

Tax Hotline

April 05, 2003

UNCERTAINTY OVER APPLICABILITY OF SERVICE TAX: CLARIFICATION SOUGHT

Taking into account the growing contribution of services to the Indian GDP, the Government of India ("GOI") first introduced indirect tax on services as a part of Finance Bill 1997. Since then subsequent Finance Bills have widened the scope of service tax by progressively adding new services every year. The Finance Bill, 2003 ("Bill") has kept up with this legacy and added 7 new services and broadened the application of 3 existing ones. The Bill has also proposed to enhance the service tax rate from the present 5% to 8%, but it is the withdrawal of exemption from service tax for proceeds received in foreign exchange this year that has led to a lot of confusion and anxiety amongst the service providers.

Service exporters were exempt from service tax vide the Government notification dated April 9, 1999. This covered services rendered to foreign clients outside India and also services provided for projects of foreign companies in India against payment in foreign exchange. This was much appreciated by the industry and regarded as being in line with the general principle followed in India and other countries of not levying local taxes on exports.

The GOI, vide notification dated March 31, 2003, has rescinded the aforementioned exemption and thus making all service exports chargeable to service tax with effect from April 1, 2003. Elimination of this exemption will have serious ramifications on the export sector as a whole and specifically on software and ITES/BPO service providers, engineering and management consultants, project exports, chartered and cost accountants, tour operators, securities and forex brokers and broadcasters.

Tax consultants state that the GOI has no intention to tax exports and this notification could be in fact an oversight on the part of the GOI. In fact the revenue officials clarified in a leading Indian financial daily that this notification would not apply to provision of services across Indian borders but to forex-earning services that are rendered within the domestic tariff area. However, the language of the notification does not support this view, thus leading to confusion amongst the exporters who are unclear on whether to include the service tax in their invoices. The Confederation of Indian Industry has made a representation to the GOI to withdraw this notification and restore the exemption. Until then the uncertainty would continue. Unless this exemption is withdrawn retrospectively, the exporters would still be liable for service tax for the interim period i.e. April 1, 2003 till the date of withdrawal. Further, if the exemption is not withdrawn and the Bill is enacted in its present form then the exporters would have to also collect the additional 3% from April 1, 2003.

Separately, please note that to enable levy of tax on services, an amendment to the Constitution is proposed (the 95th amendment bill has already been placed before the Parliament for ratification). This Constitutional amendment, and the consequent legislation would give the GOI the power to levy the tax and both the GOI and the State Governments sufficient powers to collect the proceeds.

Source: *The Economic Times*, April 4, 2003.

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