THEME

Tragedy Of Mindless Mutilation Of Charging Section 66 To Aggravate The Existing Confusion

Section 64(3) of the Chapter V of the Finance Act, 1994 (hereinafter referred to as the "Act") postulates that Chapter V shall apply to taxable services provided. Furthermore, Section 65(7) enshrines that an "Assessee" means a person liable to pay Service Tax and includes his agent. In addition, Section 65(105) mandates that "taxable service" means any service provided. Moreover, the charging provision viz. Section 66 engrafts that there shall be levied Service Tax at the rate of 10 per cent of the value of the taxable services referred to in sub-clauses enumerated in clause 105 of Section 65 and collected in such manner as may be prescribed. Further, Section 67 contemplates that the value of any taxable services shall be the gross amount charged by the services provider for such service rendered by him. Besides, Section 68(1) ordains that every person providing taxable service to any person shall pay Service Tax at the rate specified in Section 66 in such a manner and within such a period as may be prescribed. Section 71 enjoins that every person liable to pay Service Tax shall himself assess the tax due on the services provided by him. Section 71 empowers the Superintendent of the Central Excise *inter alia* to verify the correctness of the tax assessed by the Assessee on the services provided. On a conjointed, overall and combined survey and inspection of the aforementioned scheme comprising the charging and machinery provisions, which in a taxing statue normally and ordinarily together constitute an integrated code *[CIT v Srinivasa Setty (1981) 128 ITR 294(SC)]*, the conclusion is inescapable and irresistible that the primary and fundamental liability to pay Service Tax is exacted on the person who provides the service and by no stretch of imagination whatsoever, the liability can be foisted and thrust upon the recipient of the service. Nonetheless, sub-section 2 of Section 68 carves out an exception to this general canon by laying down that notwithstanding anything contained in Section 68(1) in respect of any taxable service, the Service Tax thereon shall be paid by such person in such manner as may be prescribed in the notification issued by Central Government in the Official Gazette at the rate specified in Section 66 and provisions of the Chapter shall apply to such person, as if he is the person liable by paying the Service Tax in relation to such service.

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The thrust of the charging and machinery provisions governing the liability to Service Tax is on services provided. The main liability in law thereto is on the service provider and not on the user of service. However, the legislative wisdom has been given the leverage to garner the Service Tax from the recipient of the services subject to the qualification that there must be a rational nexus between the Service Tax and the person on whom the charge is exacted. Where the law has been changed by the retrospective amendment by dislodging the foundation of the Supreme Court decision holding the legislation to be constitutionally invalid, there is no question of the legislature overruling the decision of the Supreme Court. Once the statute has been cured by removing the infirmities, the earlier pronouncement of the Supreme Court will be neutralised and such a curative legislation does not touch upon the validity of a judicial precedent.

The new legislation is not rendered constitutionally *ultra vires* merely because the subject matter of a particular List of the Seventh Schedule to the Constitution, incidentally, in some way touches upon the subject in another List of the same Schedule.

The aforesaid cardinal and vital principle of law has been propounded by the *Supreme Court in Laghu Udyog Bharati v UOI [2005] 1 VST 24: (1999) 6 SCC 418* wherein the service receivers (customers) challenged and questioned the validity, legality and propriety of the enactment of Rule 2(d)(xii) and (xvii) of the Service Tax Rules, 1994 which sought to impose the Service Tax, in effect, on the customers of Clearing and Forwarding Agents by amending the definition of the expression "person liable for paying the Service Tax" *inter alia* on the premise that these rules are in conflict with the charging provisions of Sections 65 and 66 of the Act and consequently, cannot override and whittle them down. At this juncture, it would be advantageous, beneficial and useful to extract the following telling and clinching observations (page 31 and 32 of 1 VST 24): –

(i) A perusal of these provisions relating to the machinery of the levy and collection of Service Tax clearly shows that any action which is required to be taken as qua the assessee, namely, the person responsible for collecting the Service Tax which includes his agents.

(ii) Section 66 which is the charging section provides that the charge of tax at the rate of 5 per cent on the value of the taxable services which are provided to any person by the person responsible for collecting the Service Tax. In so far as clearing agents and transporters are concerned section 66 has to be read with section 65(41)(j) and (m), according to which the taxable service is what, in the case of clearing and forwarding agents, is rendered to his client and in the case of goods transporter is rendered to its customer. The "person responsible for collecting the Service Tax", referred to in section 66 has to be read with section 65(28) which defines this expression to mean the person who is required to collect the Service Tax or to pay the same. It is clear from the reading of these provisions that according to the Finance Act the charge of tax is on the person who is responsible for collecting the Service Tax. It is he, who by virtue of the provisions of section 65(5) is regarded as assessee. He is the person who provides the service.

Service Tax is levied by reason of the services, which are offered. The imposition is on the person rendering the service

The Service Tax is levied by reason of the services which are offered. The imposition is on the person rendering the service. Of course, it may be an indirect tax, it may be possible that the same is passed on to the customer but as far as the levy and assessment is concerned it is the person rendering the service who alone can be regarded as an assessee and not the customer. This is the only way in which the provisions can be read harmoniously."

The foundation of the pronouncement of the Supreme Court in *Laghu Udyog Bharati v UOI [2005] 1 VST 24 : (1999) 6 SCC 418* was sought to be overcome by the legislature by ushering and introducing Sections 116 and 117 of the Finance Act, 2000 and Section 158 of the Finance Act 2003 respectively (hereinafter referred to as the "Finance Acts"). These legislative changes were impugned before the Supreme Court on several counts by the customers or clients (service users) of goods transporter operators and clearing and forwarding Agents by way of writ petitions which ruling is now reported as *Gujarat Ambuja Cements Ltd. v Union Of India (2005) 1 VST 1*. During the course of the aforementioned judgment, the Highest Court of the land extracted at page 10 of (2005) 1 VST 1 the portion marked in italics in the aforementioned extract in paragraph 2 supra to reaffirm the chief and key thesis that the basic exigibility to Service Tax falls on the service provider. Moreover, to further strengthen this prism of the matter, it relied on the following observations of the Supreme Court in *Laghu Udyog Bharati v Uoi [2005] 1 VST 24: (1999) 6 SCC 418* which are quoted at page 10 of (2005) 1 VST 1: –

(i) "……. the definitions contained in rule 2(d)(xii) and (xvii), which seek to make the customers or the clients as the assessee, are clearly in conflict with sections 65 and 66 of the Act." (page 425 of (1999) 6 SCC 418);

(ii) "that the return which has to be filed pertains to the payments which are received by the person rendering the service in respect of the value of the taxable services. Surely,

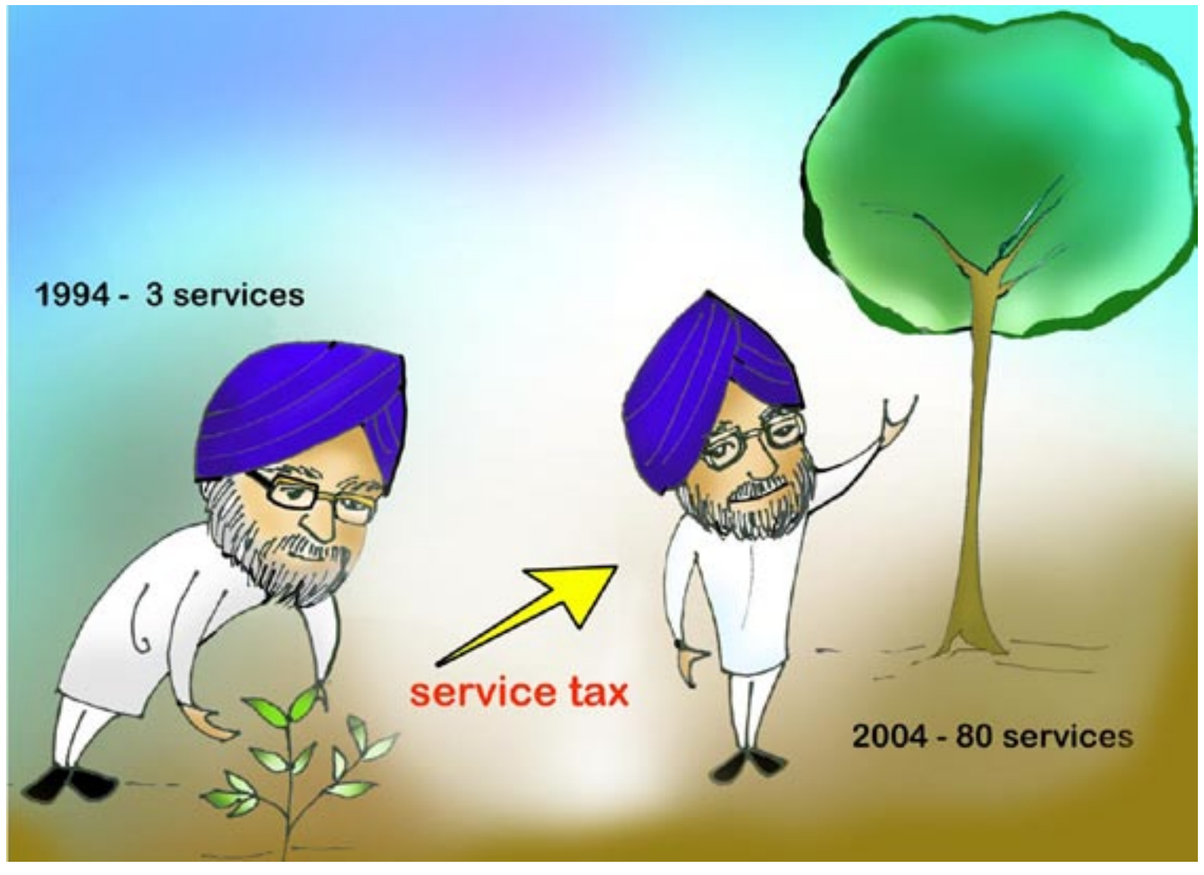
this is a type of information which cannot, under any circumstances, be supplied by the customer. Moreover the operative part of clause (1) of section 70 clearly stipulates that it is person responsible for collecting the Service Tax who is to furnish the return." (page 426 of (1999) 6 SCC 418); and

(iii) "by rules which are framed, the person who is receiving the services cannot be made responsible for filing the return and paying the tax. Such a position is certainly not contemplated by the Act." (page 426 of (1999) 6 SCC 418).

The aforestated observations of the Supreme Court in *Laghu Udyog Bharati v UOI [2005] 1 VST 24: (1999) 6 SCC 418* alluded to in paragraphs 3(i) to 3(iii) and extracted verbatim by the Apex Court in Gujarat Ambuja Cements Ltd. v Union Of India (2005) 1 VST 1 invigorate and fortify the general tenet that the basic and elementary charge of Service Tax is on the service provider and not the availer.

Despite the aforesaid, the Supreme Court in *Gujarat Ambuja Cements Ltd. v Union Of India (2005) 1 VST 1* repudiated the argument that the customer of the service cannot be mulcted with the charge of Service Tax and went on to observe at pages 20 and 21 of the report as under:

"The point at which the collection of the tax is to be made is a question of legislative convenience and part of the machinery for realisation and recovery of the tax. The manner of the collection has been described as 'an accident of administration; it is not of the essence of the duty'. It will not change and does not affect the essential nature of the tax. Subject to the legislative competence of the taxing authority a duty can be imposed at the stage which the authority finds to be convenient and the most effective whatever stage it may be. The Central Government is therefore legally competent to evolve a suitable machinery for collection of the Service Tax subject to the maintenance of a rational connection between the tax and the person on whom it is imposed. By sections 116 and 117 of the Finance Act, 2000, the tax is sought to be levied from the recipients of the services. They cannot claim that they are not connected with the service since the service is rendered to them."



In the context and text referred to in paragraph (5), the Supreme Court relied on its own ruling in *R. C. Jall v Union Of India Air 1962 SC 1281, 1286* wherein it observed that "the argument confuses the incidence of taxation with the machinery provided for collection thereof" [page 21 of (2005) 1 VST 1].

On a gleaning and conspectus of what is adumbrated hereinbefore coupled with the aforementioned quoted judicial holdings and conclusions supra, it can be unmistakably and unequivocally deduced that the paramount and rudimentary liability to bear the Service Tax liability devolves on the service provider irrespective of whether he has passed on and collected the same from the person who avails his service. Nevertheless, this is a policy matter best left to the legislative wisdom of Parliament and in that view of the matter, the latter is vested with the jurisdiction and discretion to determine the mode of recovery of the Service Tax by fixing the point of collection at the availer's end as a measure of convenience for recovery and realisation of the Service Tax with the caveat that such a evolution of the machinery will have a rational connection between the tax and the person on whom it is saddled. However, the infliction of the Service Tax on the user must be done through the instrument of substantive law namely, the charging Section of the Act and not the machinery and collection provisions, that is, the Rules a *faux pas* ruthlessly and unhesitatingly mauled by the Supreme Court in *Laghu Udyog's* case supra. It is significant to note that Rule 2(1)(d) of the Service Tax Rules, 1994 has been altered from different dates vide insertion of 3 sub-clauses through various amendments namely, clauses (iv), (v) and (vi) appertaining to foreign companies not having any permanent establishment/ place of business/residence in India, goods transport agency and mutual fund distributor by virtue of which the user of the respective services has been made liable for payment of Service Tax. Nonetheless, no corresponding amendment has been incorporated in the charging and other sections and hence, in my opinion, these modifications are possibly susceptible and vulnerable of being questioned and challenged in a Court of Law in relation to their validity, legality and proprietary as adumbrated in *Laghu Udyog's* case supra.

That according to the Finance Act the charge of tax is on the person who is responsible for collecting the Service Tax. It is he, who by virtue of the provisions of Section 65(5) is regarded as the assessee. He is the person who provides the service

I would be failing in my endeavour on hand if I do not succinctly advert to the engrossing and absorbing controversies resolved by the Apex Court in *Gujarat Ambuja Cements Ltd. v Union Of India (2005) 1 VST 1.*

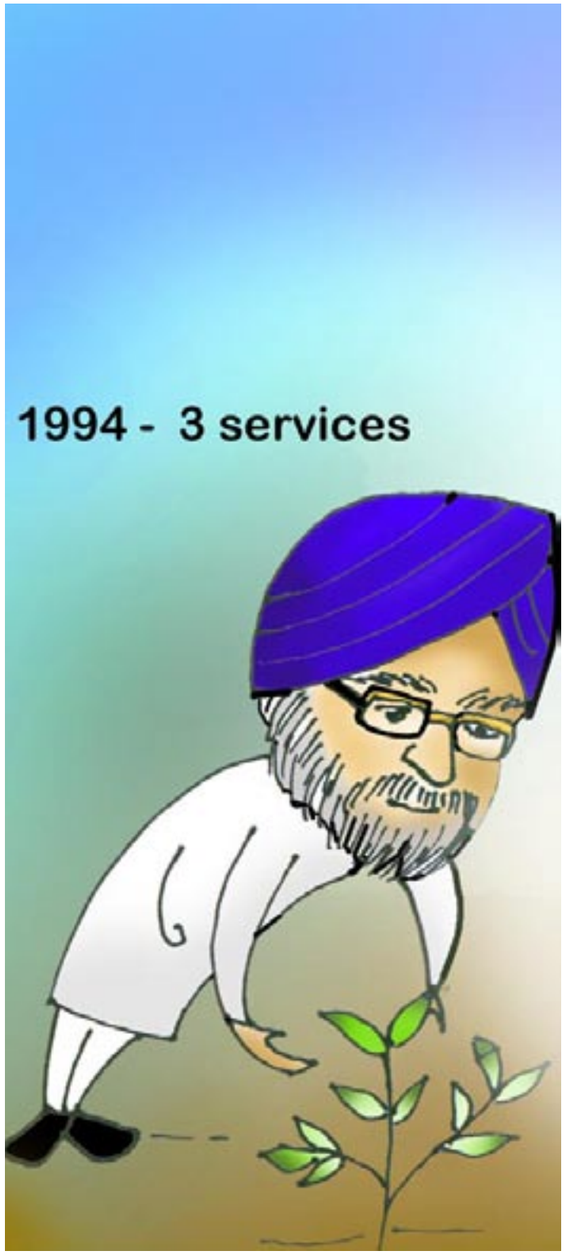
First and foremost, the Petitioners therein took exception to the formulation of the laws by the Finance Acts on the footing that by the dint of these legislative changes what Parliament had done was to overrule and replace the ruling of the Supreme Court in *Laghu Udyog Bharati v UOI [2005] 1 VST 24 : (1999) 6 SCC 418.* The Apex Court did not countenance such a submission because, in its opinion, vide these enactments the charging Section itself was altered so as to make the provisions of the Act and the Rules compatible whereby the fundamental and essential infirmity and lacuna in the law obtaining then conferring the Service Tax authorities to treat recipient of the service as the "Assessee" through the concerned *rules de hors* the charging provisions of the Act was removed and obliterated in conformity with the well entrenched and established doctrine of law that validation of a tax declared illegal may be done only if the grounds of illegality or invalidity are capable of being erased and are, in fact, eradicated and thus made lawful provided such uprooting exercise is otherwise legislatively competent and lawfully tenable and maintainable {pages 14, 15 and 16 of 1 VST 1(SC)}. In the premises, the substratum and superstructure

of the verdict in *Laghu Udyog Bharati v UOI [2005] 1 VST 24 : (1999) 6 SCC 418* having been demolished and decimated retrospectively by the new legislation through the instrument of the respective Finance Acts, the criticism of the earlier law is unsound, unsustainable and misconceived in law. To conclude, there is thus no question of the Finance Acts overruling the pronouncement of the *Supreme Court in Laghu Udyog Bharati v UOI [2005] 1 VST 24 : (1999) 6 SCC 418*. In my opinion, once the definition of "Assessee" is amended to include a user of the specific service as the person liable for collecting the Service Tax coupled with the fact that the other relevant sections including the charging one are modified accordingly then there can be no grievance regarding the constitutionality of the provisions under consideration. This is what precisely the abovementioned Finance Acts carried out, in that, the Parliament in enacting these validating legislations in fact retrospectively removed the weaknesses and flaws projected in *Laghu Udyog's* case supra by amending apposite charging and other sections.

The second count on which the Finance Acts were assailed and agitated proceeded on the thesis that the infliction of the Service Tax on the carriage of goods by transport operators intruded entry 56 of List II appertaining to the States dealing with taxes on goods and passengers carried by road or on inland waterways and is not traceable to entry 97 of the List I within the operative realm and domain of Union Government. The Supreme Court at page 19 of (2005) 1 VST 1 spurned this contention holding that: -

"It is clear therefore that section 66 read with section 65(41)(j) and (ma), Chapter V of the Finance Act, 1994, do not seek to levy tax on goods or passengers. The subject matter of tax under those provisions of the Finance Act, 1994, is not goods and passengers, but the service of transportation itself. It is a levy distinct from the levy envisaged under entry 56. It may be that both the levies are to be measured on the same basis, but that does not make the levy the same."

In this connection, it strongly and heavily relied on the observations made by the Supreme Court at pages 115 and 116 of (1989) 178 ITR



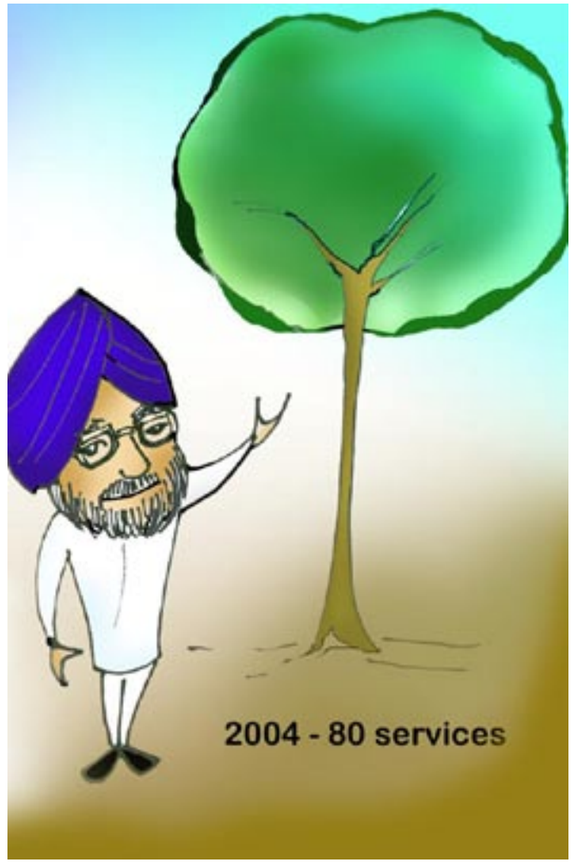
97 in *Federation Of Hotel And Restaurant Association Of India v UOI (1989) 3 SCC 634, 652, 653* wherein it was held that the subject in one List might in some way incidentally affect another subject in the other List and in the result, there might be overlapping but, such impingement is not the same thing as the law being on the latter subject because the same transaction may be the nucleus and spring of two or more taxable events, but that *ipso facto* does not detract the distinctiveness of each of the entries under consideration. In the result, the legislative ventures in the form of Finance Acts are not in pith and substance within the sphere and exclusive power of entry 56 of the State List II *inasmuch* as the relevant Acts ostensibly seek to tax what it, in substance, taxes and consequently, could not be labelled and characterised as a colourable piece of legislation perforce leading to the conclusion that the Acts falls within the four corners of the residuary power of Parliament under entry 97 of List I.

Lastly, one of the other chief and the paramount ground for challenging the constitutional validity of the Finance Acts was that they operated in a discriminatory manner by singling out only the customers of goods transport operators and clearing and forwarding agents to pay Service Tax, whereas the recipients of other kinds of similar services were not subjected to such chargeability.

The aforestated argument was negated and dismissed by the Supreme Court in *Gujarat Ambuja Cements Ltd. v UOI (2005) 1 VST 1* in the following words: –

"Because of the inherent complexity of fiscal adjustments of diverse elements in the field of tax, the legislators is permitted a large discretion in the matter of classification to determine not only what should be taxed but also the manner in which the tax may be imposed. Courts are extremely circumspect in questioning the reasonability of such classification but a 'judicial generosity is extended to legislative wisdom, if there is writ on the statute perversity, madness in the method or gross disparity, judicial credibility may snap and the measure may meet with its funeral', *(vide: Ganga Sugar Corporation Ltd. v State of U.P. [1980] 1 SCC 223; [1980] 45 STC 36).*"

To buttress and bolster its aforestated proposition of law in paragraph (13) supra, the Highest Court of the land has placed strenuous reliance on its own decision in *Federation Of Hotel And Restaurant Association Of India v UOI (1989) 3*



SCC 634, 658 wherein similar judicial wariness concerning the overstepping of the legislation into some other List was expressed.

Similar sentiments are expressed at page 23 wherein it has been observed as hereinbelow:–

"According to them the discrimination lies in the method of collection of the tax followed. But as we have said this is not of the essence

of the tax and the mere difference in the machinery provisions between the different classes of service cannot found a challenge of discrimination. If the Legislature thinks that it will facilitate the collection of the tax due from such specified traders on a rationally discernible basis, there is nothing in the said legislative measure to offend article 14 of the Constitution. It is therefore outside the judicial ken to determine whether Parliament should have specified a common mode for recovery of the tax as a convenient administrative measure in respect of a particular class. That is ultimately a question of policy which must be left to legislative wisdom. This challenge also accordingly fails".

There is yet another bone of contention which I would like to grapple and come to grip with. Rule 6(1) of the Service Tax Rules, 1994 interdicts that Service Tax on the value of taxable service received during the relevant period shall be paid to the credit of the Central Government as prescribed therein. In the result, Service Tax is payable on value of services actually received. By now, it is well accepted and settled that the rules are meant only for the purpose and object of carrying out the provisions of the Act and they cannot take away what is conferred by the Act or whittled down its effect *[CIT v Taj Mahal Hotel (1971) 82 ITR 44, 49 (SC); Director Of Inspection Of Income Tax v Pooran Mall & Sons (1974) 96 ITR 390, 396 (SC)]*. In other words or alternatively stated, rule cannot affect, control or derogate from the full operative effect of the provisions of the Sections and consequently, if any Rule purports to do so would be ultra vires and void. Sub-rule (3) of Rule 6 stipulates that where an Assessee paid to the credit of the Central Government Service Tax in respect of a taxable service which is not so provided by him either wholly or partially for any reason, the Assessee may adjust the excess Service Tax so paid by him against his Service Tax liability for the subsequent period, if the Assessee had refunded the value of taxable service and the Service Tax thereon to the person from whom it was received. Hence sub-rule (3) of Rule 6 indicates and suggests that the service provider is also liable to pay Service Tax even on advances received from the clients notwithstanding that no services were provided by the former to the latter vis-à-vis such advance receipts. On a review, analysis and dissection of the various Sections of the Act pertaining to Service Tax undertaken in paragraph 1 supra, it can be categorically, emphatically and unequivocally concluded that the taxable event for imposition of Service Tax is the provision of service by the service provider and in that view of the matter, the charging Section 66 nowhere predicates that Service Tax is exigible on advances towards which service is yet to be provided in future. Sub-rule (3) of Rule 6 contravenes the aforestated golden rule of interpretation that the rule making power cannot be repugnant to or undermine the substantive provisions of the Act so as to substitute, replace or override them inasmuch as sub-rule (3) creates a charge which is not even injucted by the charging Section 66 of the Act. This is the precise and exact reason as to why Finance Act, 2005 vide Section 88 thereof proposes to substitute the words "rendered by him" in Section 67 of the Act by the words "provided or to be provided by him" as also add Explanation 3 after Explanation 2 appended to Section 67 as under: –

Rule 6(1) of the Service Tax Rules, 1994 interdicts that Service Tax on the value of taxable service received during the relevant period shall be paid to the credit of the Central Government as prescribed therein.

"For the removal of doubts, it is hereby declared that the gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service."

In my opinion, the amendment to Section 67 adverted to supra has in law "misfired" and does not actually and really plug the lacuna and loopholes projected in paragraph 16 supra because the charging provision Section 66 has been left untouched by the legislature which is the *terra firma*, ken and gravamen for fastening the service provider with a liability under the Act. The amended Section 67 is only a machinery and computation provision subservient to the main and important charging Sections and consequently, the amendment effected by the Finance Act, 2005 is merely a shot and leap in the dark thereby vindicating the aphorism that "history repeats itself in one form or other" and may result in another *Laghu Udyog's supra*.❐