THE FINANCE BILL, 2012 WITH RESPECT TO SERVICE TAX IN INDIA – A MOVE TOWARDS INTEGRATED TAX REGIME

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Abstract

The levy of tax on services was an outcome of the New Economic Policy wherein the then Union Finance Minister Dr. Manmohan Singh introduced the tax on services in the year 1994. Service sector is a major contributory to the Gross Domestic Product of India, as also of the world and hence was the need to introduce Service Tax in India which has so far been in its nascent stage. It started as a modest tax on only three services but over a period of eighteen years it has matured into an impending taxation on the entire service sector. Till so far, the reforms in this direction were majorly procedural and resulted in enhancing the assessee base generally, but The Finance Bill, 2012, has attempted to make a major revamp in the Service Tax regime by shifting taxability from positive list to negative list or say from selective basis to comprehensive basis. This is nothing but an attempt to move towards a uniform code namely "Goods and Service Tax", to bring about an integration and simplicity in the taxation laws, making them more easy to follow and in concurrence with international taxation laws. The paper is a serious attempt to study the intention and impact of The Finance Bill, 2012, with respect to Service Tax and how it is beneficial in achieving the ultimate goal of "Goods and Service Tax".

Introduction

The levy and collection of tax on services by the nomenclature "Service Tax" was introduced by Chapter V of The Finance Act, 1994 as a moderate tax on only three services under the organised sector. Gradually, the tax base was broadened and many of the services under the unorganized sector were also made taxable with exemptions, abatements, CENVAT credit etc. A major step has been taken by the Government this year with the introduction of The Finance Bill, 2012, wherein the levy has been made more comprehensive one and a "Negative List" of services is all set to replace the "Positive List". Also the rate of Service Tax has been enhanced and consequential procedural changes have been incorporated in law. The Union Government is aiming to bring out a uniform code in the Direct as well as the Indirect Taxes scenario by the names "Direct Tax Code" and "Goods and Service Tax" respectively. The Goods and Service Tax, hereinafter referred to as GST is all set to replace all other indirect taxes like Octroi, Sales Tax, Central Excise, Service Tax etc. and bring about uniformity and simplicity in Indirect Taxes on a national and state level. It is thus important to understand the nature of taxation on services in India – so far and beyond, the changes sought to be brought by The Finance Bill, 2012, the concept of GST, the extent upto which the said Finance Bill has been able to achieve the goals of GST, implications of the same on various industries on exemplary basis, the hidden anomalies of this movement and the benefits that the Indian economy is likely to achieve from the integrated taxation system. These topics have been vividly covered in the paper after a careful study from various sources.

Meaning of service

Service can be defined as "A type of economic activity that is intangible, is not stored and does not result in ownership. A service is consumed at the point of sale. Services are one of the two key components of economics, the other being goods. Examples of services include the transfer of goods, such as the postal service delivering mail, and the use of expertise or experience, such as a person visiting a doctor."

The term Services has wide connotation and connotes transformation of use/user of goods as a result of voluntary intervention of service provider. Different people have been defining services differently but the basic character of it being an economic activity is of importance for an economy, and simply said in this context, anything which does not qualify as goods is "services".

Need of taxation on Services

The share of service sector in the Indian economy has increased significantly over the years with a contribution of about 59% towards Gross Domestic Product (GDP) of the country. Moreso, the growth in the year 2011-12, in services, is estimated to be 9.4% as against 2.5% in agriculture and 3.9% in industry. The contribution of services to GDP is immense and this has been the reason to bring the services under the net of Service Tax ever since 1994 when the Service Tax was first introduced by the then Union Finance Minister Dr. Manmohan Singh. This is also in league with the international taxation system wherein huge emphasis is laid on taxation of services looking to their increasing role in the world economy. Now, there appears to be a need to replace the Modified Value Added Tax (MODVAT) by full fledged tax across goods and services, wherein set off taxes paid is permissible and the benefit of Value Added Tax is passed on to the ultimate consumer. Indirect Taxes being not period specific and not person specific, is by far a better tool to collect revenue since by broadening the tax base and introducing simplicity and reducing burden of taxes, it restricts the general tendency among consumers to avoid taxes.

The Service Tax which is a fairly recent levy was initially imposed on a selective basis on three services but as The Finance Minister in his Union Budget 2012 speech rightly said that it has reached adulthood, being eighteen years old now and hence the need to shift gears and accelerate is inevitable.

Constitutional validity of levy of Service Tax

In 1994, Service Tax was levied by the Central Government under the powers granted under the Entry 97 of List I. Since the tax was levied under the residuary powers allotted to the Centre, in cases where the subject matter of tax is restricted to the state domain, a number of trade bodies and individual service providers had challenged the levy of Service Tax by the Union Government under the residuary Entry 97, List I in Schedule VII of the Constitution of India and therefore the Government passed the Constitution (95th Amendment Act), 2003 which provides for a formal levy of Service Tax by the Centre through the insertion of Article 268A to the Constitution and Entry 92C of List I. The levy is thus now free from all validity litigations.

The Evolution of Service Tax

The Service Tax was levied in India in 1994 with an intention to bring under tax net the sector contributing maximum to the GDP namely the service sector. Initially, the levy was on a selective basis on three services only, in its nascent stage and over a period of eighteen years the number of services covered under Service Tax had been increased to119 till May, 2011. Initially, Service Tax was levied on services under organised sector to facilitate the prompt collection of taxes and gradually its base was broadened by including the unorganized sector also, while also allowing SSI (Small Scale Industries) exemptions to small service providers generating turnover of upto Rupees Ten Lacs from rendering services. Till so far, the major changes included addition of new services, granting exemptions to various kinds of services, changes in rates of taxation, introduction of reverse charge mechanism and CENVAT credit rules and other procedural aspects. However, The Finance Bill, 2012, has brought a landmark change in the arena of Indirect Taxes by widening the tax net by introducing a comprehensive approach to Service Tax. This is a step towards the proposed "Goods and Service Tax" regime as pledged by the Government of India two years back. The changes brought about in the levy of Service Tax through The Finance Bill, 2012 have been discussed at length in the light of proposed shift to GST system.

Scope and relevance of GST in India

The Government of India is showing all intentions to move towards Goods and Service Tax which is also reflected in The Finance Bill, 2012, and hence it is time to understand the meaning, scope and relevance of GST.

The GST is an integrated value added tax system proposed to be introduced by the Government of India from April 1, 2010 (as announced by The Union Finance Minister Mr. Pranab Mukherjee) but since then, the GST has missed two deadlines and it is now expected to come into force soon.

GST is a comprehensive tax levy on manufacture, sale and consumption of goods and services at a national level and state level. It is a consumption based and not a production based tax. Through a tax credit mechanism, this tax is collected on value-added goods and services at each stage of sale or purchase in the supply chain. The system allows the set-off of GST paid on the procurement of goods and services against the GST which is payable on the supply of goods or services. In such a scene, the end consumer bears this tax as he is the last person in the supply chain.

GST is considered to be a major improvement over the pre existing Central Excise Duty, and Service Tax at the national level and the Sales Tax system at the state level. The new tax will be a further significant breakthrough and the next logical step towards a comprehensive Indirect Tax reform in the country.

World over, the GST rates are typically in between 16 percent to 20 percent and in India it is likely to be around 14 percentage. Internationally speaking, more than 140 countries have introduced GST in one form or another. It has been a part of the tax landscape in Europe for the past 50 years and is fast becoming the preferred form of indirect tax in the Asia Pacific region. It is interesting to note that over 40 models of GST are currently in force, each with its own peculiarities. The best GST systems across the world use a single GST while India has opted for a dual-GST model in which:

- a 'Dual rate structure' consisting of 'Central GST' (to be levied and administered by the Central Government) and 'State GST' (to be levied and administered by the respective State Governments) would be the new form of taxing goods and/or services;
- both taxes would simultaneously apply on a transaction and principally on the same tax base (except in cases where exclusions apply due to turnover thresholds); and
- an Integrated GST or IGST would apply on interstate supplies of goods and services.

From a legislative framework perspective, a single legislation for levying Central GST has been proposed. However, each State and Union territory will enact its own State GST legislation, with an endeavor to adhere to uniform basic features of law such as:

- chargeability;
- definition of taxable event and taxable person;
- measure of levy including valuation of goods and services;
- basis of classification of goods and services; and

- procedure for collection and levy of tax

In view of the above dual-structure, Centre and States would have concurrent jurisdictions for all tax payers; thereby resulting in dual administration and compliances.

The implementation of GST will lead to the abolition of other taxes such as octroi, Central Sales Tax, State-level Sales Tax, Entry Tax, Stamp Duty, Telecom License Fees, Turnover Tax, Tax on Consumption or Sale of Electricity, Taxes on Transportation of Goods and Services, etc., thus avoiding multiple layers of taxation that currently exist in India. Under GST, the taxation burden will be divided equitably between manufacturing and services, through a lower tax rate by increasing the tax base and minimizing exemptions.

Currently, a manufacturer needs to pay tax when a finished product moves out from a factory, and it is again taxed at the retail outlet when sold, but GST will be levied only at the destination point, and not at various points (from manufacturing to retail outlets). In this system, both Central and State taxes will be collected at the point of sale. Both components (the Central and State GST) will be charged on the manufacturing cost. **If the service providers honestly adhere to the input tax credit mechanism and pass on the benefit of all the taxes paid in the entire supply chain to the ultimate consumer, such a system will benefit individuals as prices are likely to come down. Lower prices will lead to more consumption, thereby helping companies**

The Government is working on a special IT platform for smooth implementation of the proposed GST and it is expected to help build a transparent and corruption-free tax administration.

It is estimated that India will gain $15 billion a year by implementing the Goods and Services Tax as it would promote exports, raise employment and boost growth.

Present scene of GST in India

The Finance Minister in his Union Budget 2012 speech said, "the Constitution Amendment Bill, a preparatory step in the implementation of Goods and Services Tax (GST) was introduced in Parliament in March 2011 and is before the Parliamentary Standing Committee. As we await recommendations of the Committee, drafting of model legislation for Centre and State GST in concert with States is under progress." He further stated that the structure of GST Network (GSTN) has been approved by the Empowered Committee of State Finance Ministers. GSTN will be set up as a National Information Utility and will become operational by August 2012.

There is every hope that the improvised taxation system will thus soon be implemented.

Provisions of The Finance Bill, 2012, on Service Tax

In The Finance Bill, 2012, placed before the parliament on 16th March, 2012, The Union Finance Minister, Mr. Pranab Mukherjee emphasized that the share of services in taxes remains far below its potential and that there is a need to widen the tax base and strengthen its enforcement. Accordingly, he introduced major changes in the Indirect Taxes regime especially Service Tax. Some of the proposals of the said Bill are as under:

1. Meaning of Service – In the existing system only the services specified in clause (105) of Section 65 of the Finance Act 1994 are taxed under the charging section 66. In the new system, all services, other than the services specified in the "Negative List", provided or agreed to be provided in the taxable territory by a person to another would be taxed under section 66B.

   Service has been defined in clause (44) of the new section 65B and means –
   - any activity
   - for consideration
   - carried out by a person for another
   - and includes a declared service

The said definition further provides that 'Service' does not include –

- any activity that constitutes only a transfer in title of (i) goods or (ii) immovable property by way of sale, gift or in any other manner
- a transaction only in (iii) money of (iv) actionable claim
- any service provided by an employee to an employer in the course of the employment
- fees payable to a court or a tribunal set up under law for the time being in force

Here it is important that there should be an activity, whether active or passive, including also any forbearance to an act; consideration which means everything received in return of services would include monetary as well as non monetary consideration; there should exist mutually exclusive service provider and receiver, i.e. one cannot provide service to own self and person includes natural as well as artificial or juridicial person.

With this shift from selective approach to comprehensive approach, the question of which taxable service is being rendered shall no longer arise. The taxation in future will be based on what is popularly known as "Negative List of Services".

In simple words, if an activity meets the characteristics of a "Service", it is taxable, unless specified in the Negative List comprising of 17 heads listed in the proposed new section 66D or otherwise exempted by a notification u/s 93 of The Act. Presently, services like non profit organizations relating to public and social welfare, agricultural and animal husbandry services, services rendered by Government and local authorities, education and health services, construction of small residential units, old age homes etc. are included in the negative list with few ifs and buts and similar other exemptions are also available.

This change in character of taxable services is a unidirectional move towards the proposed GST emphasizes upon the integration of taxes on goods and services alike.

2. Changes in Service Tax Rates – The rate of Service Tax has been enhanced from 10% to 12% w.e.f. 01/04/2012 and consequential changes in composition rates have also been made.

3. Place of Provision of Services Rules 2012 – With the introduction of the new Place of Provision of Services Rules 2012, the Taxation of Services (Provided from outside India and received in India) Rules 2006 are all set to be replaced. Since the Export Rules will cease to apply, the required provisions will be incorporated in Service Tax Rules.

4. Valuation – The system of valuation of services for levy of Service Tax and of availment and utilization of CENVAT credit essentially remains the same with only incidental changes required for the new system of taxation .There shall be a sufficient reduction in the cascading of taxes by permitting utilization of input tax credits in a number of services such as catering, restaurants, hotel accommodation, pandal and shamiana and transport sectors.

5. Abatement – The abatement in Service Tax in certain services have been reduced resulting in enhancing the taxable portion of the value, but the same are accompanied with liberalization in input tax credits and this availability of credits will lead to reduction in costs and hence prices for the consumers.

6. Point of Taxation Rules 2011 – These rules lay down the determination of point when the taxation should take place. The liability to pay Service Tax accrues when the invoices are issued against services or money is received, whichever

is earlier. The Finance Bill, 2012, has increased the time period for issuance of invoices to 30 days ordinarily and 45 days for banks and financial institutions.

Analysis of the impact of The Finance Bill, 2012, on Service Tax levy on various services

1. Telecom and Information and Technology industry – With an increase in Service Tax rate from 10% to 12%, there shall be an increased burden of 2.06 % on the telecom services and IT and ITES (Information and Technology enabled services) sector, rendering such services to be more expensive. At the time when the IT and ITES sector industries are already facing escalating input costs, increase in Service Tax rate by 2 percentage points shall further add to the burden.

2. Housing industry – Increasing Service Tax adds to the cost of the property thereby making it more expensive. However, the affordable housing has been included in the negative list which is a pleasant respite and would give a boost to the affordable housing sector. However, what nullifies the above positivity is an increase in Service Tax and excise duty to 12 percent each resulting in an increase in cost of raw material. On an overall basis, whereas the housing sector was looking for a relief from Service Tax, the increase in Service Tax rates will increase the cost of construction by approximately 0.5 percent.

3. E-commerce – The Finance Bill, 2012 will result in synergy and streamlining of the tax structures and thus the E-commerce entrepreneurs can expect a fall in prices of the products sold online. At present, due to differences in tax across states, online commerce ventures, which mostly operate on the hub and spoke model, have set up warehouses in cities where taxes are lower and they can now think of creating fewer and larger warehouses in the most optimal locations.

4. Services rendered by Government and local authorities – Generally the services rendered by the Government and local authorities are in the negative list and hence not subject to Service Tax, but some of the services are still proposed to be subjected to Service Tax. The rationale behind this, as clarified by the Government is that only those activities of Government or local authorities are taxed where they compete with private entities, so as to provide a level playing field to private entities. However, such exemptions would lead to competitive inequities and break the CENVAT chain as the support services provided by Government are normally in the nature of intermediary services. The flaw is amply understandable – majority of the services are consumed by common man and hence there arises no CENVAT benefit and such an act would directly result in enhancing the cost of services to common man.

5. Services mentioned in the Negative List like those related to health, education, medical facilities, agriculture, social welfare etc. along with the exempted services shall only have a sigh of relief till so far as they are waived off from the levy. It shall not be much surprising that in near future the list is further reduced, to make the levy more comprehensive and commensurate with the proposed GST.

The Finance Bill, 2012- A medium to reach the biggest taxation reform " GST"

An attempt to broaden the Service Tax base by introducing taxation on all services except those falling under negative list and exempted categories, enhancing the rate of Service Tax from 10% to 12%, allowing CENVAT credit on Service Tax on a comprehensive basis etc. are all indicative of the Government's aim of inching economy towards "GST" which will be a welcome and desired change for various industries functioning in the Indian economy. Such a migration is extremely important, being guided by a need to move towards a system that is simple, equitable and progressive.

CONCLUSION

The Finance Bill, 2012, read in consonance with the proposed GST is indicative of *per se* simple and integrated laws with larger assessee base, but the question is whether the benefit of setting off Value Added Tax (VAT) will be passed on to the end consumers who are last in the supply chain by the service providers at various stages? The matter is of grave importance because the general tendency of service providers/manufacturers is to charge the burden of increased taxation from the consumers but rarely is it seen that they provide the benefit of declining rates of taxes or benefit of setting off of VAT to them. Such a tendency results in nothing but gross **unjust enrichment** in the hands of service providers. A conceptual learning and consumer awareness are thus required on a large scale so as to educate service providers and consumers to uphold the purpose of law, rather than defeating it.

Another important issue that crops is whether the increase in rate of Service Tax from 10% to 12% is actually enhancing the burden on the consumers? The situation needs to be examined in light of the fact that The Finance Bill, 2012, approaches to broaden the base of assesses by including most of the services provided in the economy, leaving out only a few. This broadening of tax base is also accompanied by the increased VAT credit which was earlier on a selective basis. Some of the services which were earlier not in tax net have now become taxable, some others have become taxable at higher rate due to decrease in abatement and some have become exempted. The net impact would thus not be grave when an overall view of the economy is taken and such a step would only result in enhancing the assessee base, with a consequential wipe out of parallel economy and if adhered to, in honesty, will result in overall reduction in prices by transferring benefits of set off to the ultimate consumer. Such an increment should thus not pose questions about the capability of the economy to take extra burden or the Government being left with no choice but to generate more revenue from easy sources, because this is actually a step towards integration of Indirect Taxes.

Alongwith the proposed "Negative List", there is a series of exemptions available which is indicative of the intention of The Union Finance Minister to retain powers to grant concessions to the deserving cases since the Negative List has been framed with the consensus of the States and cannot be altered easily and frequently. The tendency to have available such exemptions and concessions apart from Negative List is what spoils the simplicity of tariff and provides conflicting viewpoints wherein on one hand the Government proposes to bring uniformity in law and on the other hand it itself creates disparities by different ways and methods. This issue needs to be addressed in the long run with a broader perspective to bring about equity.

In near future, it is estimated that an integrated GST shall be introduced within the country. The first step towards this has already been taken by virtue of reduction in the rate of Central Excise Duty. The next logical step would be to integrate the Central Excise and Service Tax laws into a single levy at a single rate, leading to a Central level GST. Further, the uniform implementation of VAT, the delegation of power to tax services to the states also and the phased reduction in Central Sales Tax would all result in the State level GST. The dual GST would then be assimilated into single GST with the sharing of tax revenue between the Centre and the States. Such a taxation system is good for an economy, good for consumers and administratively easier to implement and would definitely result in bringing more revenue to the Government exchequer.

Tax is the cost of civilization and one must not be disheartened merely by the fact that the rates of taxes have increased. A positive insight would yield that the absolute increase in rate is only a myth, whereas actually it will lead to uniformity and simplicity in taxation, while also reducing administrative costs.

The Finance Bill, 2012, is a positive move towards The Goods and Service Tax regime and both in turn are all set to integrate the state economies and boost overall growth. It will create a single, unified Indian market to make the economy stronger, procuring a major place for India on the world map and should thus be welcomed wholeheartedly..

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