

How would the penalty and prosecution provisions affect the IT and Services sectors – March 23, 2011

How will prosecution related provisions affect IT Industry

One major dampener arising out of the Budget 2011 proposals has been the 're-introduction' of the provision related to prosecution, under the service tax law. As we know, the Finance Act, 1994, as originally passed and amended, did contain provisions related to prosecution, in Sections 89, 90 and 91. These provisions were deleted with effect from 16-10-1998 by the Finance Act (No.2), 1998. Now, the Finance Bill, 2011, has proposed to bring back the prosecution related provisions into the statute book, in an expanded and obnoxious form.

In terms of Section 89(1), as proposed in the Finance Bill, the prosecution proceedings can be initiated against anybody, who-

(a) provides any taxable service chargeable to service tax under sub-section (1) of section 68 or receives any taxable service chargeable to tax under sub-section (2) of the said section, without an invoice issued in accordance with the provisions of this Chapter or the rules made thereunder; or

(b) avails and utilizes credit of taxes or duty without actual receipt of taxable service or excisable goods either fully or partially in violation of the rules made under the provisions of this Chapter; or

(c) maintains false books of account or fails to supply any information which he is required to supply under this Chapter or the rules made thereunder or (unless with a reasonable belief, the burden of proving which shall be upon him, that the information supplied by him is true) supplies false information; or

(d) collects any amount of service tax but fails to pay the amount so collected to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due....

Here are some of the ways, these provisions could be used against Industry in general and the IT /services industry in particular.....

- Providing a taxable service without an invoice is now an offence, which can invite prosecution proceedings. All service providers including exporters, would now be required to issue invoices, incorporating the details required to be included under the Service Tax Rules, 1994. It is seen that most IT exporters use invoices, which do not contain the details prescribed by the Service Tax Rules. This would no longer be possible, as the invoices would necessarily need to contain the prescribed details.
- Many IT services exporters have not bothered to get themselves registered. Since, invoices would need to be issued now, IT companies would need to get themselves registered, as without mentioning the registration number, invoices cannot be raised.
- Receiving an invoice in respect of transactions covered by Section 68(2), would also be an offence. Thus, services importers would now need to ensure that they receive invoices, in the prescribed form.
- Proper records would now have to be maintained including the appropriate books of accounts. Moreover, assesseees would now be required to provide any information that the Department might require, of them. Any providing of false information might attract prosecution proceedings.
- Most of the provisions contained in Section 89(1) as now proposed, seem to have been borrowed from Section 9 of the Central Excise Act, 1944. The Government does not seem to appreciate the difference and distinction between

goods and services and the attempt to do a cut and paste of Section 9 of the Central Excise Act, which is applicable to goods, could lead to a lot of unintended issues, cropping up in service tax matters.

- It seems rather obnoxious that, prosecution can be initiated against service providers including exporters, when they don't issue invoices. Invoice is only a document, based on which, the service tax liability is computed, in certain circumstances. The penalty provisions can be tweaked to penalize the service providers who do not issue invoices, but, there seems to be no justification to invoke the prosecution proceedings for what are essentially, administrative lapses.
- As aforesaid, these provisions would also include the exporting community. Many exporters haven't thought of registering themselves. Now, they would need to register themselves and also start issuing invoices containing the information required by the statutory provisions, as otherwise, the Department could invoke the prosecution proceedings against them.
- Mens Rea, (i.e. a guilty mind) is not necessary, for prosecution proceedings to be initiated, in terms of the present draft of Section 89(1). The section uses the words "shall". This is a very worrisome development. Company officials would now have to be extra careful about statements, etc. given to the Departmental officials, as these statements can form the basis for initiation of prosecution proceedings.
- Under the proposed rules, the prosecution can be launched only with the approval of the Chief Commissioner, is unlikely to give comfort. Given the track record of the Government, one should expect this power to get diluted in the coming days, with junior officers being provided with this power.
- Of course, there is no power to arrest, under the current service tax law, unlike the central excise law. We have seen that the Department is contesting practically, each and every claim of the assessee, whether it is related to the levy of service tax or to cenvat credit. Now, the Department will also use the power to prosecute, to achieve its goals and surely, the threat of prosecution would be another factor that the hapless assessee has now got to live with. Indian Subsidiaries of MNCs would have to ensure that they have good systems in place, in order that the new requirements of the service tax law are met.

Drastic Changes in penalty, search and recovery provisions under service tax

Chapter V of Finance Act, 1994 is proposed to be amended by Finance Bill 2011 as follows

- Section 73(1A) of the Finance Act, 1994 is proposed to be deleted together with both the provisos to sub-section (2) of section. As a result, the benefit of reduced penalty available in cases of fraud, collusion, etc. under proviso to section 73 (1A) shall no longer be available.
- Further, a new sub-section 4A is being inserted in Section 73 to provide for reduced penalty in cases where during the course of audit, verification or investigation it is found that the transactions not reported to the department are available in the records or invoices. Moreover, penalty is being reduced to 1 % per month of the tax amount up to a maximum of 25%.
- It is proposed to reduce the penalty for the delayed payment under Section 76 from 2% to 1 % per month or Rs. 100/- per day, whichever is higher. Maximum penalty reduced to 50% of the tax amount.
- It is proposed to increase the maximum penalty under Section 77 from Rs. 5,000/- to Rs.10,000/-
- It is proposed to amend Section 78 to revise the maximum penalty. Penalty will be hereafter mandatory and would equal the quantum of tax evaded. Moreover, in situations covered under Section 4A, the penalty shall be 50% of the tax amount. Further, the penalty is being reduced to 25% if the tax dues are paid within one month together with interest and reduced penalty.
- It is proposed to increase the maximum penalty for delay in filing of return under Section 70 from Rs. 2000 to Rs. 20000. However, the existing rate of penalty for the first 15 days and for the subsequent 15 days as well as the daily penalty of Rs. 100 per day thereafter under rule 7C of the Service Tax Rules, 1994 are being retained without any change.
- It is proposed to amend the power to waive penalty under Section 80. While penalties under Sections 76 and 77 are being retained, penalty under Section 78 is being waived only in cases where the transactions are captured in the specified records. It would now be necessary for IT and services companies to capture all the service tax transactions in their specified records.
- The power to issue search warrant under Section 82 will now be at the level of Joint commissioner and the execution of such warrant will be at the level of Superintendent. Under the current rules, the search warrant can be issued only by the Commissioner, while the search warrant can be executed by the Assistant Commissioner. Service providers should now look forward to searches, as a matter of routine.

- A new Section 88 is being inserted so as to create first charge on the property of the defaulter for recovery of service tax dues from such defaulter subject to provisions of Section 529A of the Companies Act, the Recovery of Debt due to Bank and Financial Institutions Act, 1993 and Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

Before concluding.....

The IT and Services sectors are, by and large, not covered by the central excise and VAT provisions. Consequently, they are not exposed to the harsher realities of life, arising out of some of the obnoxious provisions contained in the central excise and VAT laws. Now, with the service tax law also re-introducing the prosecution related provisions, life would seem to have a full circle for the IT and services sectors.

It is unfortunate that the Government is not distinguishing between the manufacturing and the services sectors. To extend the prosecution related provisions which are currently applicable to central excise related offences to the service tax related offences is quite unwarranted.