Taxation Of Import Of Services

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The taxation of services has gained momentum in recent times due to the exponential increase in the share of services in GDP. Every country has introduced the legislation for taxation of services. Some countries have incorporated the services in their Value Added Tax legislation, while some countries have taxed the services, separately.

There is no separate legislation for taxation of services in India but it is incorporated in 'Chapter V of Finance Act, 1994' (the Act). Thus, there is no separate Act for taxation of services. It is commonly known as Service Tax Act or Service Tax Law. The Government has notified the Service Tax Rules, 1994 and Cenvat Credit Rules, 2004 for procedures and providing input tax credit respectively.

Section 64(1) of the Act provides that it extends to whole of India except the State of Jammu and Kashmir. Every legislation is required to be notified for a particular area or country. Therefore Service Tax provisions have been extended to whole of India except State of Jammu and Kashmir which is in line with Government Policy for special status of this State.

Services provided outside Indian territory

The Government of India has right to impose the taxes within their own jurisdiction and tax cannot be imposed beyond the boundary of India. The Indian boundary is always subject to litigation to determine what area will form part of India and not. The most heated debate was on the designated areas / services provided within territorial waters. The expression India includes territorial waters of India which extend up to 12 nautical miles from the land mass.

A notification is required to be issued to extend the applicability of an Act to the Designated areas beyond 12 nautical miles within continental Shelf of India under the Territorial Waters, Continental Shelf, Exclusive Economic Zone and Other Maritime Zones Act, 1976 (80 of 1976). The applicability of Service Tax has been extended to the designated areas as specified in Notification No. S.O. 429(E) dated 18 July 1976 and S.O. 643(E) dated 19 September 1996 vide notification no. 1/ 2002 –ST dated 1 March 2002. The taxability of services within the designated areas prior to issue of the notification dated 1 March 2002 has been settled by Central Board of Excise and Customs (CBEC) by clarification dated 8 October 2001 where it has been clarified that "the services provided beyond the territorial waters of India are not liable to Service Tax as provisions of Service Tax have not been extended to such areas so far".

A similar clarification was issued with regard to services provided by Tour operators outside India wherein it was clarified that the services rendered outside India are not liable for Service Tax since Service Tax provisions are not applicable to services provided outside Indian Territory (Trade Notice 1/2000 dated 27 April 2000, Pune I Commissionerate).

These clarifications have reinforced the belief that services provided outside India are not liable for Service Tax since these provisions are not applicable outside Indian Territory which includes Indian landmass and designated areas in Territorial waters after 1 March 2002.

Services provided by non-residents in India

The services provided by non-residents within Indian Territory were subjected to Service Tax. However, since department found that in many cases non-residents have not discharged the Service Tax liability, the amendment was made in 2002. Rule 2(d)(iv) was inserted w.e.f. 16 August 2002 to make recipient of services liable for making payment of Service Tax for services received from non-residents in India. The Government thought that they can easily chase the Indian recipient of services for payment of Service Tax. The recipient is now liable for making the payment of Service Tax, interest and penalty and filing of returns as applicable.

Import of services

Due to revolution in technology and the Internet, the services can be provided in person, through remote location or report can be sent through electronic media without visiting the country of recipient. Thus there is no need to visit the service recipient to provide the services. For example a chartered accountant can conduct the system audit of a client located in USA from India if he is able to access the systems of the client and can submit the report. In this example, the chartered accountant has provided the services from India to client in USA without visiting USA.

Taxation of import of services

The recent trend in taxation front provides for taxation of goods and services in the country of consumption. Therefore each Government has introduced the mechanism in their legislation for taxation of import of goods and services. The import of goods is taxed by way of Customs Duty on import or reverse charge mechanism. The services import is normally taxed by way of reverse charge. The law provides that the recipient of services or provider of services (in few countries) will be liable for making payment of tax on import of services.

Taxation of e-commerce transactions

The taxation of e-commerce transaction has been debated a lot since in e-commerce it is very difficult to determine the place of rendering the services or place of receipt of services. A customer may visit an e-commerce website situated outside his country to avail the services. In such case it cannot be said that services are imported since services are received outside the country and consumed outside the country.

Therefore special regulations have been made to tax the e-commerce transactions. Even OECD has issued the separate guidelines for taxation of e-commerce transactions. Many countries have adopted the OECD guidelines with modification for taxation of e-commerce transactions.

Taxation of import of services under Service Tax

The Indian Revenue authorities have faced the problem of taxation of import of services. The taxation of services provided by non-resident within India in the hands of recipient has not served the purpose as per revenue authorities. Therefore Finance Act, 2005 has inserted explanation to Section 65(105) for taxation of import of services.

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Relevant provisions

An explanation has been inserted by the Finance Act 2005 (effective from 16 June 2005) in the meaning of the term "taxable service" to clarify (stated to be for removal of doubts) that taxable services would include services provided from outside India to a recipient in India.

The Explanation reads as under:

"For the removal of doubts, it is hereby declared that where any service provided or to be provided by a person, who has established a business or has a fixed establishment from which the service is provided or to be provided, or has his permanent address or usual place of residence, in a country other than India and such service is received or to be received by a person who has his place of business, fixed establishment, permanent address or, as the case may be, usual place of residence, in India, such service shall be deemed to be taxable service for the purposes of this clause."

The said explanation thus seeks to tax, in a sense, import of all taxable services unlike the position prevailing in European Union where reverse charge mechanism applies only in relation to specified services, which are primarily in the nature of consultancy and intangibles.

The Government has provided two exemptions provided in this regard:

- Service received and consumed outside India by an individual (Notification no.25/2005 dated 7 June 2005)
- Service received and consumed outside India relating to repair and maintenance of ships and other related services procured by specified ships outside India. (Notification

no. 22/2005 dated 7 June 2005)

These exemptions clearly indicate that the intention of Government is to tax services received from outside India by a person who has business / fixed establishment in India irrespective of the place where such service is consumed.

The explanation provided in Explanatory Notes on Changes Proposed by Finance Bill 2005 provided that the said clause has been inserted to clarify that taxable services would also include services provided from outside India to a recipient in India.

This explanation intended to tax the services provided by non resident to a recipient in India. Thus the recipient should be in India while receiving the services. However the explanation given and notifications speaks otherwise. They provide for taxation of services received outside India also.

Jurisdiction outside India

The moot question for debate is whether Indian Government has jurisdiction outside India or not. The International treaties and common understanding within the countries provides that the tax will be levied within their jurisdiction. It does not provide for extending the jurisdiction to other countries. By interpreting the explanation in such a manner to tax the services received outside India by the recipient would mean that Indian Government has jurisdiction outside India which will be in contrary to Section 65(1) of the Act and clarification issued in this regard. There is no change in basic framework of law at the time of issue of clarifications and at the time of insertion. It appears that this provision will lead to legal dispute by various parties leading to burden the existing legal system. Strictly speaking, in view of explanations and clarifications, Indian Government does not have jurisdiction outside the India.

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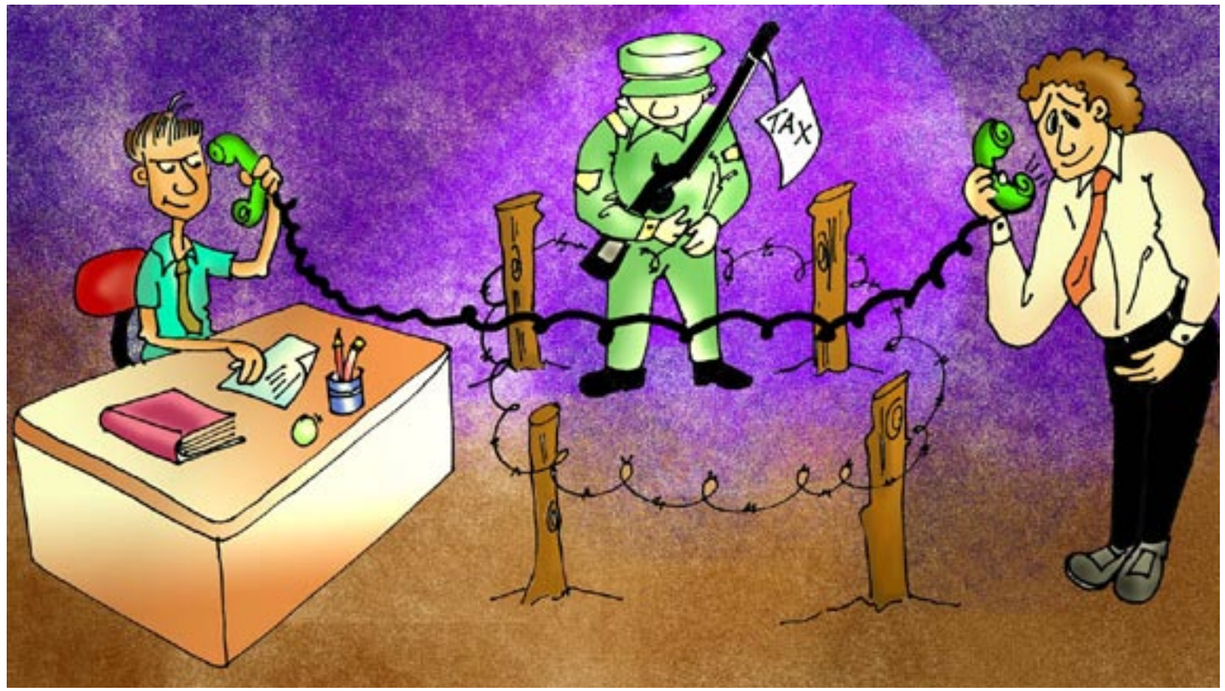
Services received by branch offices of an Indian company

Normally as per accounting practice, the branch accounts are merged to prepare the Financial Statements. The branches may also receive the taxable services outside India and consume them outside India for their business, which is located outside India. The department may argue that since branch accounts are merged in India for preparation of Financial statements, the services received by branches will be treated as import of services in the hands of Indian Company. If one takes this view, it will be an absurd view since in this case the services have been received and consumed outside India. An argument may be put forth that the services are used for business outside India.



Global corporations having branch offices in India

The global corporations having branch office in India have to re-look at their current structure since department may argue that the services received by offices situated outside India have received the services for the business in India and try to tax such services in India. One can argue that services received outside India are not for the business in India and thus not liable for tax in India.

Receipt of non-taxable services

A question may arise whether the services, which are not taxable or are exempted will also be taxed under the import of services provisions. The explanation provides that the taxable services received by the resident will only be treated as import of services. Therefore if a person is receiving non-taxable services, these services will not be subjected to Service Tax since these services are not taxable and hence explanation is not applicable. Similarly exempt services will also enjoy exemption since exemption cannot distinguish between the service provider within India and outside India.

Reimbursement of expenses to employees visiting overseas

The employees avail the taxable services during their overseas visit, which are reimbursed by the employer. These services might be taxable services like Car hire services, which are taxable under the category of 'Rent a cab services'. Such reimbursement of expenses may also be subjected to import of services provisions on the ground that Indian resident for furtherance of business receives services.

Double taxation

These provisions may also lead to double taxation in many situations, first in the country of rendering of services and in India where those countries do not treat the rendering of services as export of services not liable for tax. The cost to Indians will increase which may not be intention.

Applicability of Export of Services Rules, 2005

The Export of Services Rules defines the export of services and their treatment and are intended for export of services which is on different footing. The Government wishes to promote the export of services and hence specified the special rules for them. However applicability of said rules to import of services will not be free from debate since if these rules are applied, then probably most of the services will not be taxed under import of services, which is not the intention of law-makers.

The Government of India has the right to impose the taxes within their own jurisdiction, and tax cannot be imposed beyond the boundary of India. The Indian boundary is always subject to litigation to determine what area will form part of India and not

Conclusion

The import of services provisions has created havoc on the Indian recipient since they will have to shell out the extra tax on the services received outside India. It may affect badly to our software exports since software companies are not able to claim the rebate of tax on export of services since software services are not taxable under Service Tax and rebate provisions are applicable to taxable service providers only. It will also create hardship on the recipient to determine the import of services for discharging tax liability at each time of making remittance outside the country.

This piece of legislation will also lead to legal disputes in its current status which may be settled by Supreme Court after long time and may be revoked by Government by way of revalidation provisions as was done for Goods Transport Operator services. The Government needs to re-look the provisions in light of special provisions for E commerce transactions and double taxation and restrict the same to selected category of services.❐