Amended point of taxation rules still remain quite complex

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WHEN I received an SMS in my cell phone from **TIOL** that the Point of Taxation '(POT') Rules has been amended, I felt very happy. I had expected the POT rules to be substantially made simpler, as compared to their original form. When I actually logged on to TIOL in the afternoon, to see the amendments, I felt sad and happy, at the same time. Sad, for the service providers who had started expecting a lot, after the FM's statement in the Parliament on the postponement of the POT Rules. Happy, that as tax practitioner and a Consultant, I will have enough opportunities to make money, courtesy these amended Rules, which have retained much of their original complexity.

This is how Rule 3 read, prior to the amendment:

Determination of point of taxation

3. For the purposes of these rules, unless otherwise stated, 'point of taxation' shall be determined in the following manner, namely:-

(*a)* a provision of service shall be treated as having taken place at the time when service is provided or to be provided; and

(*b)* if, before the time specified in clause (*a)*, the person providing the service issues an invoice or receives a payment, the service shall, to the extent covered by the invoice or the payment made thereof, be deemed to have been provided at the time the invoice was issued or the payment was received, as the case may be, whichever is earlier.

Explanation. - For the purposes of this rule, wherever any advance, by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance.

Explanation 2. - For the purposes of this rule, in respect of services taxable under section 66A of the Act, the point of taxation under clause (*b)* shall be the date on which the invoice is received, or the payment is made, as the case may be, whichever is earlier.

The amended Rule 3, reads as follows:

"3. Determination of point of taxation.- For the purposes of these rules, unless otherwise provided, 'point of taxation' shall be,

(a) the time when the invoice for the service provided or to be provided is issued:

Provided that where the invoice is not issued within fourteen days of the completion of the provision of the service, the point of taxation shall be date of such completion.

(b) in a case, where the person providing the service, receives a payment before the time specified in clause (a), the time, when he receives such payment, to the extent of such payment.

Explanation.- For the purpose of this rule, wherever any advance by whatever name known, is received by the service provider towards the provision of taxable service, the point of taxation shall be the date of receipt of each such advance.".

In terms of the amended rules, the service tax liability would arise on the earliest of the following three occurrences:

++ *Raising of an invoice for service provided or to be provided, provided that where the invoice is not issued within fourteen days of the completion of the provision of the service, the point of taxation shall be date of such completion .*

++ *Date of actual receipt of the money, to the extent of such receipt, if this date is earlier to the time specified in the above clause.*

++ *Date of receipt of an advance, to the extent of this advance money.*

Now, it is clear that, the service tax liability would arise in a case, where an invoice is raised even when no service has actually been provided. To levy service tax on the basis of the raising of an invoice, when no service has been provided or when no payment has been received, is to go beyond the accrual basis. Thus, a software player who raises an invoice for a three year AMC on July 1, 2011, to run from April 1, 2012 would be liable to pay service tax on the basis of the raising of the invoice. In terms of the accrual basis, this software player would not have booked any revenue out of this AMC for the financial year 2011-12 and would not even rendered any service till April 2012. But, the software player would still be liable to pay service tax on the basis that, he has raised an invoice.

One can see a similarity between Rule 3 and the provisions contained in the VAT laws. For instance, Section 7 of the Karnataka Value Added Tax Act, 2003, reads as follows:

7. Time of sale of goods.- (1) Notwithstanding anything contained in the Sale ofGoods Act, 1930 (Central Act 3 of 1930), for the purpose of this Act, and subject to subsection(2), the sale of goods shall be deemed to have taken place at the time of transfer oftitle or possession or incorporation of the goods in the course of execution of any workscontract whether or not there is receipt of payment:

provided that where a dealer issues a tax invoice in respect of such sale withinfourteen days from the date of the sale, the sale shall be deemed to have taken place at thetime the invoice is issued.

(2) Where, before the time applicable in sub-section (1), the dealer selling the goodsissues a tax invoice in respect of such sale or receives payment in respect of such sale, thesale shall, to the extent that it is covered by the invoice or payment, be deemed to havetaken at the time the invoice is issued or the payment is received.

It is then clear that the service tax law is following the VAT law, in so far as the timing of the rendering of services is concerned. But, unfortunately, for the Government, the fixation of the point of tax, based on a legal fiction, is unlikely to stand judicial review.

In the following decisions, it has been held that, by fixing by legal fiction, the taxable event as the point of time of receipt of advance payment or issue of tax invoice, much before the goods are incorporated into the property of the contractee or ownership/possession of the goods involved in transferred to the contractee, would amount to subjecting a transaction of unfructified sale of goods or taxing an agreement to sell goods and hence, is unconstitutional.

Consolidated Coffee Board Ltd v. Coffee Board, Bangalore ***(2002-TIOL-678-SC-MISC)***

Installment Supply Ltd v. Sales Tax Officer, Ahmedabad-I (1974) 34 STC 65 (SC)

It seems that, the Point of Taxation Rules, 2011 would not stand judicial scrutiny in the light of the above decisions. It also seems that, these Rules go much beyond the authority that is vested on the Government by Sections 94 and 68 of the Finance Act, 2004. It will be good to bear in mind that, under the VAT law, the point of taxation is part of the statutory provisions while, under the service tax law, the Government is trying to achieve similar provisions through a back door mechanism by bringing in the Point of Taxation Rules, 2011, which as I said above, is sure to meet judicial resistance.

Be that as it may…. In the case of continuous supply of services, the amended Rule 6 has introduced the following Explanation:

Explanation 1.– For the purpose of this rule, where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the service receiver to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.

This provision will drastically affect the Realty and IT sectors. As we know, Realty Players enter into construction contracts with their customers/flat buyers, as per which, amounts are payable by the customers on fixed dates, subject to completion of the part service, eg. fixing of slabs, etc. Now, irrespective of whether these services have been rendered or not, the Realty Player would be liable to pay service tax on the dates mentioned in the contracts, irrespective of whether any construction work has happened on the site. Similarly, software developers, who enter into mid to long term development contractors with customers, would be liable to pay service tax on the basis of the dates mentioned in the contracts, irrespective of whether the development work has been completed or not. Here again, this Explanation is bound to create a lot of litigation.

These are some of the major issues that could arise out of the amended Point of Taxation Rules, 2011.

Before parting….

As a Chartered Accountant maintaining my books on cash basis, I am happy that, I am allowed to pay service tax on receipt basis, in terms of the amended Rule 7. The CA Institute would need to be congratulated for getting this amendment through, with the Government. However, there is one big catch here, as the benefit of paying service tax on receipt basis is notavailable when any other service is also supplied by the CA. Since, in 9 out of 10 cases, CAs also provide other services like business support services, this benefit would not be available to most CAs.

Another welcome development is the amendment to Rule 4(7) of the Cenvat Credit Rules, 2004, as per which, cenvat credit can be availed on receipt of the invoice of the service provider, except in cases where payment is not made within 3 months. I am

inquisitive to know if my client can take cenvat credit immediately on the basis of the invoice given by me, when the fact remains that I would pay service tax only on the receipt of the fee.

Should the service providers now start issuing documents which need not be termed as 'invoices'. For example, will a request letter issued by a realty player to his customer attract service tax. No, in my view.

In terms of supply of services both to domestic and export customers, I haven't come across any provision that provides for claiming a refund of the service tax paid (on the accrual method), when the customer does not pay for the services. In terms of the amended Rule 4(7), the service receiver would be required to reverse the cenvat credit availed, if he does not pay for the services received by him. But, there is no corresponding provision allowing the service provider to claim a refund in cases where he does not get paid for his services and decides to write off his dues. In contrast, most VAT Acts provide for a self-adjustment / refund of the VAT paid in the case of sales returns. A similar provision is required under the service tax law that would allow for self adjustment and/or refund, in the case of write-offs/bad debts.

Realty Players and Software Developers would be well advised to tweak their agreements to ensure that the payment requirements vis-à-vis their customers are not linked to fixed dates. A lot would now depend on how agreements are entered into by the service providers, with the customers.

It is unfortunate that, as aforesaid, the amended Point of Taxation Rules are still very complex and the element of simplicity that was expected, is badly missing, which is unfortunate, given the fact that the Government has had enough time to revisit these rules.

Wouldn't it have made better for the Government to completely replace the old rules, which only contain 9 rules, with the new set of rules, rather than going for amendments. One is now forced to do a word by word comparison of the old and the new rules, to make sense of the amendments.

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