



Clarification on Services by Government or Local Authority

Tax Alert
April 15, 2016

INTRODUCTION

With the announcement of the Budget 2016-17, the Department of Revenue, Ministry of Finance, has sought to expand the scope of taxable services provided by the Government/Local Authority to business entities. The applicability of Service tax on *any service* provided by the Government (excluding specific services) which was earlier limited to “support services”¹, and insertion of ‘assignment by the Government of the right to use the radio-frequency spectrum and subsequent transfers thereof’², within the list of declared services in Section 66E of the Finance Act, 1994 (“**Act**”), are the key amendments which have been introduced *vide* Union Budget *qua* the services provided by Government/Local Authority.

These amendments have raised various concerns across the board, more particularly, within those sectors which primarily deal with the Government on a partnership basis such as Infrastructure Companies, Mining and Exploration Industry, Oil & Gas Industry, Telecom Companies etc. Recently, the Central Board of Excise and Customs (“**CBEC**”) has offered clarifications on several aspects *vide* Circular No. 192/02/2016 – Service Tax dated April 13, 2016 (“**Circular**”) which *inter-alia* brings clarity on the expanse of the aforesaid amendments in respect of services provided by Government or Local Authority. The CBEC has also exempted certain services provided by the Government/Local Authority by amending the Mega Exemption Notification (Notification No. 25/2012 – Service Tax dated June 20, 2012) *vide* Notification No. 22/2016-ST dated April 13, 2016.

POSITION BEFORE AMENDMENT

Previously, the Negative list of service as specified in Section 66D(a) of the Act restricted the applicability of Service tax only on “support services”. Section 66D read as under –

“66D. The negative list shall comprise of the following services, namely:--

*(a) services by Government or a local authority **excluding the following services to the extent they are not covered elsewhere-***

(i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government;

(ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport;

(iii) transport of goods or passengers; or

*(iv) **support services** other than services covered under clauses (i) to (iii) above, provided to business entities”*

“Support services” in Section 65B(49) is defined as: “support services” means infrastructural, operational, administrative, logistic, marketing or any other support of any kind comprising functions that entities carry out in ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever and shall include advertisement and promotion, construction or works contract, renting of immovable property, security, testing and analysis”.

What was covered within the ambit of Service tax net, amongst others, was such payments which were in the nature of support services. This position is amended. As far as the statutory levies by the Government are concerned, which arose out of the sovereign functions of the Government, the same were kept outside the scope of Service tax; the “Taxation of Services: An Education Guide” dated June 20, 2012 (“**Education Guide**”) issued by the CBEC, provided that services provided by Government to business entity in terms of their sovereign right are not support services (Para 4.1.7).

Earlier in 2006, the CBEC *vide* Circular No. 897/7/2006 – S.T dated December 18, 2006 (“**Statutory Function Circular**”), had clarified that fee collected by sovereign/public authorities while performing statutory functions/duties under the provision of law would not be exigible to Service tax. The Statutory Function Circular reiterated an established principle that payment/fee levied and collected by Government authorities under the mandate of a statute are in the nature of compulsory levy and cannot be treated as provision of any service (by such Government authority) to any person/ entity for a consideration. Thus,

¹ The amendment was brought into force from April 01, 2016 *vide* Notification No.6/2016 dated February 18, 2016.

² Vide clause 147 of the Finance Bill, 2016. To come into force on the day the Finance Bill, 2016 is enacted.

were not liable to Service tax.

The responsibility for payment of Service tax in respect of such services by the Government has always been on the *business entity* receiving the service, i.e. on a reverse charge basis. The Notification No. 30/2012-ST dated June 20, 2012 mandated service recipient to discharge Service tax *“in respect of services provided or agreed to be provided by Government or local authority by way of support service excluding,- (1) renting of immovable property, and (2) services specified in sub-clauses (i), (ii) and (iii) of clause (a) of section 66D of the Finance Act, 1994”*.

AMENDMENTS

The term “support services” in Section 66D(a)(iv) was omitted and replaced by “any service” *vide* the Finance Act, 2015 and corresponding amendments to Rule 2(1)(d)(i)(E) of the Service Tax Rules, 1994 (*vide* Notification No. 05/2015- S.T. dated March 01, 2015) and Clause (I)(A)(iv)(C) and S.No. 6 of Table of Notification No. 30/2012 – S.T. dated June 20, 2012 (*vide* Notification No. 07/2015 – S.T. dated March 01, 2015) were also undertaken. Consequent to this, in the Budget of 2016-17, both the amendments were brought into force from April 01, 2016 through Notification No. 17/2016 – S.T. dated March 01, 2016 and Notification No. 16/2016 – S.T dated March 01, 2016 respectively.

The impact of the aforesaid amendment has been that all the services provided by the Government/Local Authority are taxable w.e.f. April 01, 2016 unless specifically excluded. Exemption have been provided to the following services (when provided by the Government or Local Authority) subject to certain conditions specified therein (Notification No. 22/2016-ST dated April 13, 2016):

- Services provided to another Government or local authority
- Services where the gross amount charged for such services does not exceed INR 5000/-
- Services by way of tolerating non-performance of a contract for which consideration in the form of fines or liquidated damages is payable to the Government or the local authority under such contract
- Services by way of-
 - a) registration required under any law for the time being in force;
 - b) testing, calibration, safety check or certification relating to protection or safety of workers, consumers or public at large, required under any law for the time being in force
- Services by way of assignment of right to use natural resources to an individual farmer for the purposes of agriculture
- Services by way of any activity in relation to any function entrusted to a Panchayat under article 243G of the Constitution
- Services by way of assignment of right to use any natural resource where such right to use was assigned by the Government or the local authority before the April 01, 2016
- Services by way of allowing a business entity to operate as a telecom service provider or use radiofrequency spectrum during the financial year 2015-16 on payment of licence fee or spectrum user charges, as the case may be
- Services by way of deputing officers after office hours or on holidays for inspection or container stuffing or such other duties in relation to import export cargo on payment of Merchant Overtime charges (MOT)

A noteworthy amendment has also been brought under Rule 4(7) of the CENVAT Credit Rules 2004, where credit of Service tax paid in respect of services provided by way of assignment of ‘right to use’ any natural resource shall be spread over the period for which the “right to use” has been assigned.

CLARIFICATIONS BY THE CBEC

With the omission of the term “support services”, the spectrum of services provided by the Government/Local Authority that are taxable has widened leading to doubts and queries. The Circular offers clarification on various aspects some of which have been set-out hereunder:

- I. It is clarified that any activity undertaken by Government or a local authority against a consideration constitutes a service and the amount charged for performing such activities is liable to Service Tax. It is immaterial whether such activities are undertaken as a statutory or mandatory requirement under the law and irrespective of whether the amount charged for such service is laid down in a statute or not. As long as the payment is made (or fee charged) for

getting a service in return (i.e., as a quid pro quo for the service received), it has to be regarded as a consideration for that service and taxable irrespective of by what name such payment is called. It is also clarified that Service Tax is leviable on any payment, in lieu of any permission or license granted by the Government or a local authority. [Point 5 of the Circular]. Further, it has been provided that Circular No. 89/7/2006-Service Tax dated December 18, 2006 and Reference Code 999.01/23.8.07 in Circular No. 96/7/2007-ST dated August 23, 2007 issued in the pre-negative list regime are no longer applicable.

- II. It is clarified that taxes, cesses or duties levied are not consideration for any particular service as such and hence not leviable to Service Tax. These taxes, cesses or duties include excise duty, customs duty, Service Tax, State VAT, CST, income tax, wealth tax, stamp duty, taxes on professions, trades, callings or employment, octroi, entertainment tax, luxury tax and property tax.
- III. It is clarified that fines and penalty chargeable by Government or a local authority imposed for violation of a statute, bye-laws, rules or regulations are not leviable to Service Tax. Further, Fines and liquidated damages payable to Government or a local authority for non-performance of contract entered into with Government or local authority have been exempted vide Notification No. 25/2012 -ST dated June 20, 2012 as amended by Notification No. 22/2016 -ST dated April 13, 2016 [Entry 57 refers].

RETROPECTIVE/PROSPECTIVE APPLICATION OF AMENDMENT

Notification No. 22/2016 – Service Tax dated April 13, 2016 provides specific exemption in respect of those assignment of rights to use any natural resources, which have been granted by the Government/Local Authority before April 01, 2016. However, what is worth noting is that such exemption is limited to one time charges (whether paid in full or in installments) for assignment of right to use such natural resource. In other words, the periodic charges/payments made by the business entities, have been kept out of the exemption and thus, would be taxable. The extract of the entry is as under:

*“61. Services provided by Government or a local authority by way of **assignment of right to use any natural resource** where such right to use was assigned by the Government or the local authority **before the 1st April, 2016:***

Provided that the exemption shall apply only to service tax payable on one time charge payable, in full upfront or in installments, for assignment of right to use such natural resource;”

In this respect, the Point 9 of the Circular also clarifies that *Service Tax is payable on such installments in view of rule 7 of Point of Taxation Rules, 2011 as amended by vide Notification No. 24/2016 – ST dated April 13, 2016. However, the same have been specifically exempted vide Notification No. 25/2012 – ST dated June 20, 2012 as amended by Notification No. 22/2016 – ST dated April 13, 2016 [Entry 61 refers]. The exemption shall apply only to Service Tax payable on one time charge, payable in full upfront or in installments, for assignment of right to use any natural resource and not to any periodic payment required to be made by the assignee, such as Spectrum User Charges, license fee in respect of spectrum, or monthly payments with respect to the coal extracted from the coal mine or royalty payable on extracted coal which shall be taxable.*

It is to be noted that specifically with respect to telecom services, entry 62 has been inserted in Mega Exemption Notification which provides that services provided by Government or a local authority by way of allowing a business entity to operate as a telecom service provider or use radiofrequency spectrum during the financial year 2015-16 on payment of licence fee or spectrum user charges, as the case may be, would be exempt from Service tax.

ELP COMMENTS

The effect of the amendment and Circular would be far reaching inasmuch as it provides that **any service** (except few specifically excluded) provided by the Government/Local Authority will be exigible to Service tax irrespective of the fact whether payments have been made to the Government *qua* performing their statutory functions/duties or otherwise. While the impact of the amendment is on all the sectors, it is prominent for Infrastructure Companies, Mining and Exploration Industry, Oil & Gas Companies, and Telecom Companies etc. which involve granting of rights to use natural resources by the Government to such companies against huge sum towards it and thereby issue as to taxability.

While the one-time charge for grant/assignment of right to use natural resources issued prior to April 01, 2016 have been kept out of the levy, Service tax is payable on periodic payments made to Government/Local Authority. In view of this, payments by the Companies such as royalty etc. paid by the Oil and Exploration Companies and other payments by Infrastructure Companies will be impacted especially when their output has no set-off available. In the mean while, it would

be best for parties adversely impacted to reach out to the CBEC with suitable Representation seek appropriate relief.

It is also worth examining the issue that in the scheme of our Constitution and in line with law declared by the Hon'ble Supreme Court, the Central Government deals with various streams of natural resources as part of its sovereign duty to ensure that such natural resources are commercially exploited in a manner which best promotes the nation's interest. In that background, a question will arise whether the discharge of this sovereign duty (often by creating joint ventures or co-ventures) by the grant of licenses / leases / prospecting / exploration rights *qua* such natural resources, can be regarded as the rendition of a service.

Disclaimer: *The information provided in this update is intended for informational purposes only and does not constitute legal opinion or advice. Readers are requested to seek formal legal advice prior to acting upon any of the information provided herein. This update is not intended to address the circumstances of any particular individual or corporate body. There can be no assurance that the judicial/ quasi judicial authorities may not take a position contrary to the views mentioned herein.*

ECONOMIC LAWS PRACTICE | ADVOCATES & SOLICITORS

MUMBAI

mumbai@elp-in.com

NEW DELHI

delhi@elp-in.com

BENGALURU

bengaluru@elp-in.com

AHMEDABAD

ahmedabad@elp-in.com

PUNE

pune@elp-in.com

CHENNAI

chennai@elp-in.com

© Economic Laws Practice 2016