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Reverse Charge Update

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This document contains a brief on Reverse Charge Updates

Reverse charge: Demand of service tax already paid to vendor

The directors of the retail chain were shocked to receive a notice from the service tax department demanding a large amount of service tax. "But we sell goods, not services," said a bewildered head of finance of the entity; "and we have paid the service tax charged to us on all the bills of our vendors; then why this demand?"
Examination of the calculation sheet appended to the service tax notice showed that the department was demanding service tax that had already been paid by the entity to its vendors. For example, 12.36% service tax was charged on housekeeping services by the service provider, and this had been paid by the entity. However 75% of these amounts were being demanded by the department again. All the items listed in the demand notice were services on which service tax is payable wholly or partially on reverse charge basis. The demand notice was based on the proposition that tax must be paid to the government by the person who is liable to pay it under the law.
Is there any way out of such a situation, which happens to be all too common? Below I shall first look at the legal basis of such demands, and then at possible solutions.

Basis of demand of service tax though already paid
Under section 68 of the Finance Act 1994 (the enactment that levies service tax), the default mode is that service tax is to be paid by the service provider. However, an exception is made in sub-section (2) of the said section 68, by which the tax is payable,

- → in respect of services that are notified by the central government,
- → by the person 'prescribed'.

'Prescribed' means prescribed under rules made for the purpose [- definition in section 65B(39) of the Finance Act 1994]. Accordingly, for the services that are notified in notification 30/2012-ST, the service tax is payable by the person prescribed under rule 2 of the Service Tax Rules 1994.

Rule 2(1)(d) of the Service Tax Rules 1994 prescribes who is the "person liable for paying service tax". Notification 30/2012-ST notifies the following: the description of services on which a person other than the service provider must pay service tax; the categories of recipients of each of these services who are liable to pay the tax; and how much of the service tax is to be paid by these recipients and how much is to be paid by the service provider. For the services thus notified, the person liable to pay service tax is defined in rule 2(1)(d)in the same manner as the specified categories of recipient of service in the said notification.

To illustrate the workings of notification 30/2012-ST and rule 2(1)(d):

- For the service of 'sponsorship', the notified category under notification 30/2012-ST, in which the recipient has to pay service tax, is "service provided by way of sponsorship to any body corporate or partnership firm located in the taxable territory".
- In rule 2(1)(d), clause (i)(C), the person liable to pay service tax is, for service "provided by way of sponsorship to any body corporate or partnership firm located in the taxable territory, the recipient of such service". This is a service for which the recipient has to pay the entire amount of tax payable.
- For the partial reverse charge services, like manpower supply and security services, works contracts, and rent-a-cab, the "person liable for paying service tax" is defined accordingly in rule 2, as "both the service provider and the service recipient to the extent notified under sub-section (2) of section 68 of the Act, for each respectively."

Thus the Act and Rules clearly provide that for the notified categories of services, the recipient of service is the person liable to pay the service tax, either fully or partially as notified. The notification 30/2012-ST gives the necessary information to carry out one's legal obligations in this regard. Under section 68 of the Finance Act 1994, the recipient of service is bound to pay the amount of tax notified as his liability.

The CBEC has clarified in its Education Guide, paragraphs 10.1.3 and 10.1.6, that, "The liability of the service provider and service recipient are different and independent of each other." There can be no quarrel with this proposition, as each has been defined as the person liable for paying service tax to the extent notified.

The departmental officials interpret the legal provisions to mean that, irrespective of the payment of the entire amount of service tax (including what should have been paid by the service recipient) made by the service provider, the service recipient is obliged to discharge his liability independently by paying service tax to the credit of the government. How to counter this threat of double payment resulting in a huge financial drain is discussed below.

Case law on double payment
When the service provider (for example, an individual supplier of manpower) has paid service tax at the rate of 12.36% on his bill, the requirement that the client should again pay service tax of 75% of this sounds unreasonable. Taking this view, and without actual statutory backing, the CESTAT, in Final Order No. 627/2010, dated 10-6-2010 in appeal No. ST/274/2009 of Nagaraja Printing Mills versus CCE Salem, struck down a demand of service tax on goods transport from the appellant-consignee who had paid the freight along with service tax to the transporter. The single member who decided the case observed as follows: "In the circumstances, I agree with the assessees that the present demand against them cannot be sustained, as it would amount to double payment, set aside the impugned order and allow the appeal."

However, as seen in the foregoing, such a view is without statutory backing and also contrary to the principle that there is no equity in taxation. Tax laws are generally given a literal interpretation, unless there is something repugnant in the context. In view of this it may not be prudent to place complete reliance on this single-member order, or others of its kind, which have not yet been tested in higher courts of law.

Refund of tax wrongly paid to the service provider
One possible recourse would be to apply to the department for refund of the tax wrongly paid to the service provider. Refund in service tax is governed by section 11B of the Central Excise Act as made applicable, *mutatis mutandis*, to service tax under section 83 of the Finance Act 1994. Section 11B provides for refund of excise duty (and therefore service tax also) to the buyer from whom it was collected.

The CESTAT has upheld refund of duty to the buyer in several cases, including –
McNally Bharat Engineering Company Limited v CCE Guntur,
2006 (194) ELT 318 (Trib-Bang)

CCE Surat-1 v ABG Shipyard,
2008 (224) ELT 76 (Trib–Ahm)

As far back as 1997, the Supreme Court had upheld these provisions under which refund of excise duty is available to the customer:

Mafatlal Industries Limited v Union of India,
1997 (89) ELT 247 (SC)
(paragraphs 89, 90, 99)

Thus, the service recipient, as customer or buyer for the services, is entitled to claim refund of the amount of service tax wrongly paid to the service provider. At the same time he would face a demand to pay the amount directly to the government. Section 11 of the Central Excise Act, by which refunds are adjustable against demands, is not applicable to service tax; hence refund and payment have to proceed on separate tracks.

The refund has to be claimed within one year of payment of service tax to the service provider, as provided under Explanation B(f) to the aforementioned section 11B of the Central Excise Act. Thus for payment made on 5 October 2014, refund must be claimed by 4 October 2015.

On the other hand, limitation for the department's demand of service tax is eighteen months from the date of filing service tax return for the period, or if return was not filed, from the date on which the return was due. Service tax returns in form ST-3 are filed six-monthly, and are due on April 25 and October 25. For any date during the six-month period October 2014 to March 2015 (e.g., October 5 2014), the return is due on 25 April 2015, and service tax can be demanded eighteen months thereafter, i.e., by 25 October 2016.

It can be seen that for a payment wrongly made to the vendor instead of to the government on 5 October 2014, the refund is to be claimed by 4 October 2015, but the demand for payment to the government can be made till 25 October 2016. This asymmetry of the time limitation for refunds and demands of service tax means that it is very likely that refund will have been time-barred by the time service tax is demanded. For this reason, claiming refund and paying service tax may not be a feasible proposition.

Adjustment under section 73A

The only solution seems to be the one available under section 73A of the Finance Act 1994. The scheme of this section is as follows, subsection-wise.

Subsection (1): A person who has collected any amount as service tax which is **"in excess of the service tax assessed or determined and paid on any taxable service from the recipient of the taxable service"**, must forthwith pay the amount to the government.

Subsection (2): A person who has collected any amount by representing it as service tax, which is not required to be collected, from any other person, must forthwith pay the amount to the government.

Subsection (3): If either of the persons referred to in (1) or (2) does not deposit the amount, he can be served a notice to do so.

Subsection (4): He can reply to the notice; thereafter the competent officer will determine the amount due from him, and the person should pay the amount so determined.

Subsection (5): The amount paid by the person under subsections (1), (2) or (4) **"shall be adjusted against the service tax payable by the person on finalisation of assessment or any other proceeding for determination of service tax relating to the taxable service"**.

It is seen that under section 73A, clause (5), if a person has collected service tax in excess of the service tax assessed (or determined and paid) on any taxable service, and has paid it to the government, this amount can be adjusted against the service tax payable in any proceeding for determination of service tax relation to the same taxable service.

In view of the provisions of section 73A(5), a person from whom service tax has been collected in excess may request for adjustment of the same against the tax determined as payable by him. There is no time limit in the section for such adjustment.

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