Employers are service providers vis-a-vis employees under the new service tax law – June 22, 2012

EMPLOYERS ARE SERVICE PROVIDERS, VIS-À-VIS EMPLOYEES, UNDER THE NEW SERVICE TAX LAW

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In terms of the definition of 'service' covered under Section 65B(44) of the Finance Act, 1994, to take effect from 1-7-2012 contained in Section 65B(44) of the Finance Act, 1994, 'service' does not include 'any service provided by an employee to an employer in the course of the employment'….. Very well, Sir……. Per se, employees may not be service providers, vis-à-vis their employers… But, can employers be treated as service providers?

The following are some of the comments, excerpted from the TRU Circular dated 16-3-2012,

Quote :

2.7 Provision of services by an employee to the employer is outside the ambit of services

2.7.1 Are all services provided by an employer to the employee outside the ambit of services?

No. Only services that are provided by the employee to the employer in the course of employment are outside the ambit of services. Services provided outside ambit of employment for a consideration would be a service. For example, if an employee provides his services on contract basis to an associate company of the employer, then this would be treated as provision of service. Likewise a person engaged by the employer in private capacity and beyond the demands of employment will be taxable.

2.7.2 Would services provided on contract basis by a person to another be treated as services in the course of employment?

No. Services provided on contract basis i.e. principal-to-principal basis are not services provided in the course of employment….

Unquote :

A combined reading of the Section 65(44B) and the TRU Circular, gives rise to a lot of disturbing possibilities of transactions, which are currently outside of the net, being brought under the new service tax law….

Here are, some of these possibilities….

In terms of the definition, any 'activity' undertaken by the employer, to the employees, is not included in the excluded category…. As we know, companies, as employers, provide several employee related benefits, which do not form part of the terms of employment. A typical example is that of a Company providing free transport or providing transport at concessional rates, to employees, to its employees to attend office. In many cases, this is also a mandatory requirement, especially, in a city like Bangalore, when women are employed in the BPO sector, beyond certain hours. Is this a taxable activity? Well… it does

seems so, under the new service tax law, irrespective of whether or not, the employer, i.e. the Company, recovers any amounts from its employees.

Take another case….. providing of food, free cost or at concessional rates, by a Company, to its employees, whether or not, thro' an outside caterer. This is a HR practice followed all over the country, by progressive employers. Can this facility be treated as a taxable service, under the new law? In my view, a strong Yes, in the absence of a specific exemption given.

Take another case….. a Company meets a part of the expense incurred by an employee, towards undergoing a specific training course or a professional degree, let's assume. This is a practice widely followed in the IT Sector, as part of the efforts of the employer to equip the employees with the required skill sets. Can this be treated as a service, under the new law, Sir. The answer is, unfortunately, a strong Yes, with the amount paid/incurred by the employer being treated as a service, to the employees.

Any recoveries effected by the Company from the employees' salaries towards notice pay, etc. could be treated as services rendered by the employer to the employee. Any waiver of the notice pay could also get treated as a service as consideration would include 'non-monetary' consideration.

Several other instances of employee welfare expenses incurred by Companies, including payment of mediclaim insurance premiums could be treated as services, under the new law, irrespective of whether these form part of the terms of employment.

Now… let's discuss the exemption given to 'activities' rendered by employees to employers, in the course of employment. The usage of the words 'in relation to employment' could restrict the exempt…. Per se, payments made to ex-employees by employers, could end up attracting service tax. A typical example is severance bonus or any gratuitous payment made to ex-employees, after the cessation of employment.

Let's take another example… a Company follows the practice of paying sales incentive/commission to its sales force, based on collections…. let's assume that, this Company, pays sales commission to its ex-sales manager, on sales effected during the period that this gentleman was employed, but after he has quit office and joined another company. Though this payment can be treated as having been made 'in the course of employment', the fact remains that, the recipient is not an 'employee' when he gets the amount… Can this be treated as a 'service' under the new law? I have no clue, except to say that, transactions like this could create a lot of issues under the service tax law.

Another example…. a Company sends its Sales Head and his family on a paid holiday to Europe, on the surpassing of the annual sales target… A service, under the new law, at least, in so far as the holiday expenses pertaining to the employee's family? My guess is as good as anybody else's…

And, how about, referral bonuses paid to employees for referring/getting their unfortunate (sometimes, fortunate) friends/ex-colleagues to join their employers … a popular practice followed by the IT Sector… can this could be a 'service' under the new law on the premise that, payment of referral bonus is to be treated as outside the ambit of employment… I have no clue, Sir.

A company organizing a picnic for its employees can also be treated as a service provider, vis-à-vis the employees. Birthday Parties, get-togethers and many other expenses classified under 'Employee Welfare Expenses' can get covered under service tax.

Before concluding….

Many gratuitous payments effected by employers could be treated as not having been made in the 'course of employment' and consequently liable to service tax. Typical examples are….gifts given on special occasions such as the Founder's Day, on the Company completing ten years, cash awards given to employees' children, etc.

There could be several other complications that would arise, under the new service tax law, in respect of employer-employee related transactions and one would have to wait and see the havoc the new service tax law would wreak on corporates.

The accrual basis to be compulsorily adopted by corporates for payment of service tax would be another major issue, vis-à-vis 'activities' with employees. For example…. assuming that, a large IT Company in Bangalore provides free canteen facility to its employees and follows the practice of settlement of the catering/canteen provider's bills in 90 days' time. When does the liability to pay service tax arise, for the employer, in this case?… at the end of the relevant month, or on the date of payment of the canteen service provider? And, how does the Employer raise an invoice, which is mandatory, under the service tax law, for taxable services provided? Does he have to raise an invoice on each of his employee, which could run into thousands of invoices? My God…. I can't even imagine the consequences, Sir.

Industry should lobby to get an exemption notification issued covering all transactions between employers and current and ex-employees.

One would wonder as the compliance cost for corporates under the new service tax law… each and every transaction would need to be seen with a lens to ascertain the service tax liability.