

POST-BUDGET MEMORANDUM – 2008

INDIRECT TAXES

A. INTRODUCTION

- 1.0 The Council of the Institute of Chartered Accountants of India considers it a privilege to submit this Post-Budget Memorandum to the Government.
- 1.1 Every year, the Institute organizes a workshop on the Union Budget in which the senior officials from the Central Board of Excise and Customs participate and give appropriate clarifications. Accordingly, a workshop on the Union Budget 2008-09 was organized by the Institute on 5th March, 2008. The session was devoted to a discussion of the indirect tax proposals. Senior Officials of the Government participated and gave appropriate clarifications on the various issues. In this memorandum, we have suggested certain amendments to the proposals contained in the Finance Bill, 2008 which would help the Government to achieve the desired objectives.
- 1.2 In the Post Budget Memorandum on indirect taxes we have given the relevant issues arising out of the budget proposals and have also given our considered suggestions to address the same.

POST BUDGET MEMORANDUM-2008

INDIRECT TAXES

A. AMENDMENTS TO CUSTOMS ACT AND CENTRAL EXCISE ACT

1. Issue

Section 129EE is proposed to be inserted in the Customs Act, 1962 and Section 35FF is proposed to be inserted in Central Excise Act, 1944.

The proposed amendment is a welcome move as it provides for payment of interest on delayed refund of the amount deposited under proviso to Section 129E and 35F respectively.

The proposed section provides for payment of interest after expiry of three months from the date of communication of the order of the appellate authority till the date of refund of such amount except in cases where the operation of the order of the appellate authority is stayed by a Superior Court or Tribunal. This exception creates practical difficulties as the said order of the Superior Court or Tribunal may come late and if the reference is proposed, the order of the appellate authority may not be communicated to the assessee till such time as the appeal is filed to the Superior Court or Tribunal and the Superior Court or Tribunal issues the order.

Further, this results in denial of interest on appellant's amount during the period of stay even though the matter is ultimately decided in favour of the tax payer.

Also, a strict reading of the section indicates that if a stay is granted against the operation of the order by a Superior Court or Tribunal, there would be no interest payment at all even if finally the matter is decided in favour of the tax payer and the deposited amount is refunded.

Further, the interest on the refund is sought to be provided from the expiry of three months from the date of communication of the order of the appellate authority till the date refund of such amount which results in denial of interest from the date of deposit made by the tax payer. The section requires determination of the date of communication of the order to the appellate authority which create difficulties as against the date of passing of the order which is simpler, identifiable measure.

Suggestions

- a) ***Interest on refund of the deposit amount be provided from the date of deposit of the amount.***
- b) ***Alternatively, the period of three months be reckoned from the date of passing of the order by the appellate authority.***

- c) *Interest on delay in granting refund be provided in all cases irrespective of the state of operation in all cases even if the operation of the order of appellate authority is stayed by a Superior Court of Tribunal.*

2. Issue

An exception is proposed to be added to Section 2(d) of Central Excise Act, 1944 explaining the meaning of the term “goods”. It provides that any article, material or substance, which is capable of being bought or sold for a consideration, shall be deemed to be marketable.

For goods to be excisable, the same ought to result from a process of manufacture which term is again defined only in an inclusive manner. The courts have interpreted the term to mean “*a process leading to change in the name, character or use of the material processed*” and have, in some cases, also added the marketability element as well as a criteria for determining whether the goods emerging from the process could be regarded as manufactured. As will appreciate the terms “goods” and “manufacture” have been explained and read together for the purpose of determining excisability of manufactured goods.

It may, therefore, be necessary to also modify the definition of “manufacture” [Section 2(f)] to avoid possible disputes especially in relation to taxability of waste and scrap arising in the course of

manufacture which is not arising as a result of manufacture per se but in the course of manufacture of primary goods.

Suggestion

An appropriate sub-clause to the effect that any process by which goods arise / come into existence at any time during the course of manufacture of any goods and which are bought and sold for a consideration shall be deemed to be a process of manufacture.

B. AMENDMENTS TO SERVICE TAX LAW

Banking and Financial Services - Foreign Exchange Broking

3. Issue

Service rendered in relation to the activity of purchase and sale of foreign currency in the capacity of principal is proposed to be brought into the service tax net by substitution of sub-clause (iv)(a) to S 65(12) which is not the case with any other goods.

The activity of purchase and sale of goods is within the domain of the State Government and, therefore, we believe that the provision to tax the activity relating to purchase and sale of foreign currency would be ultra virus.

We, however, understand that what is sought to be taxed is only the service being provided by foreign exchange **brokers (agents)** for purchase and sale of foreign currency. This is also clear from the fact that 0.25% of the purchase or sale price is sought to be treated as the service element.

The tax is sought to be levied on both legs of the transaction i.e. purchase as well as sale of foreign currency. If the transaction is between two brokers, it would amount to double taxation as the purchase as well as sale transaction would be taxed separately.

Further, service provided by “any person” is taxable under the category of banking and financial services. Thus, an individual who sells foreign currency or buys foreign currency may also be held to be liable to service tax.

Suggestions

a) Appropriate amendment/clarification be issued to the effect that the tax is on the service provided by brokers/agents in relation to purchase or sale of foreign currency.

b) One leg of the transaction either the purchase or the sale may be taxed or appropriate amendment be made/exemption notification be issued to the effect that the tax is leviable only on the broker and not on the purchaser or seller of the foreign currency .

4. Information Technology Service

We welcome the proposal to consolidate and introduction of new entry relating to Information Technology Software service and also note that the definition of the term “Information Technology Software ” is the same as that adopted for Customs and Central Excise Duty purposes to maintain uniformity.

There are few areas of concern in this regard:

1 The new category proposes to bring to charge taxation of software supplied electronically and as we read the language, it appears to cover both customized and packaged software. Packaged software delivered on media from outside of India is today exempt from charge of customs duty. The reason for taxing the same when delivered electronically is not clear to us.

2 Some of the services relating to information technology software are still covered under other categories like repair and maintenance of software, technical testing. Since the tax treatment is the same, all the categories are taxable, there does not seem to be a justifiable reason to keep them under other categories.

3 It is not clear as to how the same are to be treated for the purpose of Import and Export of Service Rules.

4 Many States impose tax (VAT) on software which includes customized and packaged software. The States do not distinguish between the mode of delivery and therefore, even if the packaged software is delivered electronically, they would tax it. Thus, there will be double taxation and spate of litigation.

Suggestions

a) Tax incidence ought not to be different based on the mode of delivery and, therefore, we suggest that either customs duty entry be

amended or service tax entry be amended. As per our understanding, based on the Geneva Agreement/Convention to which India is also a party, the cross border movement of software is to be at zero duty. If that be so, it will be necessary to amend the service tax law or make appropriate provision in the Import of Service Rules.

b) All the services relating to information technology software be brought under one entry only for the sake of simplicity and clarity

c) Determination of place of supply for cross border transactions in software services ought to be based on the location and status/use (business or personal) of the recipient as the most appropriate one.

d) There is need to clarify that if any transaction is treated as a transaction of “service” for the purpose of charge of service tax, it ought not to be treated as “goods” of “deemed goods” by states. A more appropriate measure will be to define “service” as “other than goods or deemed goods” so as to avoid disputes and litigation and harassment of the service providers.

5. Associated Enterprises

Clause (c) of Explanation to Section 67 is proposed to be substituted by providing that “.....any amount debited or credited.... in the books of account of a person liable to pay service tax where the transaction of taxable services is with an associated enterprise”.

Section 67 is the valuation provision and the amount debited or credited by way of book adjustment constitutes gross value of consideration for the purpose of levy of service tax. The term “book adjustment” even before the amendment included book entries between two types of enterprises and the addition of “the transactions with associated enterprises” does not really explain the scope.

Further, the way the clause is drafted, it may be interpreted to cover within its scope exempt or non taxable services as it refers to book adjustment of “**any** amount.....” where the transaction of taxable service is between associated enterprises.

As we understand, what is sought to be achieved is that in cases of transactions between associated enterprises, any debit or credit of amount towards taxable service to the account of the associated enterprise is to be deemed to be receipt of the gross value of consideration and that such an entry would trigger liability to pay service tax.

Suggestion

If that be the intention, the appropriate amendment is required in Rule 6 of Service Tax Rules.

6. Issue

Further, the term “associated enterprise” is quite complex to understand and will be quite difficult to apply for the Central Excise officers who carry out audit of these enterprises.

Suggestion

The objective of the Service tax law would be achieved even if this term “associated enterprise” is replaced by the term “subsidiary and / or associate of an enterprise”. A “subsidiary” is a entity in which another company (called parent/holding company) holds 51% or more of the share capital or controls 51% or more of the Board of Directors or the management group. “Associate” is an enterprise on which another entity exercises significant influence and which, in turn, is ordinarily measured by a shareholding of 20% or more of the other enterprise.

All these terms are used in accounting standards and any transactions between holding/parent and subsidiary and associates are required to be separately disclosed in the financial statements of an enterprise. This might be more simpler and easier to apply as also verify.

7. Issue

If the associated enterprises are Indian and foreign entities and if entries are made in respect of services received outside India for use in business

outside India, it may need to be excluded from the purview of taxation e.g. an Indian Bank having subsidiary/branch outside India and receiving services outside India for the purpose of carrying on business outside India.

Suggestion

Appropriate amendment be made or clarification be added to avoid possible uncertainty and litigation.

8. Issue

Any service to constitute “Export” under the Export of Service Rules, 2005 ought to satisfy a condition of receipt of convertible foreign exchange in India. If the book adjustment is deemed to be receipt of consideration for rendering service, appropriate amendment is also required in the Export of Service Rules.

Suggestions

Export of Service Rules may be amended to provide that receipt of convertible foreign exchange will include book adjustment as defined in the Act.

Alternatively, if the intention is to apply the book adjustment rule to only import of services, appropriate amendment be made in the Act itself.

9. Best Judgment Assessment

Issue

Section 72 is proposed to be inserted to provide for the best judgement assessment. This applies in cases where a person has failed to furnish return or fails to assess tax correctly.

A best judgment assessment is required when the tax payer or person liable to pay tax fails to provide details, furnish documents and like to enable the assessing officer to make assessment.

Suggestion

This provision be amended to add “and the person fails to produce books/documents.....” to enable the assessing officer.

Alternatively, if the intention is to adopt a system where, if an assessee fails to furnish return or pay tax, an automatic demand is generated based on tax paid in the past (it cannot be left totally open to the judgment of assessing officer as that can be arbitrary), appropriate amendment needs to be made in the provisions.

10. Penalty – Section 77

Issue

Section 77 is proposed to be replaced and failure to “**take**” registration is sought to be made liable to penalty. A person cannot “take” registration but only “seek” registration.

The offence referred to in the section is continuous one and there is need to provide for cap on the amount of liability and it ought to be provided that it shall not exceed the amount of service tax that is not paid. Too harsh a penalty leads to corrupt practises and the aim of the department/revenue authorities ought to be to collect taxes and not penalties.

Suggestions

- a) *The word “take” be replaced by the word “seek”*

- b) *A cap on penalty amount that can be imposed for the offences referred to in the section be introduced which ought not exceed the amount of service tax.*

11. Penalty- electronic payment of taxes

Issue

We support the initiative of the Government to move to e-regime and welcome steps to facilitate the same. However, to introduce a penalty for not doing so at this stage would be very harsh.

Suggestion

Postpone the applicability of penal measure by a year till such time as the assesseees and the departmental systems are well established.

ICAI will be happy to work with government and facilitate greater use of electronic measures for tax payment and return filing.

12. Service Tax Dispute Resolution Scheme

The Scheme is a welcome move to clear up the system of the backlog especially relating to small amounts of demands.

There is however, need to clarify issues for which clarity is required for the Scheme to be successful.

Also, there may be tax payers who have not paid taxes or whose returns are not yet taken up for verification and demand notices are not issued. It will be useful to provide for some time to department to complete verification of cases up to a particular date and also for the assessees to voluntarily obtain registration, file returns for the past period for which they may not have done so and demand could be raised and then covered in the Scheme.

This Scheme could cover specified services where the tax payers are usually small and not so well educated.

The Scheme may also be extended to cover all the demands arising out of CENVAT Credit irrespective of the amount of demand as there were areas where there was confusion.