

Budget 2008: Will Mr. PC up Service Tax Rate? – Feb 15, 2008

EXPECTATIONS are high on what Mr. PC would do in his forthcoming Budget, with regard to service tax, dubbed the country's 'future tax'. Service tax, of course, has come a long long way. Dr Manmohan Singh takes the credit for first thinking of taxing services, when he introduced the levy in respect of three services, in his 1994-95 Budget. However, it is Mr. PC who takes the credit for fully tapping the potential of service tax as a major revenue earner for the Government. Having seen a huge success in terms of service tax collections during 2006-07 and in the current financial year, it would not be surprising to see Mr. PC to expand the scope of service tax to rake in more revenues. With the 2007-08 budgetary estimate of Rs 50,200 corers all set to be surpassed, we would have to look forward for the expansion of the service tax base in terms of introduction of new taxable services, increase in the tax rate and the expansion of the number of assesses from the current base of around 4.75 lakhs.

There is already a talk of 12 new taxable services being introduced in the Budget. The new services likely to be included in the service tax net, as per press reports, are legal draft writing and stamp paper vending, all unaided non-government schools and colleges, unaided non-government hospitals, amusement parks and similar attractions, coin-operated amusement machines and other recreation and amusement services.

Is there a possibility of the service tax rate being increased? A strong Yes, in my opinion. With inflation hovering at around 3.5%, we should not be surprised to see the service tax rate getting increased to 14%. There have been reports that the FM had wanted to raise the service tax rate to 14% in the last year's Budget itself, but had to shelve the plan as the inflation level had crossed 6.5% in Feb 2007. An increase in the service tax rate would also be a right step in the direction in terms of the efforts aimed at introducing the Goods and Service Tax in 2010. Under the dual GST regime initiated by the empowered committee of the State Finance Ministers, it has been reported that Service tax rate under Central GST and State GST is likely to be uniform. An increase in the service tax rate would also enable alignment with the proposed peak rate of tax under the proposed Central GST regime.

Is there a possibility of the States being allowed to levy service tax? This would have to wait as the Government would need to amend the Constitution to grant the power to the States to levy service tax. Of course, States already have the power to collect and appropriate service tax but what they lack is the power to levy tax. Out of the 100 taxable services, the Centre shares 30.5% of the revenue in respect of 67 services, while the States will get 100% of the revenue in respect of the other 33 services, as part of the compensation package aimed at phasing out the central sales tax by 2010. The Centre had also agreed to transfer 44 new services to the States. The empowered committee of state finance ministers had recommended imposition of service tax on three out of these 44 new services, including healthcare, education and amusement parks and coin-operated amusement machines. Post Budget, we could possibly see some activity on the Constitutional amendment related to the power to be granted to the States for levying service tax.

What would the FM be looking at, in terms of the service tax targets for 2008-09? Around Rs 70,000 corers, perhaps? Given the fact that the Government would have achieved a 40% growth in service tax collections in 2007-08 as compared to 2006-07, a target in the region of Rs 70,000 corers would indeed be achievable and would put the Government on track vis-à-vis its target of collecting Rs 100,000 corers by 2010, to coincide with the proposed implementation of the GST. Of course, the Government will have enough justification for the increasing percentage of service tax, in the overall tax collection basket. With the overall contribution of services in India's GDP having increased from 40% in 1994 when service tax was first introduced to the current levels of 60% and with the services sector growing at around 10%, we should expect a sharp correction vis-à-vis the current situation where service tax constitutes only 18% of the indirect tax revenues and less than 9% of the total tax revenues of the Government.

Any possibility of the initial exemption limit being increased? Looks very likely and Mr. PC might increase the exemption limit to Rs 10 lakhs from the existing Rs 8 lakhs.

Mr. PC surprised many of us by levying service tax on commercial rentals. Who knows, he might come out with something as unexpected, in his 2008 Budget.