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AN OVERVIEW OF SERVICE TAX IN INDIA

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Abstract

The attainment of rapid economic development is the most important objective of all developing countries. To achieve economic development capital accumulation is necessary. In this connection the basic question is how to raise the required finance for development. There are two sources for a government to raise resources- i) internal source & ii) external source. Although taxation may have a large share in promoting a country's development, its actual efficiency depends on the choice of various types of taxes. The government should take into account the legal system, political and social power and administrative ability before making its choice.

This article analyze the overview of service tax in India. The main areas covered in this article are service tax,, constitutional background, approaches of levy of service tax, body of service tax law. Rules and regulations, rationale of levying tax on services, genesis of services, Assessed under Service and tax, rate of service tax.

Introduction

The economic structure of India provides for different type of revenue sources but the taxes constitutes the most important source of revenue. In other words, taxation policy is one of the important instruments in the hands of the government to decide the direction of the economic growth. Indian taxation system consists of two components i.e. direct taxes & indirect taxes. The direct taxes consist of personal taxes levied on the income of individual assesses such as Income Tax and Wealth Tax and Corporate Taxes are levied on the income of the corporations. Indirect taxes include the Commercial Taxes and Excise Duties on sale of goods and manufacturing respectively and also includes customs duty levied on international trade. However after reforms a new breed of tax i.e. service tax is introduced in Indian taxation system[1]. As service sector is growing by leaps and bounce in the Indian economy, this sector is supposed to be utilized by the State as a vibrant avenue to augment its revenues by taxing this sector.

Service Tax

Service tax is a tax on services. It is not a tax on profession or trade but is a tax on the service provided in exercise of the profession or trade. It is levieable only if there is provision of service. "Service" means a useful result or product of labour which is intangible and cannot be seen through eyes. In other words service is a value addition that can be felt only but cannot be seen. It is different from "sale of goods". Only the states government have the power to impose tax on sale of goods; the parliament or central government does not have the power to levy tax on sale of goods hence "sale" is liable to sales tax which is imposed by the state while "services" are liable to service tax which is imposed by the parliament and or central government. The Economic structure of India provides for different type of revenue sources where taxes constitute the most important source of revenue. Indian taxation system consists of two component i.e. direct taxes and indirect taxes. Service Tax is introduced in Indian taxation system economy with the hope of bringing reforms in the Indian economy.

Service Tax is a tax on services provided in exercise of the profession or trade. It is clarified that any services provided or to be provided to a person or a client or customer by a service provider is called as taxable service.

From starting i.e. from July 1994 year on year there is increase of different service covering almost all segment of the common man requirement in day to day activity including insurance, stock broking, telephone service etc. There is a criterion for treating a taxable service as an export of taxable service as well as import of taxable service for the purpose of implementation of service tax on different services. For the purpose of valuation of taxable services the Finance Act 2006 was amended to change the earlier concept and after that the valuation of taxable service is determined on the basic of cost of service to the service receiver.

On the basis of budget provisions of 2004-05 Cenvat Credit Rules, 2004 have been issued and made effective from September 2004. The logic behind introduction of Cenvat was to give tax credit on inputs, input services and Capital goods. Capital goods include machinery, plant, spare parts of machinery, tools etc. used for manufacture of final product or output taxable services. The meaning of input service is changed from 1st April 2011 and according to new concept the input service means any service used by a provider of taxable service for providing an output service or used by a manufacturer, directly or indirectly, in or in relation to the manufacture of final products.

The budget 2012-13 proposes a major shift in country's service tax regime with the negative list that includes seventeen items. The list of seventeen services mentioned in the negative list and will not be taxed include interest payment from the financial sector, human interest services such as funeral service, public interest such as education and health care.

Constitutional Background:

According to article 265 of the Constitution of India, no tax of any nature can be levied or collected by central or state government except by the authority of law[2]. According to article 246, law can be enacted by parliament or the state legislature if such power is given by Constitution of India. Such power is explained list wise which are as follows.

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 state has the power to make law with respect to any matter enumerates in List-III.

Approaches of levy of Service Tax:

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

(1) Comprehensive coverage /approach

(2) Selective coverage /approach

(1) Comprehensive coverage /approach- It contemplates taxation of all services and a negative bill is given in case some services are to be exempted.

[2] STR stands for Service Tax Rules.

(2) Selective coverage /approach- In the case of selective approach, only selective services are subject to service tax. In this case, the legislator attempts to specify and list the services that would be taxable and the scope of coverage of each service. There is no residuary category for taking all.

Table 1 Service and Liability to Pay Tax

S.No.	Nature of service	Service provider	Service Receiver	Person liable to pay tax
1.	Insurance auxiliary services	Insurance agent	Insurance company	Insurance Company
2.	Service provided to a person in India from outside India.	Person Outside India	Person in India	Person in India
3.	Goods Transport Agency for transport of goods by road. (Note:- If the service receiver is Individual, HUF etc, tax is payable by the service provider.)	Goods Transport Agency	(a)Any registered Factory (b)Any company (c)Any corporation (d)Any registered society/corporative society. (e)Any registered dealer of excisable goods. (f)Any registered firm or body corporate.	The service receiver or his agent (i.e. consignor or consignee)
4.	Business Auxiliary Services, Mutual Fund Distribution	Mutual Fund distributor or an agent.	Mutual Fund company	Mutual Fund company
5.	Sponsorship service	Any Person	Body Corporate or firm	Body Corporate or firm

Body (contents) of service tax law:-

Service tax was introduced in the year 1994 but there is no independent act on service tax. It is imposed by Central Government by virtue of powers given to it under Entry 97 of the Union list of Schedule VII of the Constitution of India. The body of Service tax law comprises the facts is mentioned in of following table:-

Table 2

Rules and provisions

1	Finance Act 1994	Chapter V contains provisions on levy or collection, registration and other procedures like appeals, revisions, rectification, interest and penalties, recovery and refunds, search and seizure, etc. Chapter V-A contains provisions on advance rulings.
2	Various rules and forms	Section 94 and 96 I of the Finance Act 1994 empowers the Central Government to make rules for carrying out the provisions of Service Tax. The various rules framed in exercise of these powers are listed below :-
		(a)Service Tax Rules 1994- It provides for registration, maintenance of record, self assessment and provisional assessment, payment of tax, filing of returns, etc.
		(b) CENVAT Credit Rules, 2004
		(c)Export of Service Rules, 2005
		(d)Service Tax (Registration of special category of persons) Rules 2005
		(e)Service Tax (Determination of value), Rules 2006
		(f)Taxation of Services(provided from outside India and received in India) Rules,2006
		(g)Works Contract (composition scheme for payment of service tax)Rules,2007
		(h) Various other Rules.
3	Notifications	The aforesaid rules are amended from time to time The rules have to be in conformity with the provisions of the Act; any rule contrary to the Act will be void. The notification on service tax are issued by central government/CBEC[3] for granting or withdrawing exemptions from Service Tax u/s 93; or dealing any other matter so as to facilitate governance of service tax matters.
4	Circulars, Instructions, Office Letters	They are issued by CBEC to the department administration for explaining the scope and gamut of Service Tax Law. The circulars /instruction letters clarify the position of law, but they cannot go contrary to the law.

Rationale of levying Tax on Services

There is robust logic for contribution of the service sector towards the tax net. This is because economist doesn't distinguish between the goods and services and take both as productive activities that enhance the income of nations. Therefore, several economists are of the view that if tax is payable on the manufactured goods

[3] CBEC stands for Central Board of Excise and Custom.

In the form of excise duty then the services should also not be excused. This has become a basis for the levy of Service Tax. Other jurisdictions for levying Service Tax are:-

- Firstly, as the share of industry in GDP decreases while that of services expands, the tax base shrinks, aggregates buoyancy of excise tax revenue declines and the excise tax / GDP ratio falls.
- Secondly, failure to tax services distorts consumer choices encouraging the tilt towards spending on services at the expense of goods.
- Thirdly, non taxation of services will lead to lavish spending on services by the high income groups. This will reduce savings and ultimately the investment in the economy.
- Fourthly, non taxation of services will mean that traders will not be able to claim VAT on their service inputs. This will result into cascading effect, distorts choice and encourages business to develop in house services creating further distortions.
- Lastly, as most of the services that are under tax net are consumed by high income bracket, so this tax is equitable and progressive in nature.

Genesis of Service Tax in India

Looking back into the past of 1970's the custom duties were as high as 200 percent on many products. Excise duty was also ranged between 2-100 percent[4]. These excessive duties were burdening the manufacturing sector and international trade excessively. So to correct this imbalance, Dr Raja Chelliah Committee appointed by the then Finance Minister Dr Manmohan Singh strongly recommended to bring the services under the tax net. The committee suggested certain services to be taxed to make a move towards the new tax regime called "Value Added Regime". Subsequently in the budget of 1994-95 three services i.e Telephone, General Insurance and Stock Broking were brought under the service tax net @ 5% for the whole of India except the State of Jammu & Kashmir[5].

Assessee under Service tax:-

Payment of Service Tax is the responsibility of the assessee who may be a person or a firm or a Company. Following points are important to mention with regard to levy of service tax-

✓ Service tax is levied only on the final party who renders service to the client. Thus
✓ the sub contractors are not within the ambit of levy of the Service Tax.
✓ Services that are rendered outside India are not subject to Service Tax.
✓ Service Tax is not payable on payments that are received in India in convertible
✓ foreign exchange provided the payment is not repatriated outside India.
✓ Service Tax is not levied or reimbursed out of pocket expenses.

Rate of Service Tax

The rates of Service Tax have been raised in a phased manner in order to boost revenue generation of the State as below-

- The introductory rate of Service Tax was 5% in the year 1994-95.
- This rate was raised from 5% to 8% on all taxable services w.e.f 14-5-2003.

[4] RBI Bulletin, March 1994
[5] Ibid.

From 10-09-2004, the rate of Service Tax was made 10%. Besides this, 2% of Education Cess on the amount of service tax has also been introduced. Thus the effective rate of Service Tax became 10.2%.

In the budget of 2005-06, the rate has been further enhanced to 12%. Education Cess has been retained at the same rate.However from the Finance Act 2009 Service Tax rate has been reduced to earlier rate of 10%. Education Cess has been retained at the same rate[6]. Till Finance Act 2011 the rate of service tax remained 10%.From finance Act 2012 the rate of Service Tax has again increased to 12% from previous 10%[7].

If we will go through close scrutiny of rate changes of service tax, we will find that there have been ups and downs time to time by the hon'ble finance ministers. Let us discuss the same by taking all data in the following table.

Table-3 Rate of Service Tax

Period	Rate of tax
Introduction to 13.05.2003	5.00%
14.05.2003 to 09.09.2004	8.00%
10.09.2004 to 17.04.2006	10.20% (Including 2%E.Cess)
18.04.2006 to 10.05.2007	12.24 %(Including 2%E.Cess)
11.05.2007 to 23.02.2009	12.36% (Including 2%E.Cess & 1% Higher E.Cess)
24.02.2009 to 31.03.2012	10.3% (Including 2%E.Cess & 1% Higher E. Cess)
01.04.2012 to till date	12.30 %(Including 2%E.Cess & 1% Higher E.Cess)

Conclusion

Service tax was introduced in 1994-95 in a small way to operational the principle of neutrality of the tax system to different forms of production and in regulation of the fact that value additions, whether in manufacturing or service, should form the basis of taxation. Taxation of services faces three problems. Firstly a large number of service providers are in the informal sector without a regular system of accounts. Secondly, revenue potential of some of the services may not be commensurate with the efforts involved in the identification, assessment and enforcement. Thirdly, lack of standards in assessments, in view of the wide variations in value additions across and within sectors, may lead to disputes. A system of self-assessment is in vogue since April 2001, where by service providers, on whom the responsibility of payment of tax vests, are required to file a simple return. The rate of service tax was increased from 5 % in 1994-95 to 8% on all taxable services from May 14, 2003. As a major step towards integrating the tax on goods and services, budget for 2004-05 extended the credit of service tax and excise duty across goods and services.

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