Exercise of caution – New proposals in Service Tax could get misused – Mar 8, 2013

taxindiainternational.com taxindiaonline.com
taxindiaonline.com
one-stop destination for taxman & taxpayer

MARCH 08, 2013

By S Sivakumar, Advocate

A cursory glance at the proposed Section 78A which talks of imposition of personal penalties on Directors, Managers, etc., amended section 89 and new sections 90 and 91 sought to be introduced by the Finance Bill, 2013 in the Finance Act, 1994 which deal with imprisonment, arrest, etc. reveals one common thread. Collection of service tax and not remitting it to the Government within a period of 6 months from the due date is now being clearly recognized as an offence, attracting the penal and imprisonment provisions. In fact, in terms of the proposals, a case involving collection of any amount as service tax and failure to pay such amount to the credit of the Central Government within a period of 6 months from the due date is to be treated as a non-bailable offence and could attract an imprisonment of a minimum of 6 months and a maximum period of 7 years, when the amount involved is Rs 50 lakhs or more.

By default, it would seem that, a delay in remitting the service tax collected for a period of less than six months is not recognized as a specific offence, though, such an act could still be treated as an 'evasion of tax'. It is natural for the Government to treat cases of collection of service tax and not remitting to the Government's coffers as an offence, far more serious, than any other offence.

So far so good…none of us have any sympathies for a wilful offender who does not remit the service tax collected to the Government, within a period of 6 months from the due date.

But, very unfortunately, these Sections, insofar as they deal with collection and non-remittance of tax could be potentially mis-used by an over-zealous Department in cases, where the prices quoted by the service provider are 'inclusive of taxes'. As we know… it is very common for turn-key contracts to be awarded by the Central and State Governments, PSUs, Defence Establishments, etc., at 'all inclusive' rates or prices. One reason is that, most of these establishments are not manufacturers or service providers and hence, cannot avail of cenvat credit. Moreover, the entire budgetary process is based on monitoring of total costs of projects.

It is very common in these contracts or orders to come across a typical clause which would state that, the contractee is liable for all taxes and levies, under the Central and State laws. It is also common for many players in the private sector, to follow this practice of having a billing price which is 'inclusive of all taxes', especially in cases involving turn-key contracts, construction contracts, etc.

Despite that, service tax is not meant to be collected and is not included in the pricing in many of these contracts, there is a real danger for the Department to invoke the penal and imprisonment provisions on unsuspecting companies on the basis that, the 'all inclusive' prices include the service tax component.

It is very important for contractees, who have entered into 'all inclusive' pricing contracts to re-visit their contracts and to incorporate clear provisions, wherever necessary, to state that the prices do not include the service tax component.

Taking this discussion forward…. though the proposals make use of the words 'amounts collected as service tax', instances involving 'all inclusive' prices could get covered under these provisions.

Now…talking of the personal penalties on Directors and Managers for service tax contraventions…

One major distinguishing feature of this Budget has been the proposal related to the levy of personal penalties on Directors and other officers of companies, for certain specified offences, contained in Section 78A. The proposal to make the Directors and other officers, responsible for the misdeeds of the company committing the prescribed offences is not something that is being done for the first time. The fact remains that Section 81 of the Finance Act, 1994, as it then stood before it was deleted with effect from 10-9-2004, did talk of 'offences by companies'. This Section 81, used wordings that were similar to that used in the Central Excise Act, 1944 [Section 9(1)], the Customs Act, 1962, the FEMA, etc.

A perusal of the new proposal would seem to indicate that, it is far more stringent, as compared to the earlier provision. Section 78A, as proposed, talks of the Director, Manager, etc. being subjected to the levy of a personal penalty, in respect of the four specified offences committed by companies, if such Director, etc. "was in charge of, and was responsible to, the company for the conduct of business of such company and was knowingly concerned with such contravention". The litmus test for a Director etc. to be proceeded against under the proposed Section 78A is that he should have been 'knowingly concerned' with the contravention.

The word' concerned', from a legal perspective, has several meanings and can cover many instances where the Director, etc. might just have been negligent or, might not have exercised due care or diligence. In a large company, it is very natural for the Directors to leave the operating management including management of tax matters to professional managers. In a typical case where contraventions happen at the operational level without the knowledge of the top management, it is much easier for the Director to take the protection of Section 81 as it stood before 10-9-2004 and similarly worded Sections in the other economic laws by proving that the offence was committed without his knowledge and that he had exercised all due diligence to prevent the commission of the offence.

It would seem that the words 'knowingly concerned' might cover several cases wherein the Directors and other members of the top management team could be held liable for contraventions committed by the operational team without their knowledge.

Another interesting issue that arises out of the proposed Section 78A is whether the penalty prescribed can be levied for each contravention of the Company. Thus, for example, let's say, in a hypothetical case of evasion involving non-payment of service tax on 30 invoices spread over a period of 6 months, let's say, can penalty be levied at, let's say, Rs 1 lakh for each of the invoices, resulting in a total penalty of Rs 30 lakhs, on the Director. In terms of this rather loosely worded Section 78A, such an action of levying penalty on each contravention might not be illegal.

Needless to say…. this Section can be used as a harassing tool by the Department, against unsuspecting companies. The Finance Ministry should re-visit this Section and incorporate a paragraph on the lines of the erstwhile Section 81 which granted immunity to a Director etc. who exercised due diligence. The Board should also come with a detailed Circular on how this Section is to be read and implemented by the Field Force.

This Section 78A along with the arrest and imprisonment provisions should serve as a wake-up call for corporate managements. Every company should have a clear internal manual of Dos and Don'ts in respect of tax matters and especially, for service tax matters, given these provisions. Top Managements of companies should conduct a regular review of the corporate tax policies and procedures to ensure that no contraventions

are committed ‘knowingly’ and that there is a clear distinction between aggressive tax planning/tax avoidance backed by legal opinions and tax evasion given the inevitable consequences that would follow the latter.

Before concluding…..

Talking of these proposals… it seems clear that for a case to be covered under these provisions, the amount of service tax that is involved should be more than Rs 50 lakhs and the period of default should be 6 months or more. In cases where the service tax amount involved is more than Rs 50 lakhs, there would be no default, if the delay is less than 6 months.

These provisions, draconian as they are, do not cover cases where there is no physical collection of service tax, by the service provider. For instance…. when the service provider has raised an invoice for, let’s say, Rs 5 crores involving a service tax liability of Rs 61.80 lakhs, and has not discharged his service tax liability, let’s say, for a year owing to the service receiver not paying service tax, there would be no default under these provisions as there is no collection of service tax, though, such a case could still come under the provisions related to ‘evasion of service tax’.

I am not sure, if these provisions could get attracted in a case, where the service provider is not paying the service tax component, owing to a dispute. Though the service receiver would have collected the amounts representing the value of services rendered by him, it cannot be said that, he has collected an amount representing’ service tax’.

The Government needs to make it clear that, a dispute related to the allowability of cenvat credit cannot be covered under the new logic of “collecting and not-depositing” service tax. The Department would be most happy to convert cenvat credit related disputes under these proposals (as, denial of cenvat credit would automatically lead to a situation of the service provider collecting and not paying service tax) and use the threat of arrest, penalties, etc., on the unsuspecting assessees.

The Government also needs to make it clear that these proposals would only cover cases, where service tax is collected as a separate head, in the invoices or bills, as aforesaid.

Given the potential misuse that the new proposals related to ‘collection and non-deposit” could be subjected to, the Board needs to come out with a circular, detailing the circumstances which can be covered under this specific offence.