Ernst & Young point of view on negative list

Industry analysis
The Finance Act 2012 introduced a new law for levy of Service Tax, based on the Negative list concept (Negative List) from 1 July 2012. The Act replaced the erstwhile Positive List of 119 taxable services. The Central Government believes that introduction of Negative List is a step in the right direction toward eventual transition to Goods and Services Tax.

“Service” has been defined to mean “any activity carried out by a person for another for consideration and including a declared service.” “Taxable territory” encompasses the whole of India except Jammu & Kashmir.

The new regime seeks to widen the tax base wherein all services (other than sale of goods, deemed sales under Article (366) of the Constitution of India, transactions in money and actionable claims) provided or agreed to be provided in a taxable territory by one person to another will be taxable, except those under a Negative List or those that are specifically exempted.
Service Tax will also be applicable on nine specified “declared services” including those in the nature of agreeing to refrain from an act, to tolerate or undertake an act, renting of immovable property, development, upgrading of Information Technology (IT) software, etc.

Around 17 services have been covered under the Negative List. These include trading, manufacture or production of goods and services relating to agriculture, education, public transportation, distribution of electricity, etc.

Furthermore, 39 services, including health care, specified services for the Government and construction of airports, dams, roads, bridges, etc., have been covered under Mega Exemption.

In addition, the Place of Provision of Service Rules, 2012 (PoS Rules) have been introduced to determine the place where a service is deemed to have been provided to replace existing rules governing export and import of services. The Service Tax Rules, 1994, Cenvat Credit Rules, 2004, Service Tax (Determination of Value) Rules, 2006 and the Point of Taxation Rules, 2011 have all been amended to reflect changes under the Negative List.

The Law has also for the first time introduced the concept of a portion of the tax to be paid by a service receiver on specified services. This will be onerous for the industry from the compliance and IT standpoint.

The new law, with its wide definition of services, will have significant implications across industry from the perspective of expanded scope, taxability, credit, the PoS rules and partial reverse charge liability.

There had been a consultative process in coordination with stakeholders before the introduction of this new law. This was a welcome measure. Moreover, the law is accompanied by an “Educational Guide,” wherein the background, intention and views of the policymakers have been elaborated on. But in spite of the Educational Guide, the reading of the details of the new law suggests that there are several areas of doubt and debate which need clarification.

It is therefore imperative for businesses to examine every activity for a consideration (including barter), re-evaluate the impact of the Negative List on their Service Tax liability and compliances.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the automotive sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Service Tax implications on extended warranty packages offered by auto manufacturers**

In the erstwhile regime, no Service Tax was paid by auto manufacturers for consideration received upfront on sale of extended warranty packages on the basis that the contract for extended warranty was only an agreement to repair or service a vehicle for a specified period of time and did not constitute any service.

However, under the Negative List regime, the activity of agreeing to an obligation to refrain from an act, to tolerate an act or a situation or to carry out an act has been specifically included as a declared service. Hence, the activity of extended warranty may qualify as a service.

- Whether the amount charged for the extended warranty will attract Service Tax
- Value on which Service Tax will be taxable will need to be determined, given that the consideration is for an agreement to service a vehicle, which includes supply of spare parts
- Whether such a transaction can qualify as a works contract, and therefore, Service Tax paid on the abated value

**Key issues**

- Taxability of bonuses being paid to distributors and dealers will need to be evaluated.

**Bonus to dealers/distributors**

Under the erstwhile regime, no Service Tax was paid as bonus to dealers on the basis that they were not directly rendering any services to auto manufacturers (with transactions of purchase of vehicles by dealers from auto manufacturers being on a principal to principal basis).

However, post the Negative List regime, services include any activity carried out by a person for another for a consideration, and includes a declared service. Hence, it needs to be determined whether such payment of a bonus will attract Service Tax.
Review of annual contracts for repair of vehicles (involving supply of goods and provision of service)

Previously, repair or servicing of goods or vehicles was not covered within the definition of a “works contract” service. Moreover, there was no abatement prescribed in the regulations under the taxable service category of “service station.” Accordingly, unless the service providers could claim deduction for the value of goods sold by them, Service Tax had to be paid on the entire value of a contract.

Under the Negative List regime, repair of goods has been specifically included in the definition of a works contract. Hence, annual maintenance contracts for repair of vehicles will qualify as works contracts and the service portion in a contract will be determined in accordance with the rules specified in this regard. Furthermore, where the value of goods sold is not available, Service Tax may have to be paid on 70% of the entire value of the contract under the abatement scheme.

Pooling arrangements between auto manufacturers and distributors

Pooling arrangements are entered between auto manufacturers and distributors to cover the loss of a financing company, wherein a manufacturer and a dealer contribute an amount (that has been agreed on) into the account of a manufacturer. Previously, the contribution of the dealers into a risk pool account could be considered an agreement between the manufacturers and the distributors to share the risks. This was not covered under any specific taxable service category, and hence, was not liable to Service Tax.

Under the Negative List regime, this service has been defined as any other activity carried out by a person for another for a consideration and includes a declared service. The term “declared service” has been defined to include agreeing to the obligation to refrain from an act, to tolerate an act or a situation or to carry out an act.

Hence, it needs to be examined whether contributions to a risk pool will now qualify as a service or a deemed service.
Aviation, Aerospace and Defence

The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the aviation, aerospace and defence sectors. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Taxability of various services after the initiation of the Negative List regime

The taxability of various services after the implementation of the Negative List regime and introduction of PoS Rules in the airline sector needs to be determined.

- Whether additional charges collected by airlines from passengers, e.g., as cancellation of tickets, changes in journey dates and re-routing will qualify as a service (If it does, will abatement be available to such charges?)
- Whether collection of excess baggage charges from passengers will qualify as a bundled service
- Computer Reservation Systems (CRS) procured by airlines may qualify as online information and database access or retrieval services for which the place of provision has been specified as the location of the service provider. Taxability of such services will need to be analyzed, especially in light of ongoing litigation on the matter.
Maintenance services in relation to moveable property to be treated as “works contract”

In the erstwhile regime, repair or service of goods was not covered within the definition of “works contracts.” Under the Negative List regime, maintenance and repair of aircraft, defense equipment provided by MRO units and others may come under the definition of works contract. Hence, contracts for maintenance and repair will qualify as works contract and the service portion will be determined in accordance with the provisions of Service Tax (Determination of Value Rules), 2006.

However, services provided to the Government, a local authority or a governmental authority by way of repair or maintenance of a vessel or an aircraft have been specifically exempted from levy of Service Tax. Furthermore, Service Tax will also be exempted in cases where the Government, a local authority or a governmental authority receives services for non-commercial purposes from a service provider located outside India.

Services performed in India on behalf of a foreign party

Under various arrangements, the Indian offset partner may provide services in India on behalf of a foreign OEM.

- Taxability of such transactions will need to be analyzed on a case-to-case basis, since Export Rules have been rescinded on the introduction of PoS Rules, which prescribe different criteria for determination of place of provision of service.

Change in abatement rates

A comparison of the percentage of abatement is provided below:

<table>
<thead>
<tr>
<th>Service</th>
<th>Prior to 1 July 2012 (taxable percentage)</th>
<th>From 1 July 2012 (taxable percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic journey – Economy class</td>
<td>10% up to a maximum of INR150</td>
<td>40%</td>
</tr>
<tr>
<td>International journey - Economy class</td>
<td>10% up to a maximum of INR750</td>
<td>40%</td>
</tr>
<tr>
<td>Domestic and International journey - Business class</td>
<td>100%</td>
<td>40%</td>
</tr>
</tbody>
</table>
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the financial services sector.

Generally, the scope of banking and financial services, which attract Service Tax, continues to be largely the same. Furthermore, the following services continue to be exempted:
- Discounting income from bills
- Transactions between banks and authorized dealers
- Sub-broker services
- 90% abatement on interest on financial leasing
- Service provided by RBI

The place of provision of the majority of banking and financial services will be based on the location of the service recipient, with the exception of services provided to account holders and services that qualify as "intermediary services."

We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Interest on loans, advances and deposits**

Under the Negative List regime, interest on loans, advances and deposits have been included under the Negative List. Furthermore, 50% reversal of credit has been retained in Cenvat Credit Rules 2004. This is only applicable to banks, financial institutions and NBFCs engaged in providing services pertaining to provision of deposits, loans and advances.

**Credit card transactions**

Interest for services by way of extending loans and deposits have been included under the Negative List. Interest charged on credit cards is likely to attract Service Tax, since it is not a loan or advance because it is not contractually negotiated.

**Foreclosure or cheque-bouncing charges**

Transactions in money or actionable claims have been excluded from the definition of "service." However, according to the explanation provided, it emerges that a money transaction does not include any activity in relation to money for which a separate consideration is charged.

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**Key issues**

- Whether interchange fees between players in credit card transaction will attract Service Tax
- Whether foreclosure or cheque-bouncing charges will attract Service Tax
- Scope of services provided to account holders to determine the place of supply under the Place of Provision of Service Rules, 2012

**Key issues**

- Scope of the 50% credit reversal rule, specifically in the context of interpreting the term "engaged in"
- Whether interest earned on investment in debt securities, government securities, etc., will qualify for exemption on interest earned from "loans, advances and deposits"
- Impact on Cenvat credit for input services used exclusively to earn interest on loans, advances and deposits in the context of Rule 6 of Cenvat Credit Rules 2004
It needs to be determined whether the following transactions will attract Service Tax:

- Over-the-counter transactions in securities
- Forward contracts in commodities and commodity futures
- Taxability of premiums earned from derivatives, e.g., option premium

Treasury operations: trading in securities

The definition of “goods” includes “securities” (as defined under the Securities Contract (Regulation) Act, 1956 and is aligned to include derivatives under the definition provided in the Reserve Bank of India Act, 1934.

Treasury operations: buying and selling of foreign exchange

Currency forward and future contracts should not attract Service Tax, since these relate to sale or purchase of securities. The slab rate for foreign exchange will continue to apply under the Negative List regime.

Key issues

- Whether conversion of currency at time of settlement will attract Service Tax

Stockbroking services

Stockbroking services will continue to attract Service Tax. Determining the place of provision of stockbroking services will be relevant in light of the rule for intermediary services, on performance-based services as well as on the main rule based on the location of the service recipient.

- What will be the place of supply of stockbroking and clearing services provided to non-resident clients?
- Valuation of stockbroking services — whether reimbursement of expenses or taxes will be recovered
- Will “margin money” placed with an exchange considered an “extending deposit”?
- Impact on the taxability and place of supply of services provided under the Securities Lending and Borrowing scheme

Mutual Funds

Purchase and sale of mutual fund units being a transaction in goods should not attract Service Tax. It should be exempt from Service Tax payable on a reverse charge basis on distribution and marketing commission.

- Whether the entry and exit load will attract Service Tax
- Examination of implications on reimbursement of expenses received by Mutual Fund from the Asset Management Company (over and above the SEBI-approved expense ratio)

Leasing transactions

Leasing transactions will continue to attract Service Tax provided the right to use the goods is not transferred, with the key condition that there is no transfer of effective use or control. Service Tax continues to be applicable on 10% of the interest on financial leases.

Investment Advisory services

While investment advisory services continue to qualify as “services,” some key issues relating to these activities include:

- Determination of the place of supply for origination fees and arranger fees in light of the specific rule pertaining to intermediary services
- What will be the place of provision of real estate advisory services — whether it will be the location of immovable property?
- Implications, if any, on transfer pricing settlements viewed as transactions between an “association of persons” for Service Tax purposes
Hospitality

The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the hospitality sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Change in abatement rates

The percentage of abatement for various services related to the hospitality sector has undergone changes. A comparison of the percentage of abatement has been provided below:

<table>
<thead>
<tr>
<th>Service</th>
<th>Prior to 1 July 2012 (taxable percentage)</th>
<th>From 1 July 2012 (taxable percentage)</th>
<th>Credit eligibility post 1 July 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Convention center/mandap with catering</td>
<td>60%</td>
<td>70%</td>
<td>All credits except on input of Chapters 1 to 22 of Central Excise tariff available</td>
</tr>
<tr>
<td>Pandal or shamiana with catering</td>
<td>70%</td>
<td>70%</td>
<td>Credit on input services allowed</td>
</tr>
<tr>
<td>Accommodation in hotel, etc.</td>
<td>50%</td>
<td>60%</td>
<td>Credit on input services allowed</td>
</tr>
</tbody>
</table>

Valuation of services

Rule 2C has been introduced in Service Tax (Determination of Value) Rules, 2006 (Valuation Rules) to determine the value of the service portion involved in supply of food, other article of human consumption or drinks in a restaurant or as outdoor catering. The value of the service portion will be determined as follows:

- Whether the valuation mechanism provided in Rule 2C of the Valuation Rules is optional or mandatory
- Value of Service Tax to be charged, i.e., whether it will be on the actual amount charged for services and is ascertainable
- Issues relating to industry segments such as airline caterers

Exemption under Notification 14/2008 dated 1 March 2008 withdrawn

In the erstwhile regime, vide Notification 14/2008 dated 1 March 2008, the following services were exempt from Service Tax:

- Services provided by an entity with a place of business outside India
- To a hotel in India
- In relation to booking of accommodation in such a hotel
- For a customer with place of business, permanent address or usual place of residence outside India

Under the Negative List regime, the Place of Provision of Services Rules, 2012 (the PoS Rules) seek to introduce a new concept of “intermediary services,” wherein the place of provision of service is deemed to be the location of the service provider.

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1 Prior to 1 July 2012, no credit was available of taxes paid on inputs, capital goods and input services if abatement was claimed under Service Tax Notification 1/2006 dated 1 March 2006.
2 Under Notification 1/2006 dated 1 March 2006
3 Prior to 1 July 2012, abatement was available under Service Tax Notification 1/2006 dated 1 March 2006 subject to the condition that no credit is available of taxes paid on input, capital goods and input services was claimed.
The term “intermediary” is defined as follows:

“... a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of service (herein called the “main service”) between two or more persons, but does not include persons who provide the main service on their own account.”

Service Tax should not be applicable if the services used in relation to booking of accommodation in hotels provided by overseas companies to a hotel in India qualify as “intermediary services.” If the services provided are not intermediary in nature, Service Tax should be applicable under the reverse charge mechanism.

Service Tax on dining in a hotel room

Under the erstwhile regime, services provided by a restaurant with an air-conditioned facility and a license to serve liquor on its premises (and not in a hotel’s rooms) attracted Service Tax. Furthermore, it was clarified in Circular 139/8/2011 - TRU dated 10 May 2011 that food served in a room would not be liable to Service Tax under “accommodation services” or “restaurant services.”

From 1 July 2012, the list of declared services includes a “service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity.” Hence, under the Negative List regime, dining in a hotel room should qualify as a taxable service.

Rule 2C of the Valuation Rules stipulates that the value of a service portion in any activity involving supply of food, drink, etc., in a restaurant is 40% of the total amount charged.

Dry-cleaning services

Under the erstwhile regime, dry-cleaning services attracted Service Tax. However, it was clarified by Circular F. No. B11/1/2002-TRU dated 1 August 2002 that wet cleaning services do not attract Service Tax.

Bundled services

The concept of “bundled services” has been introduced under the Negative List regime, which does not differentiate between various elements of services with separate charges. A bundled service refers to a bundle of provision of various services, wherein an element of provision of one service is combined with an element or elements of provision of any other service or services.

Bundled services will be treated as provision of the service providing the bundled service its essential character if the various elements are naturally bundled in the ordinary course of business. If the elements are not naturally bundled in the ordinary course of business, it will be treated as provision of service with the highest Service Tax liability.

Furthermore, it has been clarified that a hotel accommodation package with breakfast is a natural bundling of services, and in this case, the essential character is of hotel accommodation.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the infrastructure sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Services in relation to construction, installation, etc., of water supply and treatment plants and sewerage treatment plants**

Under the erstwhile regime, no Service Tax exemption was accorded for construction, installation, etc., of water supply and treatment plants and sewerage treatment plants. However, under the Negative List regime, specific exemption has been provided for construction, erection, commissioning, installation, fitting out, repair, maintenance, renovation or alteration of water supply and treatment plants and sewerage treatment plants when provided to the Government, a governmental authority or a local one.

**Works contract services in relation to dams and canals**

Under the erstwhile regime, no Service Tax was levied on works contract services (construction, erection, commissioning, etc.) rendered in respect of dams, canals, etc. (irrespective of the nature of project owner). Post the Negative List regime, exemption of Service Tax is only with respect to services provided to the Government, a governmental authority or a local one by way of construction, erection, commissioning or installation of canals and dams. Hence, the scope of the existing exemption has been restricted since it is now only available for projects executed for the bodies mentioned above.

Under the Negative List regime, services relating to the erection, construction, commissioning or installation of original works pertaining to an airport, port or railway, including the metro and monorail, have been exempted from levy of Service Tax. It is imperative to note that metros and monorails are specifically included in the scope of the exemption. Furthermore, this exemption is available for services rendered in relation to movable and immovable property.

**Maintenance services in relation to railways, airports and dams**

Under the erstwhile regime, exemption from Service Tax was available with regard to maintenance of railways, ports, airports, etc. Excise Tax and Service Tax paid on input, capital goods and input services for such services was a cost to service providers.

However, maintenance of railways, airports and dams is taxable under the Negative List regime. Hence, tax paid on capital goods and input services used to provide such services will be allowed as Cenvat credit.

**Construction, erection, commissioning and installation services in respect of railways**

In the erstwhile regime, construction, erection, commissioning and installation services, when provided in respect of airports, ports and railways, were exempt from Service Tax. However, there was no clarity as to whether the term “railways” included a “metro.” Furthermore, there was no clarity as to whether this exemption would be available for contracts relating to erection or commissioning of a movable property.

**Works contract composition scheme and inclusion of free-of-cost supplies by service recipient**

In the erstwhile regime, works contract services were taxable at a composite rate of 4.94%, and was applicable on the gross amount charged for the contract. The gross amount included the value of all the goods used in or in relation to the execution of a works contract, a governmental authority or a local one by way of construction, erection, commissioning or installation of canals and dams. Hence, the scope of the existing exemption has been restricted since it is now only available for projects executed for the bodies mentioned above.

Key Issue

- Contracts need to be analyzed to determine whether project owners qualify as a “government, local authority or governmental authority” to determine their eligibility to avail of the exemption.

- Whether exemption will be available for turnkey contracts (i.e. works contracts) only due to reference to the term “original works” or will the exemption also be available for related “pure service contracts”

- Whether exemption will be applicable for expansion projects, since it is only for original works.

- It is important to determine whether maintenance services relate to movable or immovable goods to determine the actual cost of a maintenance contract and the specific abatements available thereon.

- Whether exemption will be available for expansion projects, since it is only for original works.

- Under the Negative List regime, the composition scheme has been replaced by the abatement scheme where Service Tax is payable on the total amount charged (reduced by the prescribed
percentage of abatement. The total amount charged will be the gross amount charged for the works contract in addition to the fair market value of all the goods and services supplied by the service recipient less the amount recovered by the service recipient for such goods and services. The fair market value will be determined on the basis of generally accepted accounting principles.

There is better clarity with regard to the inclusion of supplies made by the service recipient (whether procured from third parties or separately from service providers) in the total amount charged.

A position was adopted that all goods procured by port developers or owners and supplied to contractors undertaking construction activities (on a free of cost basis) should qualify as input, although this was disputed by the Service Tax authorities. Accordingly, the port developers or owners availed Cenvat credit of the taxes in respect of such input.

The definition of “input” has been amended under the Negative List regime. According to the amended definition, only goods that have been procured directly by a contractor (to provide construction services) should qualify as input. Accordingly, from 1 July 2012 onwards, port developers or owners should not be eligible to avail of Cenvat credit of duty paid on such goods, since these goods should no longer qualify as “input” for such port authorities.

Implications when immovable property and the service provider or receiver are in different territories

Under the erstwhile regime, a service could qualify as export (provided other conditions for exports were met) even if the service provider and service recipient were located in a taxable territory, in the event the immovable property (in relation to which a works contract service was rendered) was situated outside the taxable territory.

However, under the Negative List regime, the place of provision of the service will be the location of the service recipient (i.e., in the taxable territory), since the service provider and service recipient are located in India. Accordingly, such services will not qualify as exports.

Maintenance services in relation to moveable property to be treated as “works contract”

In the erstwhile regime, repair or servicing of goods was not covered within the definition of a “works contract service.” Accordingly, maintenance of goods was taxable under “management, maintenance or repair services;” wherein the entire consideration was liable to Service Tax (subject to deduction of the value of the goods supplied).

Under the Negative List regime, the definition of works contracts has been amended to include specified activities in relation to movable property as well as maintenance activities. Hence, contracts for maintenance and repair of goods will qualify as works contracts and the service portion will be determined in accordance with the provisions of Service Tax (Determination of Value Rules), 2005. Furthermore, if abatement is availed, Service Tax will be paid on 70% of the entire value of the contract, subject to valuation provisions in this regard.

Services rendered by sub-contractors to contractors

In the erstwhile regime, various works contract services were exempt from Service Tax, but there was no specific exemption to sub-contractors who provided services to principal contractors. However, it was clarified by Circular no. 138/07/2011-ST (dated 6 May 2011) that exemption available under works contract services to contractors will also be available for sub-contractors providing services in relation to such exempted services.

Under the Negative List regime, exemption of Service Tax has been specifically accorded to sub-contractors providing works contract services to other contractors, which render works contract services that are exempted from paying Service Tax. However, no specific exemption has been accorded for “pure services” availed by principal works contractors. Accordingly, pure services availed by principal works contractors will be a cost, since their services will be exempt from Service Tax.

Cenvat credit of input used to provide port service

Port developers and owners procured goods and supplied these to contractors on a free of cost basis. These goods were used by the contractors while undertaking construction activities for these port developers and owners.

According to the erstwhile definition of inputs under Cenvat Credit Rules, 2004, goods used for construction of civil structures, etc., will not qualify as “input” unless they are used to provide certain specified services (including port services).
Insurance sector

The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the Insurance sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

A. Life insurance

Surrender charges for life insurance

The Guidance Note clarifies that “advances forfeited for cancellation of an agreement to provide service” will represent consideration for provision of services.

Taxability of initial contribution under group policies

In the case of group policies, insurance companies make an additional/initial contribution to funds on behalf of policyholders as an incentive that is over and above the actual premium at the time the policy is initiated. This additional contribution is recovered from the fund by the insurance company in installments over the term of a policy.

Taxability of initial proposal deposit, renewal premium and reinstatement premium/charges

Under the Negative List regime, services provided or agreed to be provided will attract Service Tax.

Credit reversal

Under Rule 6(7A) of the Service Tax Rules, 1994, a life insurance company has the option of paying Service Tax for certain products on the gross premium less the amount allocated for investment or savings. In the case of certain other products, they can pay Service Tax at a lower rate of 3% or 1.5% of the premium charged to the policy holder.

Furthermore, with effect from 1 April 2012, an amendment has been made in Rule 6(3) of the Credit Rules in relation to proportionate reversal of Cenvat credit in the case of a life insurance company, providing taxable and exempted services, which has opted to pay Service Tax as per Rule 6(7A) of the Service Tax rules.

B. General insurance

Place of provision for insurance broking services

According to PoS Rules, the place of provision of services to intermediaries such as agents and brokers will be the location of the service provider.

Place of provision for immovable property in Jammu & Kashmir

As per Rule 5 of the PoS Rules, the place of provision of services relating to immovable property will be the location of the immovable property. Furthermore, according to Rule 7 of the PoS Rules, where a service is provided at more than one location (including a location in a taxable territory), the place of provision of service will be the location in the taxable territory where the largest share of the service is provided.
C. Common Co-insurance

Sometimes, insurance companies form a consortium to provide insurance, wherein the lead insurer recovers premiums from policyholders and charges Service Tax on these. Subsequently, these premiums are distributed by the lead insurer to the co-insurers. The lead insurer also charges administrative fee to the co-insurers as consideration for front-ending the consortium.

Key Issue
• For a comprehensive policy covering immovable property located within Jammu & Kashmir and outside Jammu & Kashmir, the liability of the general insurance company to pay Service Tax (even on general insurance provided for property located in the state) will need to be examined.

Taxability of return under motor-pooling model

All general insurance companies collectively contribute the premiums collected to a pool account to underwrite third party motor insurance, since part of the pooled business is (on a multi-lateral basis) reinsured by all the participants of the pool.

Key Issue
• The impact of the Negative List regime on such motor-pooling transactions should be analyzed.

Key Issue
• Whether distribution of premiums between consortium members will be taxable under the Negative List regime
• Whether administrative fees will be subject to Service Tax

D. Other issues

We have also highlighted other key issues that should be analyzed:
• Point of taxation for insurance companies, given that no invoices are raised by them
• Whether target incentives received by insurance agents, brokers or intermediaries will be subject to Service Tax under the Negative List
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the IT/ITES sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Electronic supply of software
The Guidance Note clarifies that pre-packaged or canned software, which is put up on media, is in the nature of “goods,” and hence, is subject to VAT. However, if the software is supplied electronically, then it does not qualify as goods. In this case, the transaction qualifies as a service and will be subject to Service Tax.

Taxability of software licenses
The Guidance Note clarifies that license to use software will qualify as a “transfer of right to use” or a “service,” depending on the terms and conditions of the license. If it qualifies as transfer of right to use, VAT will be attracted and if it qualifies as a service, Service Tax will be attracted.

Supply of software on physical media overseas
Rule 4 of PoS Rules provides that if a service in relation to goods is provided from a remote location by way of electronic means, the place of provision will be the location where goods are located at the time of provision of service.

Taxability of customized software
Post the Negative List regime, development, design, programming and customization of software has been included as a declared service. However, the Madras High Court, in the case of Infotech Software Dealers Association vs the Union of India1, had held that customized software put up on media can be goods and can attract VAT.

Maintenance and repair of software/hardware in India and overseas
Rule 7 of PoS Rules provides that if a service is provided at more than one location, including a location in India, the place of provision of such a service will be the location in India where its largest share is provided.

Maintenance and repair of software
In the erstwhile regime, repair/service of goods was not covered within the definition of “works contract services.” Under the Negative List regime, maintenance and repair of software will be classified as a works contract, i.e., a transaction involving supply of goods and services.

Hence, contracts for maintenance and repair of software will qualify as works contracts and the service portion will be determined in accordance with the provisions of Service Tax (Determination of Value Rules), 2005. Furthermore, if the abatement is availed, Service Tax will be paid on 70% of the entire value of the contract.

Key issue
- Whether a change in the manner of supply of software will result in a change in indirect tax implications.

Key issue
- Terms and conditions for each kind of license may need to be analyzed separately to determine whether license to use packaged software will attract VAT or Service Tax.

Key issue
- There may be instances where software is supplied on a physical medium but is placed on a server located outside India and is accessed by an Indian company electronically. In this case, it needs to be determined whether the transaction will be liable to Service Tax or become non-taxable by applying Rule 4 of PoS Rules.

Key issue
- On a case to case basis, an analysis may be required to determine whether customized software should be subject to Service Tax or VAT.

Key issue
- Where an IT/ITES company is providing maintenance and repair services in relation to software/hardware to an overseas client and the services are partially undertaken for software/hardware located in India, it needs to be examined whether the entire transaction will be subject to Service Tax.

Key issue
- It will need to be examined on a case to case basis whether maintenance and repair of software qualifies as a works contract or a pure service contract.

Key issue
- Applicability of the valuation mechanism and availability of Cenvat credit may require examination of such contracts.

1 AIT 2010 359 HC
Maintenance and repair of software/hardware on behalf of overseas clients

In the IT/ITES sector, various organizations maintain and repair software or hardware “on behalf of clients.” Until now, these organizations were paying Service Tax on such transactions under the category of “business auxiliary service.” The criterion for determining whether this category came under the ambit of export was the location of the service recipient.

• Since category-based application of Service Tax will not be relevant under the Negative List regime, it will need to be examined whether such transactions will continue to qualify as export of service after 1 July 2012.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the Life Sciences sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Health care services

Under the erstwhile regime, health check up and treatment services provided by clinical establishments or specified services provided by doctors (who were not employees of clinical establishments) were exempt from Service Tax.

Under the Negative List regime, exemption has been provided for specified health care services provided by clinical establishments, authorized medical practitioners or para-medics.

Hence, exemption available for health check-ups and treatment services has been continued in the Negative list regime. Additional clarity has been provided by specific reference to exemption of services rendered by para-medics and authorized medical practitioners. Specified services provided by veterinary clinics have also been kept out of the Service Tax net.

Clinical trials – exemption from Service Tax

Prior to the Negative List, tests carried out for the purpose of clinical testing of drugs and formulations were included under technical testing and analysis (TTAS). TTAS services provided by clinical research organizations that were approved to conduct clinical trials by the Drugs Controller General of India were exempt from Service Tax, subject to conditions.

Activities in relation to clinical trials will continue to attract Service Tax under the Negative List regime. The exemption provided for approved clinical trials (under the pre-negative list regime) has also been extended under the Negative List regime.

Clinical trials – change in condition for export

Prior to 1 April 2011, TTAS qualified as exports, based on the performance of such services, i.e., the criteria for determining exports was the place of provision of service. After 1 April 2011, the criterion for determining whether TTAS would qualify as exports was changed from “performance based” to “recipient based.” Accordingly, TTAS provided to clients located outside India qualified as “export of service.”

However, under the Negative List regime, the place of provision of technical testing services has been again shifted to the place of performance.

Hence, services in relation to clinical trials provided to overseas clients may attract Service Tax under the Negative List regime, irrespective of the location of the service recipient.

Key Issue

- Clarity may be obtained by way of a representation on the taxability of clinical trials undertaken for recipients located outside India.
**Intellectual Property Right services – patent rights**

Under the erstwhile regime, temporary transfer, permitting use and enjoyment of Intellectual Property right was covered under the taxable service category of “Intellectual Property service.” Intellectual Property right was specifically defined inter alia, referring to the right to intangible property under any law in force with the exception of copyright. Vide Circular No 80/10/2004 dated 17 September 2004, it was clarified that intellectual property rights “not covered by Indian law” would not be liable to Service Tax.

Under the Negative List regime, temporary transfer or the use or enjoyment of any intellectual property right has been specified as a declared service. Furthermore, specific exemption has been provided for temporary transfer, use or enjoyment of copyright.

However, there is no provision or reference that that the intellectual property should be covered under Indian law to be subject to Service Tax. The term “Intellectual Property Right” has also not been defined.

In this regard, the Guidance Note provides that temporary transfer of intellectual property rights registered outside India or right to use or enjoy the said intellectual property will also be liable to Service Tax, since there is no condition mandating registration of this within India, subject to the provisions of the PoS Rules.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the Media and Entertainment sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Film**

Under the Negative List regime, all film actors, dancers, technicians and other artists will be liable to pay Service Tax on the fees charged by them to film producers. On the other hand, transfer of copyright in cinematographic film has been made exempt from payment of Service Tax. Therefore, the revenue earned by a film producer by exploiting the rights in a film will not be liable to Service Tax under the Negative List. Consequently, no credit will be available to the film producer on the Service Tax charged by actors, technicians, etc. These costs form a substantial part of the film budget, and with credit of Service Tax being disallowed, the cost of film making will rise substantially.

Exemption from Service Tax on transfer of copyright also covers transactions in distribution of non-theatrical rights such as music, satellite, mobile and IPTV rights. Film distributors are also excluded from levy of Service Tax under the Negative List regime. This exemption is in addition to that on transfer of copyright in original works of literature.

**Advertising**

Selling of advertisement space on media other than TV and radio has been included in the Negative List of services. Given this, selling of advertisement space or time on digital media such as the internet and neon boards will not be liable to Service Tax. Furthermore, sale of advertisement on outdoor media such as hoardings and billboards will also not attract Service Tax.

Under the Negative List regime, the Place of Provision of Services Rules, 2012 (the PoS Rules) seeks to introduce a new concept of “intermediary services,” wherein the place of provision of service is deemed to be the location of the service provider. The term intermediary is defined as follows: “... a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of service (herein called the ‘main’ service) between two or more persons, but does not include a person who provides main service on his own account....”

Advertising agencies are likely to qualify as “intermediaries” under PoS Rules.

### Key Issue

- While services rendered by advertisement agencies to foreign clients could qualify as export of service under the erstwhile regime, it needs to be examined whether this will continue under the Negative List regime.
Television broadcasting

With exemption being provided for temporary transfer of copyrights, licensing of television content will also be exempt from payment of Service Tax.

Furthermore, based on downlinking guidelines, an Indian representative is required to act as the agent of a foreign channel company. Hence, it is a regulatory requirement for an Indian agent to execute contracts on behalf of a foreign channel company for sale of advertisement time, distribution of channels and syndication of content. Under the erstwhile regime, Indian agents did not pay Service Tax on the agency commission, since they were deemed to be broadcasting companies and were required to pay Service Tax on the entire revenue of their principals, including the agency commission.

Post the Negative List regime, an Indian representative will not be considered a broadcaster.

Sports

Due to restriction on exemption for players playing for recognized sports organizations, all players playing for other teams, clubs or franchisees will be liable to deposit Service Tax.

Shares received by franchisees from bodies organizing tournaments as a share of the revenue generated by the tournaments may also be liable to Service Tax. Similarly, shares received by franchisees as prize money from bodies organizing tournaments may also be liable to Service Tax.

A new refund scheme has been introduced under Cenvat Credit Rules, 2004, which provides for refunds to providers of services that are liable to Service Tax under the reverse charge mechanism. Given that Service Tax on sponsorship services will be payable under the reverse charge mechanism, such franchisee teams may be eligible to claim refunds of unutilized Cenvat credit.

Key issue

- It needs to be examined whether the agency commission charged by an Indian representative to foreign channel companies could attract Service Tax or whether such service may qualify as export of service.
Metals & Mining

The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the metals and mining sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Service Tax on mining rights**
The Government grants mining rights to various private players to undertake mining in specified areas. For its grant of such rights, the Government either receives an upfront amount or annual payment on a periodic basis. In the erstwhile regime, no Service Tax was levied on such mining rights.

Services provided by the Government have been included in the Negative List. However, certain specified support services provided by the Government are not covered in the list and will attract Service Tax. In the case of support services provided by the Government or local authority, the liability to pay Service Tax rests wholly with the recipient of the service.

It is clarified in the Guidance Note that grant of leasing rights will not be covered under the definition of support services. It is further clarified that in the event a transaction pertains to renting of immovable property, this may be subject to Service tax in India. Therefore, it is important to structure mining rights contracts in a tax-efficient manner.

**Taxability of survey and exploration services**
In the erstwhile regime, data-processing services undertaken outside India with respect to survey and exploration did not attract Service Tax in India. In the Negative List regime, the place of provision of services in relation to the survey and exploration is the location of the immovable property, i.e., of the mine.

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**Key issue**
It needs to be analyzed whether processing services outside India in relation to a mine located in India will attract Service Tax.

**Treatment of un-incorporated association of body of persons**
Generally, various companies enter a JV or consortium and undertake specified activities to undertake exploration and mining activities. In the past, there has been ambiguity about whether transactions inter se the members of an un-incorporated JV are subject to Service Tax, since it has been argued that such transactions are in the nature of a “self service.”

In the Negative List regime, it has been specifically provided that un-incorporated persons or a body of persons will be considered as distinct persons.

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**Key issue**
It needs to be analyzed whether transactions inter se members of an un-incorporated JV will be subject to Service Tax.
Applicability of Service Tax on forfeiture of Earnest Money Deposit/Security deposit/ payment of Liquidated Damages

At the time of inviting bids from service providers, mining companies usually demand earnest money or a security deposit. In the event of a contractual default on the part of the service provider, the mining company may forfeit this earnest money or security deposit.

Under Service Tax (Determination of Value) Rules, 2006, it has been sought that charges recovered as demurrage or by any other name in respect of services provided are included in the value of services for the purpose of levy of Service Tax (the only exception being accidental damages).

Key issue

Whether forfeiture of earnest money or security deposit on account of contractual default will be subject to Service Tax
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the Oil & Gas sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Upstream operators**

**Treatment of un-incorporated association or body of persons**

E&P companies operate oil and gas blocks as un-incorporated joint ventures (JVs). In the past, there has been ambiguity on whether transactions inter se the members of the un-incorporated JV are subject to Service Tax, since it has been argued that such transactions are in the nature of "self service."

Similarly, various oilfield service providers may also form a consortium and jointly provide services to an operator.

In the Negative List regime, it has been clarified that un-incorporated persons or a body of persons and their members will be considered as "distinct" persons.

**Key issue**

It needs to be analyzed whether transactions inter se members of the un-incorporated JV will be subject to Service Tax.

Similarly, it needs to be analyzed whether the consortium formed by oilfield service providers will be treated as an association of persons for services rendered individually by such members and will compliance relating to joint liability arise.

**Applicability of Service Tax on forfeiture of earnest money deposit/security deposit/payment of liquidated damage**

At the time of inviting bids from service providers, operators usually demand an "earnest money" or security deposit. In the event of a contractual default on the part of the service provider, the operator may forfeit this earnest money or security deposit.

**Key issue**

It needs to be analyzed whether forfeiture of an earnest money or security deposit or payment of liquidated damages on account of contractual default will be subject to Service Tax.

**Oilfield service providers**

**Taxability of survey and exploration services**

In the erstwhile regime, data processing services undertaken outside India with respect to survey and exploration did not attract Service Tax in India. However, in the Negative List regime, the place of provision of services in relation to the survey and exploration is the location of the immovable property, i.e., the location of the oilfield in this case.

Under Service Tax (Determination of Value) Rules, 2006, it has been sought that charges recovered as demurrage or by any other name in respect of services provided are included in the value of a service for the purpose of levy of Service Tax (the only exception being in the case of accidental damage).
Key issue
It needs to be analyzed whether processing services outside India in relation to an oilfield located in India will attract Service Tax.

Key issue
It needs to be analyzed whether the address of an overseas service provider in India can be considered its “representation office” in the country, merely for regulatory purposes.

Treatment of branch, agency or representational office in India as an Indian establishment

In the erstwhile regime, there was ambiguity as to whether a service provider was to be construed as having an office in India in the event it did not set up a full-fledged administrative and technical office in the country and only had an Indian address to comply with regulations.

However, under the Negative List regime, business carried out through a branch, agency or representational office in any territory will be treated as the establishment of entity in the territory.

Downstream operators

Taxability of various charges based on taxation regulations in Negative List

With the introduction of the Negative List’s regulations on taxation, companies engaged in sale and distribution of gas through pipelines may need to re-evaluate the taxability of various charges recovered from their customers, e.g., purging, compression, meter replacement or relocation charges, which may currently not be subject to Service Tax.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the Real Estate sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Implications when immovable property and service providers/receivers are in different territories**

Under the erstwhile regime, if the immovable property (in relation to which a works contract service was rendered) was situated outside the taxable territory, the service could qualify as export (provided other conditions for exports were fulfilled), even if the service provider and service recipient were located in the taxable territory.

However, under the Negative List regime, the place of provision of the service will be the location of the service recipient (i.e., in the taxable territory), since the service provider and service recipient are both located in India. Accordingly, such services will not qualify as exports.

**Construction of a complex, building, civil structure or a part thereof, intended for sale to a buyer, wholly or partly, except where consideration is received after issuance of completion certificate**

<table>
<thead>
<tr>
<th>Service</th>
<th>Prior to 1 July 2012</th>
<th>From 1 July 2012</th>
<th>Credit eligibility after 1 July 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>When cost of land has been recovered separately</td>
<td>Service Tax was payable on 33% of gross amount charged.</td>
<td>Service Tax is on 25% of the amount charged when the value of the land is included in the amount charged from the service receiver.</td>
<td>Cenvat credit was not allowed earlier. However, credit is now allowed on input service and capital goods.</td>
</tr>
<tr>
<td>When cost of land had not been recovered separately</td>
<td>Service Tax was payable on 25% of gross amount charged.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Key issue**

- Under the erstwhile regime, if the service provider opts to discharge Service Tax on 25% of the gross amount charged, the cost of land cannot necessarily be recovered separately from the buyer. However, it is not clear whether this restriction has been removed under the Negative List regime.

**Construction of more than one residential unit on a single premise**

Under the erstwhile regime, construction of more than 12 residential units located within the same premise was liable to Service Tax.

However, in the Negative List regime, a residential complex includes any complex comprising a building or buildings with more than a single residential unit.

Hence, construction of any number of residential units will attract Service Tax. Furthermore, the restriction that residential units have to be located within the same premise has been removed.

**Key issue**

- Whether construction of, for example, 10 villas for 10 different customers on the same plot of land can be considered a standalone residential premise and not part of a complex

**Premium for providing preferential location**

Under the erstwhile regime, the premium charged for providing a preferential location was taxable under the category of “preferential location and development of complex service.” Furthermore, the benefit of abatement or composition available for construction or work contract services was not available where this amount was charged separately.
• The extent of co-relation with immovable property for a service to be treated as one provided in relation to immovable property under PoS Rules is not defined and needs to be analyzed.

Key issue

Sale of space for advertisement

Services, by way of sale of space on or inside (usually display screens near elevators) residential buildings, shopping arcades, etc., for the purpose of advertisement were taxable under “Sale of space for advertisement services or advertisement agency services” in the erstwhile regime.

Under the Negative List regime, transfer fees collected by a builder from the seller of property under construction or composition schemes available for the main activity may continue to be liable to Service Tax.

In the erstwhile regime, services such as consulting engineer services, management consultancy services and technical testing and analysis services qualified as exports if the recipient was located outside India, irrespective of the location of the immovable property.

Under PoS Rules, the place of provision of any services in relation to immovable property is the location of the immovable property. Hence, such services may not qualify as exports in the current Service Tax regime, since the immovable property is located in taxable territory.

Key issue

• Whether transfer fees collected by a builder from the seller of property under construction will attract Service Tax.

Transfer fees collected by registered society from seller/buyer of property under construction

In the erstwhile regime, transfer fees collected by a registered society from a seller or buyer of construction property was liable to Service Tax under the category of “clubs and association service.”

In the Negative List regime, such services may be covered as a declared service as an obligation to execute an undertaking. In this case, such a service will continue to attract Service Tax.

Key issue

• The applicability of Service Tax needs to be analyzed in cases where the developer or owner engages a third person (concessionaire) to manage, maintain advertising sites and procure advertisements. The concessionaire then contracts with advertisers or agencies on its own account, and provides a minimum guarantee amount (in addition to a revenue share to the developer or owner).

Transfer fees collected by builder from seller/buyer of property under construction

In the erstwhile regime, transfer fees collected by the builder from a seller or buyer of property under construction was not liable to Service Tax. It was not specifically covered in any taxable service. However, in the Negative List regime, service includes any activity carried out by a person for another for a consideration. Hence, such activity may now qualify as a service.

Key issue

Service Tax in relation to Immovable property located in taxable territory

In the erstwhile regime, services such as consulting engineer services, management consultancy services and technical testing and analysis services qualified as exports if the recipient was located outside India, irrespective of the location of the immovable property.

Under PoS Rules, the place of provision of any services in relation to immovable property is the location of the immovable property. Hence, such services may not qualify as exports in the current Service Tax regime, since the immovable property is located in taxable territory.

Key issue

• Whether such a premium amount can also be treated as part of the consideration for construction or work contract services, and accordingly, be eligible for abatement or composition schemes available for the main activity.
Amendments introduced by the Finance Act 2012, which ushered the Negative List regime from 1 July 2012, have had a varied impact on the retail sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Taxability of trading services**

Under the erstwhile regime, trading did not attract Service Tax under any taxable service category. Under the Negative List regime, trading activity has been specifically included in the Negative List of services. Accordingly, it will continue to not attract Service Tax.

**Non-taxability of sale of space or time for advertisement services**

Selling of advertisement space on media other than TV and radio has been included in the Negative List of services. Given this, selling of advertisement space or time on digital media such as internet and neon boards will not be liable to Service Tax. Furthermore, sale of advertisement on outdoor media such as hoardings and billboards will also not attract Service Tax.

Under the Negative List regime, the PoS Rules seek to introduce a new concept of “intermediary services,” wherein the place of provision of service is deemed to be the location of the service provider. The term “intermediary” is defined as follows:

“... a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of service (herein called the ‘main’ service) between two or more persons, but does not include a person who provides main service on his own account ....”

Advertising agencies are likely to qualify as “intermediary” under PoS Rules.

**Distribution of input service by Input Service Distributor (ISD)**

Under the erstwhile regime, an ISD could distribute credit for various input services used in multiple units and distribute it among its units on the basis of the methodology prescribed in Cenvat Credit Rules, 2004 (Credit Rules).

Under the Negative List regime, Credit Rules have been amended and a restriction has been introduced whereby credit of services that are wholly used in a premise can only be distributed to that particular unit. In the event services are used in more than one unit, credit will then be distributed in proportion to the turnover of the unit. This restricts distribution of credit, and consequently, of credit availment for the unit.

- **Key issue**

  - Review of methodology for distribution of Cenvat credit by an ISD to its units

**Payment of cash incentives to retailers**

Under the erstwhile regime, cash incentives provided to retailers were like a reward given to them at the end of the year or adjusted with their next year’s sales targets. There was no express provision that taxed such receipts of incentive. Accordingly, no Service Tax was levied on payment of cash incentives to retailers.

However, since such activity is not included in the Negative List or exempt services now, it will be subject to Service Tax.

**Receipt of non-compete fee**

Under the erstwhile regime, non-compete fees were not liable to Service Tax.

However, under the Negative List regime, the activity of agreeing to an obligation to refrain from an act, to tolerate an act or situation, or to carry out an act has been specifically included as a declared service.

Accordingly, uncompleted fees received by job workers engaged exclusively for a specific principal manufacturer or by retailers engaged in selling the specified brand of a manufacturer/wholesaler will be liable to Service Tax.
Key issue

• Whether such cash incentives will qualify as a service in the Negative List regime

Availment of Cenvat credit on input services by service providers prior to Service Tax registration

In the erstwhile regime, expenses incurred prior to Service Tax registration were allowed as eligible Cenvat credit. However, in the Negative List regime, it has been specifically provided that expenses incurred prior to registration will not be allowed as eligible Cenvat credit to the service provider.

Key issue

• Whether this will lead to reduction in the credit pool and thereby trigger cash flow issues for service providers
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on telecom equipment manufacturers/vendors. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Packaged software excluded from definition of service

The Supreme Court, in the case of Tata Consultancy Services v/s State of Andhra Pradesh, held that software constituted goods, and accordingly, transfer of the right to use software would attract VAT/CST. Furthermore, transfer of the right to use software through the electronic mode or for commercial exploitation was specifically covered under the taxable service category of Information Technology Software Services. Considering the lacuna, the industry paid VAT as well as Service Tax on supply of software to avoid disputes with the tax authorities for a long time.

Under the Negative List regime, the definition of the term “service” specifically excludes sale/deemed sale of goods. Deemed sale includes transfer of the right to use goods. Furthermore, one of the categories of “deemed sale” specifically excludes transfer of the right to use goods as follows:

“transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use goods”

Since software has been held to be goods, transfer of the right to use software should now be out of the purview of Service Tax and should only attract VAT/CST.

Key issue

- Issue of applicability of VAT and Service Tax on right to use software needs to be examined.
**Promotion and marketing services**
Under the erstwhile regime, promotion and marketing services provided by an Indian entity in relation to services sold by an overseas party were covered under “business auxiliary services” and qualified as exports. Under the Negative List regime, PoS Rules seek to introduce a new concept of “intermediary services,” where the place of provision of such services will be based on the location of the service provider. Prima facie, it appears that the intention of “intermediary services” is only to cover persons including commission agents, air travel agents, etc. However, given the wide definition, it appears that any facilitation or arrangement of provision of service between two persons will be covered within the ambit of “intermediary services” (unless the main service is provided on account of the principal).

**Maintenance services in relation to moveable property to be treated as “works contract”**
In the erstwhile regime, repair/servicing of goods was not covered within the definition of “works contract services.” Accordingly, maintenance of telecom equipment was taxable under “management, maintenance or repair services,” wherein the entire consideration was liable to Service Tax (subject to deduction of the value of the goods supplied). Since many industry players were not able to produce and substantiate the value of goods supplied, a large part of the industry paid Service Tax on the entire consideration without claiming any deduction.

Under the Negative List regime, the definition of a works contract has been amended to include specified activities in relation to movable property as well as maintenance activities. Hence, contracts for maintenance and repair of goods will qualify as works contracts and the service portion will be determined in accordance with the provisions of Service Tax (Determination of Value Rules), 2006. Furthermore, in the event abatement is availed, Service Tax will be paid at 70% of the entire value of a contract.

**Key issue**
- It needs to be determined whether Indian entities providing promotion and marketing services to their overseas client could qualify as intermediaries, and the taxability of such services needs to be determined accordingly.

**Key issue**
- New valuation provisions in respect to work contracts need to be analyzed on a case-to-case basis to determine value of services and structuring of contracts.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had a varied impact on the telecommunications services sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

**Taxability of telecommunications services provided in/from Jammu & Kashmir**

Under the Negative List regime, services provided in a non-taxable territory will not attract Service Tax. The taxable territory is the whole of India except for Jammu & Kashmir. Furthermore, for telecommunication services, the place of provision of service will be the location of the service recipient. It has been specifically provided in the PoS Rules that the billing address will be treated as the location of the service recipient. Hence, where the billing address is in Jammu & Kashmir, the place of provision of service will be outside the taxable territory and no Service Tax will be applicable.

**Telecom services**

**Key issue**

- Whether Service Tax will be applicable on roaming services provided in circles located in taxable territory during roaming when the billing address is in Jammu & Kashmir

**Bundled services**

The concept of bundled services has been introduced under the Negative List regime, which does not differentiate between various elements of services that have separate charges. Bundled services refer to a bundle of various services provided, wherein an element of provision of one service is combined with an element (or elements) of provision of any other service or services.

In the case of bundled services, if the various elements are naturally bundled in the ordinary course of business, they will be treated as provision of service (giving a bundled service its essential character). If the elements are not naturally bundled in the ordinary course of business, they will be treated as provision of service with the highest Service Tax liability.
India’s telecommunications sector is at a highly competitive and evolving stage, and therefore, satisfying a condition whether services are naturally bundled in the ordinary course of business (or not) is highly subjective and open to contradictory interpretations, which may lead to protracted litigation. Multiple innovative business products such as bundling correctly to use goods with services (blackberry service enterprise solutions), sale of mobile space along with connectivity services, sale of starter kits containing CDMA mobile phones, SIM cards, user manuals and CDs have been introduced in the market. Determining whether these are services that are bundled in the ordinary course of business is open to different interpretation by various authorities.

**Key issue**

- Review of various transactions to determine whether they qualify as bundled services

**Intermediary services**

Under the Negative List regime, PoS Rules seek to introduce a new concept of “intermediary services,” wherein the place of provision of a service is deemed to be the location of the service provider.

In the telecommunications industry, it is common to find transactions where there are intermediary transactions that are essentially B2B transactions, e.g., international roaming services provided to a foreign subscriber by an Indian telecom operator (B2C transaction between the overseas telecom operator and its subscriber) where the Indian telecom operator enters a B2B arrangement with the overseas telecom operator while providing a B2C service. Other instances of B2B transactions will be in the case of ILD, IPLC and MPLS agreements, where operators have contracts with other operators or global holding companies.

**Key issue**

- New valuation provisions in respect to work contracts need to be analyzed on a case-to-case basis to determine value of services and structuring of contracts.
The amendments introduced by the Finance Act 2012, which ushered in the Negative List regime from 1 July 2012, have had varied impact on the Tour and Travel sector. We have highlighted the key impact areas and discussed certain issues that necessitate an analysis to ensure a smooth transition to the new regime.

Transportation of passengers by air and services provided by tour operators continue to be taxable in the Negative List regime.

Presumptive rate of tax for Service Tax liability being discharged by Air Travel Agents (ATAs) providing service of “booking of tickets for travel by air” will continue under Negative List regime.

First Class Rail Travel/AC Coach Rail Travel is taxable in the Negative List regime. However, exemption from Service Tax has been provided to such services up to 30 September 2012.

Services relating to visa facilitation/visa counseling are taxable under the Negative List regime, even when provided to individuals.

Various incentives earned by ATAs and tour operators now taxable:
- Productivity Linked Bonus (PLB): Target sale-based incentives provided by airlines
- CRS commission: Received from Global Distribution System (GDS) vendors for using their online ticketing platforms
- Other special incentives: For example, over-riding commission earned from travel agents for booking of tickets

Cancellation charges received for cancellation of tickets/tours received by ATAs/tour operators are now taxable.

Tour packages provided by tour operators to outbound travelers will no longer amount to export of services, since both the service recipient and the service provider will be located within the taxable territory.

Ancillary activities such as travelers’ cheques and foreign exchange sold by tour operators on behalf of financial companies outside India will become taxable under “Intermediary services.”
Key issues

- In the case of ATA services, the flow of provision of service is not aligned with that of invoicing and consideration. Moreover, there is ambiguity on valuation of services and the credit availment mechanism.

- There is ambiguity on whether margins arising out of bulk purchase and sale of air tickets will be liable to Service Tax under new regime.

- Lump-sum deposits are kept by ATA with airlines in relation to booking of tickets. In lieu of the amount deposited, airlines provide deposit incentives (DIs) in the form of reduction of ticket prices for each subsequent transaction. There is ambiguity on whether such DIs will attract levy of Service Tax.

- The option to discharge Service Tax at presumptive rates will be continued for ATAs. However, ATAs are not defined under the new regime. It therefore needs to be determined whether a sub-agent can also discharge its Service Tax liability under the presumptive rate model.

- Considering that exemption under Notification No. 22/97-ST has been rescinded, will management/transaction fees separately recovered from customers attract Service Tax? Will the implication be different when the presumptive rate is opted for?
Reverse charge liability on specified domestic services

Where the following services are provided by an individual, Hindu Undivided Family, partnership firm or an association of persons to a body corporate, the liability to deposit Service Tax accrues on the service provider and the service recipient according to the specified ratios in the table below:

<table>
<thead>
<tr>
<th>Description of service</th>
<th>Percentage of Service Tax payable by service provider</th>
<th>Percentage of Service Tax payable by service recipient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Supply of manpower</td>
<td>25%</td>
<td>75%</td>
</tr>
<tr>
<td>Works contract</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Renting of motor vehicle (for carriage of passengers)</td>
<td>Nil</td>
<td>100%</td>
</tr>
<tr>
<td>Service Tax paid on abated value of 40%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Renting of motor vehicle (for carriage of passengers)</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Service Tax paid on full value of services</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In the case of legal services provided by an advocate or firm of advocates or support services provided by a Government or local authority, the liability to deposit Service Tax accrues to the service recipient.

Businesses will need to analyze their procurements to determine their liability as a service recipient.

Establishments in taxable territory and non-taxable territory to be treated as establishments of distinct persons

Under the Negative List regime, the office of an entity in India will be treated as a distinct legal person vis-a-vis its overseas office. This deeming fiction was only applicable in relation to services rendered by an overseas office to its office in India, e.g., for import of services earlier.

Furthermore, on the basis of the new provisions, transactions inter-se establishments of the same entity (e.g., a branch office and a head office) will not qualify as exports. Accordingly, the implications on services provided by an Indian office to its overseas office will be as follows:

- If the place of provision of service is outside the taxable territory, its services will not be taxable, but the Indian office will not be able to avail of Cenvat credit.
- If the place of provision of service is in the taxable territory, its services will be taxable in India and the Indian office can avail of Cenvat credit.

Furthermore, where services are provided by the overseas office to the Indian office, the Indian office will be liable to pay Service Tax (under the reverse charge mechanism) if the place of provision of the service is in taxable territory.

Businesses will need to analyze transactions inter-se offices in India and overseas to determine the applicability of Service Tax for them.

Changes in provisions related to works contract services

Under the Negative List regime, a “works contract” has been defined as a contract “wherein transfer of property in goods involved in the execution of such contract is leviable to tax as sale of goods and such contract is for the purpose of carrying out construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, alteration of any moveable or immovable property or for carrying out any other similar activity or a part thereof in relation to such property.”

Therefore, the definition of a works contract has been amended to include specified activities in relation to movable property as well as maintenance activities.
Under the erstwhile regime, a service provider had the option to pay Service Tax, either at 12.36% of the actual value of services or under the composition scheme at 4.94% of the total contract value.

Under the Negative List regime, the service provider can continue to pay Service Tax at 12.36% of the actual value of services. In the event the service provider is unable to bifurcate the value of goods and services, an option has been provided to pay Service Tax on the abated value, which have been specified for different types of works contracts as depicted in the following table:

<table>
<thead>
<tr>
<th>Service</th>
<th>Abatement</th>
<th>Effective rate of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original works:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) New constructions</td>
<td>60%</td>
<td>4.94%</td>
</tr>
<tr>
<td>(ii) Additions/Alterations to abandoned/ damaged structures to make them workable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Erection/Commissioning/ Installation of plants, machinery or structures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maintenance/Repair/Reconditioning/ Restoration/Servicing of goods</td>
<td>30%</td>
<td>8.65%</td>
</tr>
<tr>
<td>Other works contracts</td>
<td>40%</td>
<td>7.41%</td>
</tr>
</tbody>
</table>

Furthermore, the composition scheme is no longer in effect under the Negative List regime. Accordingly, companies who had adopted the composition scheme in the erstwhile regime will need to review their tax position.

**Changes in provisions related to SEZ units**

A new notification has been issued providing exemption or refund for input services provided to an SEZ unit. However, the notification requires the list of specified services to be approved by the Unit Approval Committee (UAC).

For the purpose of claiming exemption under this notification, a fresh approval of the list of input services for authorized operations may be required. In addition, a specific approval may be required to obtain approval for an outright exemption, wherever applicable.

In this regard, the impact of the application of the formula prescribed for refund for an SEZ unit undertaking DTA supplies needs to be examined.

Furthermore, there is also ambiguity regarding the period of transactions to which the notification will apply, i.e., whether refund claims for transactions undertaken till 30 June 2012 should be filed under the old notification or the new one.

**Taxability of various employment-related transactions**

Under the Negative List regime, the taxability of various transactions inter-se employers and employees, secondment of personnel and remuneration of directors needs to be examined. Some of these issues are detailed below:

- Service Tax implications in the case of joint employment
- Service Tax on remuneration of directors
- Service Tax implications on emoluments or perks accorded by employers to employees
- Service Tax on reimbursement made by employers to employees

In this regard, a draft circular has been issued on the taxability of some of the issues mentioned above. The circular seeks comments from trade and industry. Businesses will therefore need to analyze the applicability of Service Tax on the transactions and structure employment contracts mentioned above for optimization of Service Tax liability.
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