of service.

Evaluation of Service Tax in India

In the year 1994-1995, Dr. Manmohan Singh, the Union Finance Minister , in his budget introduced the new concept of Service tax and stated as under :

1. There is no sound reason for exempting services from taxation , where goods are taxed and many countries treat goods and services alike for tax purpose ,therefore , propose to make a modest effort in this direction by imposing a tax on services of 'telephone', 'non life insurance' and 'stock brokers'
2. Thus the service tax was levied under the Finance Act 1994.
3. It was first introduced for the first time on 3 services with a nominal rate of 5% advalorem
4. Subsequent Finance Acts have added more and services to be taxes for service tax purpose
5. As such today there are more than 100 services are chargeable to service tax

Approaches of Levy of Service Tax

The levy of service tax can be based on either of the following 2 approaches

1. Comprehensive coverage / approach

2. Selective coverage / approach

Comprehensive coverage / approach :
The comprehensive approach contemplates taxation of all services and a negative list is given in case some services are to be exempted

Selective coverage / approach :
In case of selective approach , only selective are subjective to service tax . In this case, the legislature attempts to specify and list the services that would be taxable and the scope of coverage of each service . there is no residual category for taxing all service .