Will FM handle these most contentious service tax controversies…

S Sivakumar, CA

Service tax, despite being a relatively new law, has generated a lot of unique controversies, issues and confusions. Being the Budget time, one expects that these controversies, some of which have been discussed below, receive the FM's attention.

Issue No.1 - Will the Government please take out packaged software from MRP regime?

The semblance of clarity in terms of the levy of service tax on software, which had emerged, post Budget 2010, would seem to have shattered once again, with the Government bringing the packaged software industry under the MRP based central excise levy scheme by issuing Notifications bearing Nos 30/2010-CE and 53/2010-Service Tax, both dated December 21, 2010. In terms of these Notifications, an abatement of 15% has been given on the MRP of the packaged software, based on which, central excise duty will have to be paid by the manufacturer and CVD to be paid by the importer. This recent development would seem to have added fresh issues for the packaged software industry, which, as such, is not sure as to whether it should charge central excise or service tax. There is no justification in bringing the packaged software industry under the MRP regime which can be applied only for goods which are sold through multiple channels like pharmaceuticals, consumer goods, etc. There are reports that packaged software importers are shifting to the electronic mode, to get over the issues related to the MRP system. The FM would do well to withdraw these Notifications in the Budget and provide relief to the packaged software industry.

Issue No.2 - Can service tax be charged on electronic transfer of software licenses?

The Government seems to be under the impression that, the software industry would have to pay either central excise duty or service tax and it is not possible for a transaction related to software, not to fall under either of these central levies. Not quite true, Mr FM, Sir.

Transfer of right to use goods is a sale which attracts VAT. The Union Government is levying service tax on the same transaction, under Clauses (v) and (vi) of Section 65(105)(zzzze). This goes against the basic principle that the same transaction cannot be a sale and a service, a view upheld by the Courts, including in the Imagic Creative case.

One hopes that this major anomaly is rectified in the forthcoming Budget so that, the industry is not required to pay both VAT and service tax on the electronic transfer of software licenses.

Issue No. 3 - Why is the Department not willing to exempt the value of goods, for levying service tax?

Assessees have an excellent benefit in Notification 12/2003, according to which, the value of goods and materials sold by the service provider cannot be subjected to the service tax levy. The Department is hell bent on refusing the benefit of this very important Notification to most players, on flimsy and legally unsustainable grounds. Some of the instances where the Department is refusing to apply this Notification are in respect of Developers/Builders, Software players who license out their products, players who render annual maintenance contracts, etc., despite that, the Tribunals have been giving decisions against the Department.

Will the FM have the Board clarify that the benefit of Notification No. 12/2003 should not be denied on flimsy and frivolous grounds?

Issue No. 4 - Department imposing penalty in most cases despite salutary amendment to Section 73(3)……

In terms of the insertion of Explanation 2 to Section 73(3) by the Finance Act, 2010 with effect from 8-5-2010, no penalty under any of the provisions of theFinance Act, 1994 shall be imposed if the service tax along with interest is paid before the issuance of the Show Cause Notice. Many of us believed that this was a good amendment which would bring a lot of relief to the service tax payers. But, it seems that, this amendment has completely failed to achieve any great purpose as the Department has been classifying most of the cases under Section 73(4) as per which, the benefit of penalty not being levied cannot be extended to cases involving fraud, suppression of facts, etc.

It is seen that the show cause notices are issued and penalty provisions are invoked even in cases of genuine mistakes on the part of the assessees. Surely, the intention behind the salutary amendment to Section 73(3) and the Board Circular No. 137/167/2006-CX-4 dated October 3, 2007 has not been met, as the Department is classifying almost all cases as those involving fraud, suppression of facts, etc.

The FM could think of bringing yet another amendment or have the Board issue a circular instructing the Department to extend the benefit of Section 73(3) to genuine cases.

Issue No. 5 : Service tax refunds are just not flowing, despite innumerable circulars and communications from the Government

This is one area which the Government would perhaps feel really helpless, in terms of its inability to have the Department implement the spirit behind the numerous clarifications, circulars, notifications and amendments issued on this subject. As I have seen over the months, the Circular No. 120/01/2010-ST dated January 19, 2010 is actually being used by the Department to reject refund claims of exporters, in toto and flimsy and frivolous reasons are being cited by the Adjudicating Officers to reject refund claims. One wonders if even a micro fraction of the refund claims filed by exporters are getting sanctioned by the Department.

Worse, the Departmental officers are going on appeal against the orders of the Appellate Commissioners and, in effect, questioning the very validity of the said Board Circular.
Exporters are fed up with the current situation. It is reported that tens of thousands of crores of

service tax refunds have either been rejected or are pending adjudication for years. This is a very unhealthy state of affairs and many exporters have stopped submitting refund claims, utterly disgusted with the current state of affairs. It's time, the Government acted firmly in this matter and took the errant officers who are not sanctioning refunds, to task.

Many junior adjudicating officers informally say that they are under 'informal' instructions from their senior officers like Additional Commissioners, Commissioners and Chief Commissioners not to allow refunds except for three or four input services. This becomes clear when one goes through the 'cut and paste' adjudication orders issued by the Asst/Deputy Commissioners. If the issue is indeed with the senior Departmental officers, the Government would do well to study the facts and take remedial action at the earliest, as exporters are fastly losing hope in the system.

Issue No. 6 – Department hell bent on denying cenvat credit…..

Cenvat credit is one of the most contested and litigated subjects in indirect taxation. The Department seems to be hell bent in contesting each and every cenvat credit claim by the assessee. Of course, the Department has been highly encouraged by some of the circulars issued by the Board, under which, highly unsustainable and ethically incorrect stands have been taken on the subject matter of cenvat credit. The classic case is that of Circular No. 98/1/2008-ST dated January 4, 2008 wherein the Board says that, lessors/developers/builders/landlords who are liable to service tax under 'Renting of Immovable Property' services are not entitled to avail of cenvat credit in respect of service tax paid to contractors who have actually constructed/built the complexes. One completely fails to see the justification here… while, for purposes of levy of service tax, the Government says, renting is a service… but, for purposes of allowing cenvat credit, the Government says, there is no service involved in renting and that, it is a transaction involving immovable property. While privately, most Adjudicating Officers including Commissioners make fun of this Circular, they still invoke this Circular to deny credit and the result has been a sharp increase in the cases being filed before the Tribunals. It's time the FM scrapped this Circular.

With the Department bent on refusing cenvat credit claims in most cases, the assesses can expect justice only at the level of the Tribunal. The Department does not want to accept the binding decisions of High Courts rendered in the cases of Coca Cola, Ultratech and Convergys, wherein, it has been held, in no uncertain terms that cenvat credit is admissible in respect of service tax paid on all services used in relation to the business of manufacturing the final product and that, the definition of "input service" is very wide and covers not only services which are directly or indirectly used in or in relation to the manufacture of final products, but also includes various services used in relation to the manufacture and that, the definition of "input service' is wider than the definition of "input" and that, cenvat credit is available on all expenditure incurred by the assessee which forms part of the assessable value of the final product.

One would request the FM to introduce statutory amendments to the Cenvat Credit Rules, 2004, so to ensure that cenvat credit is made available in respect of duties and taxes paid on all inputs and input services, the cost of which, have gone into the final price of the manufactured product or the

service. Even the Apex Court had also commented on the improper manner in which the cenvat credit rules have been drafted, in the GNFC case.

Issue No. 7 - Why can't the Government just accept that service tax cannot be levied on import of services prior to April 18, 2006 and let the importer get his sleep?

The date from which the Government is entitled to levy service tax on import of services is one of the most confusing concepts in service tax. Very briefly, as per Notification No. 36/2004-ST, service tax on import of services is applicable effective from January 1, 2005. Notwithstanding this, the Government introduced Section 66A in the Finance Act, 1994, as per which, service tax on imported services can be levied only from April 18, 2006. Despite that the Bombay, Karnataka and Delhi High Courts have held service tax on import of services cannot be levied prior to April 18, 2006, the Department has been issuing protective show cause notices, presumably on the basis of its view that, service tax in respect of services imported into India, as contrasted to services received outside India, can be taxed effective from January 1, 2005. Some over-enthusiastic officers seem to believe that service tax on import of services is actually leviable from August 16, 2002, in the light of the amendment to Rule 2(1)(d)(iv) of the Service Tax Rules, 1994.

It's time the Government graciously accepted the decisions of the Apex Court and the High Courts and clarified that, it would not ask for service tax to be paid on import of services, prior to April 18, 2006, irrespective of whether the service is received in India or outside India.

Issue No.8 - No retrospective amendments in this Budget, please…

One fervently hopes that the FM does not go in for retrospective amendments in this Budget and especially, in service tax. Last year, we saw the retrospective amendment in respect of the levy of service tax on renting of immovable property services. We also saw totally unclear amendments being inserted through Explanations to existing services like Construction of Complex services. As a matter of practice, the Department takes the view that all taxing amendments are retrospective in nature, while all benefit giving amendments are only prospective. There can be little doubt that, the power to retrospectively amend a taxing statute should be exercised only in exceptional and in the rarest of rare cases. It's a bad practice to amend the law retrospectively, every time the Government encounters an adverse judicial view.

Before concluding…

Two of the country's most promising industries, viz. Software and Realty, have been suffering from a total lack of clarity in respect of service tax provisions and are, perhaps, the only sectors which have seen retrospective amendments. These sectors are being subjected to double taxation in terms of VAT and service tax being levied on the same part of the transaction value. The software sector has also been hit by the refusal of the Department to sanction refund of service tax. This is a rather sad state of affairs and reflects badly on the Government of the day.

One hopes that the FM would use the Budget to bring in the long pending clarity in terms of the service tax provisions and open the tap of service tax refunds to the exporters.

(The Author is Director, S3 Solutions Pvt Ltd, Bangalore)