Point of Taxation Rules and Taxable Event

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This article deals with the Point of Taxation Rules, 2011 introduced in the Budget 2011 for levy of service tax. These rules define the taxable event in the case of service tax. The rules were notified by Notification No. 18/2011-ST, dated 1st March, 2011, w.e.f. 1st July, 2011. Subsequently, Notification No. 25/2011-ST, dated 31st March, 2011, was issued which notified Point of Taxation (Amendment) Rules, 2011, whereby some amendments were made in the said rules as originally notified. These rules embody a new concept so far as levy of tax in the case of indirect taxes is concerned. It is significant to note that there are no such rules in the case of other indirect taxes like Excise Duty, Customs Duty, Sales Tax, VAT, etc. In the statutes the "Taxable Event" and the point of collection of the tax have been specified.

1. History of Service Tax

Service tax was introduced in 1994 by Dr. Manmoham Singh, the then Finance Minister. Initially, only three services were brought under the service tax net, viz. General insurance service, Telephone service and Stock brokers service. As years passed, more and more services were brought under the purview of the service tax. At present, there are 119 taxable services with tax earnings of Rs. 71,174 crores[1].

2. Position Till Now

2.1 The service tax is levied and collected under Finance Act, 1994. Section 66 of the Act is the charging section. The heading of this section is "Charge of Service Tax" and it lays down that "There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent of the value of taxable services referred to in sub-clauses … of clause (105) of section 65 and collected in such manner as may be prescribed." Section 68 provides for "payment of service tax". Section 94 gives "Power to make rules" to the Government. In terms of these powers the Service Tax Rules, 1994 were made. Rule 6 provided that "the service tax shall be paid to the credit of the Central Government by…immediately following the calendar month in which the payments are received, towards the value of taxable services". Thus, the liability to pay service tax arose from the date of "receipt of payment" for taxable services provided by a provider of such services. This system, naturally, envisaged that where payments for services rendered were not received, payment of service tax was not required. This created a rather anomalous situation. On the one hand, the "charge of service tax" arose, as per Section 66, on the providing of taxable services and, on the other hand, the liability to payment of the taxable services arose only on the receipt of payment for the taxable services. There was thus a serious dichotomy in the situation prevalent earlier to the coming into force of 2011 provisions.

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[1] Source: Central Board of Excise and Customs (http://www.servicetax.gov.in).

2.2 Not only that, in the absence of specific provision defining the timing of taxable event, there has been confusion in certain sections of trade and business. Some of the trade sections were under the impression that as tax is payable on receipt of consideration, the taxable event is receipt of consideration. This view is defective as taxable event in case of service tax is "provision of service". The same view was affirmed by various court decisions stating that taxable event shall be rendering of taxable service[2]. The collection was deferred till receipt of payment as in case of excise duty where taxable event is manufacture but the payment is deferred until removal of goods from the factory/depot. In a nutshell, there was a lot ambiguity as to taxable event in the case of service tax.

2.3 To remedy the above anomalous situation, the requisite changes have been made in the legislative provisions in 2011. The first change is that Rule 5B has been introduced in the Service Tax Rules. Rule 5B of these rules provides for the "Date of determination of rate" of service tax and stipulates that "The rate of tax in case of services provided, or to be provided, shall be the rate prevailing at the time when the services are deemed to have been provided under the Rules made in this regard". These rules have been made by way of "Point of Taxation Rules". The position after the above changes is that the point of arising of the liability to pay the tax is to be determined in terms of the provisions of the "Point of Taxation Rules". It is significant that the "Taxable Event" is still not defined or specifically stipulated in the Service Tax statute though the point of taxation has been specified.

3. Changes Brought About

The said rules have brought about a number of changes in the matter of levy of as well as collection of service tax. The following are the main changes brought about:

3.1 Taxable Event/ Point of Taxation

There was a lot of ambiguity as to the taxable event in the case of service tax. The legal precedents however acted like a lighthouse in stormy seas and time and again held that the taxable event is the "provision of service". With a view to end this confusion and bring certainty, Rule 3[3] of the rules has been introduced to define the point of taxation. Rule 3 states that–

> "For the purposes of these rules, unless otherwise provided, 'point of taxation' shall be,–
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> (*a*) the time when the invoice for the service provided or to be provided is issued:

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2 See *CCE* v. *Schott Glass India Pvt. Ltd*. [2009 (14) S.T.R. 146 (Guj.)].

3 See Rule 3 of Point of Taxation Rules, 2011, notified by Notification No.18/2011 as amended by Notification No.25/2011.

> Provided that where the invoice is not issued within fourteen days of the completion of the provision of the service, the point of taxation shall be date of such completion.
>
> (*b*) in a case, where the person providing the service, receives a payment before the time specified in clause (*a*), the time, when he receives such payment, to the extent of such payment.
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> Explanation.– ….”

Thus, the above rule clearly specifies the point of taxation or the taxable event in case of service tax. As per Rule 3(*a*) point of taxation shall be date of invoicing. However, the proviso to Rule 3(*a*) specifies that in case no invoice is issued within 14 days of completion of service, the taxable event shall be completion of service. Further, Rule 3(*b*) states that in case any part of the consideration is received prior to any of the two events mentioned above, the taxable event for that part of consideration shall be date of receipt of that consideration. To summarize, the point of taxation shall be: (*i*) the date of invoicing/billing, or (*ii*) the date of receipt of consideration, or (*iii*) the date of completion of service, whichever is earlier. It is significant to note that there can be more than one points of taxation in respect of the same taxable service. For example, if part payment is received in advance in respect of a taxable service and the remaining part is received only after the invoice is issued, then the point of taxation for the first part (received in advance) will be the date on which such payment is received. So far as the second part of the payment, which is received after the invoice is issued, the date of issue of invoice will be the relevant date provided the invoice is issued within fourteen days of completion of service; in case the invoice is issued after fourteen days, then the relevant date will be the date of completion of service and not the date of issue of invoice.

With regard to the point of taxation mentioned in clause (*a*) of Rule 3, a view has been expressed that in view of the words “service provided or to be provided” the liability to pay the tax can arise on the signing of a contract for providing a service even when no invoice has been issued nor any payment received. This is view has been based because of the words “to be provided” used in the above provisions. Such a view may not be correct. As per the well established rules of interpretation, which require that the provisions should be read in their normal meaning, the said words (namely, “to be provided”) need to be read with the preceding words “the time when the invoice for the service” is issued. In other words, the “point of taxation” shall be the time of issue of invoice for a service which is either provided or to be provided in the future. Therefore, when a contract for providing service is entered into the date of such contract will not be the point of taxation but it will be when an invoice is issued in terms of the said contract.

3.2 Continuous Supply of Service

Continuous Supply of Service refers to provision of service over a period of time. However, there were different views as to which service shall be construed as Continuous Supply of Service. In the absence of any specific provision defining continuous supply of service, the problem increased manifold. To iron out the confusion and difficulties, continuous service has

been defined under Rule 2(*c*)[4]. This rule states that "'continuous supply of service' means any service which is provided, or to be provided continuously, under a contract, for a period exceeding three months, or where the Central Government, by a notification in the Official Gazette, prescribes provision of a particular service to be a continuous supply of service, whether or not subject to any condition". A reading of the above rule shows that a continuous service is one which is provided under a contract which extends over a period exceeding three months; in the alternative, a taxable service can be notified by the Central Government as continuous supply of service. At present, the Central Government has notified the following services – commercial or industrial construction service, construction of complex service (residential), telecommunication service, internet telephony service and works contract service, as services deemed to fall in the category of continuous supply of service, vide Notification No. 28/2011-ST, dated 1st April, 2011. Thus, the above-notified services will always be treated as continuous supply of services even if provided for a day.

Furthermore, the taxable event in the case of continuous supply of service was also not clear. The provision of continuous service spread over a period of time with no specific provision defining the taxable event resulted in a constant rift between the taxpayers and the tax authorities or point of taxation. To overcome this shortcoming Rule 6[5] has been introduced which defines the point of taxation in the case of continuous service. Rule 6 states:

> "Notwithstanding…in case of continuous supply of service, the 'point of taxation' shall be,–
> (*a*) the time when the invoice for the service provided or to be provided is issued:
> Provided that where the invoice is not issued within fourteen days of the completion of the provision of the service, the point of taxation shall be date of such completion.
> (*b*) in a case, where the person providing the service, receives a payment before the time specified in Clause (*a*), the time, when he receives such payment, to the extent of such payment.
> Explanation 1. – For the purpose of this rule, where the provision of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the service receiver to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service.
> Explanation 2.– …."

Thus, in case of continuous supply of service also the taxable event has been stipulated in the same manner as in the case of non-continuous service in the first two clauses of Rule 6 as well as in Rule 3. However, where periodic payment is required to be made by the service receiver as per the contract between the Service Provider and the Service Receiver then the point of taxation will be the date of completion of event when the periodic payment is to be made regardless of whether such periodic payment is received by the Service Provider or not. In the case of the continuous supply of service, therefore, there can be more than one point of taxation depending upon the periodicity of payments envisaged by the contract. In other words, where the invoicing

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[4] See Rule 2(*c*) of Point of Taxation Rules, 2011, notified by Notification No.18/2011 as amended by Notification No.25/2011.

[5] See Rule 6 of Point of Taxation Rules, 2011, notified by Notification No. 18/2011 as amended by Notification No. 25/2011.

or receipt of payment is prior to the date mentioned in the contract, such date shall be the point of taxation.

3.3 Rates Applicable in Case of Tax Rate Change

Section 93 of the Act empowers the Government to provide exemption if the Government is satisfied that it is in public interest to do so. The Government has issued a number of exemption notifications under this section. While some of the notifications reduce the tax rate, others provide for abatement in the taxable value of services provided. Irrespective of the type of notification the final impact of such notification is reduction in effective rate of tax. Till now, service tax was linked with payments; however, with the introduction of these new rules the point of taxation shall be invoicing/payment/completion whichever is earlier. Thus, it was required to explicitly define the applicable tax rate in case of tax rate change. To address this need Rule 4 has been introduced in the rules. Implication of this rule has been summarized in the following table.

Events occurring before ST rate change	Events occurring after ST rate change	Point of taxation
Taxable service provided before tax rate change		
Service provided	Invoice is issued and payment is received	Date of receiving payment or date of issue of invoice whichever is earlier
Service provided and invoice issued	Payment is received	Date of issuing the invoice
Service provided and payment received	Invoice is issued	Date of receipt of payment
Taxable service provided after tax rate change		
Invoice is issued	Service provided and payment is received	Date of payment
Invoice is issued and payment is made	Service provided	Date of receipt of payment or date of issue of invoice whichever is earlier
Payment is received	Service provided and invoice is issued	Date of issue of invoice

The principle followed in the above table is that tax rate applicable shall be the one where any two of the following events, viz. issue of invoice, payment, provision of service occur. Once the tax rate is decided the taxable event shall be the earlier of payment of issue of invoice.

4. Comparative Review

4.1 Service tax in India was linked with payment. With the introduction of these rules, service tax has been aligned with the other taxes in India. Both direct and indirect taxes are

charged on accrual basis in India. Tax is levied on crystallization of the tax event, irrespective of the fact whether consideration is received or not. The following is a summary of the taxable events or point of taxation of various indirect taxes in India.

4.2 Generally, charge and actual levy are differentiated for ease in compliance, administration and other factors. Firstly, excise duty is a tax on manufacture. Section 3 of the Central Excise Act, 1944, the charging section states, that there shall be levied a duty of excise on goods manufactured or produced in India. However, collection of the levy has been deferred till removal in accordance with Rule 4 of the Central Excise Rules, 2002. Excise duty liability arises on manufacture irrespective of the facts whether such manufactured goods are sold or not.

4.3 In the case of Customs duty, Section 12 of the Customs Act, 1962, the charging section, states that there shall be levied a duty of custom on goods imported into India. The liability is fastened as soon as the import of goods takes place. The date of payment could be before the arrival of the vessel or after arrival before clearance from the port or clearance from warehouse. The payment of Customs duty is not linked to payment of sale consideration to the exporter for the consignment imported.

4.4 In the case of CST, Section 6 of the Central Sales Tax Act, 1956, the charging section states that every dealer shall be liable to pay tax on inter-state sales affected by him during the year. However, after perusal of the rules it can be concluded that the payments are made on monthly basis by aggregating the turnover effected during that month. The upshot is that the “charge” precedes payment of tax.

4.5 In the case of VAT, there are separate state legislations; however, they all have certain common features. The tax is levied on sale of goods within the state. Thus, the liability to pay arises every time a sale has been made; however, the liability is discharged on monthly basis.

4.6 It is evident from the above provisions that the taxable event materializes irrespective of the fact whether consideration is received or not. Prior to Point of Taxation Rules, in case of service tax, tax collection was dependent on receipt of consideration by the service provider. Taxable event in case of service tax was provision of service which can be interpreted by reading of Section 66 of the Finance Act, 1994. However, the liability was deferred till receipt of consideration in view of Rule 6 of the Service Tax Rules, 1994. In case of non-payment or short-payment of consideration, the tax liability was computed accordingly. As a result, the taxable event of service tax was provision of service; however, for collection purposes there were two conditions, viz. provision of service and receipt of consideration. With introduction of the above rules, service tax levy has been brought in line with the other taxes. The changes introduced by the said rules ensure that the taxable event and liability to pay tax is largely synchronized, with the position in the case of the indirect taxes with one exception in service tax, namely taxation of advance received or issue of invoice in anticipation of provision of service.

5. Critical Analysis

5.1 Advantages

(a) Harmonizes the taxation system

The said rules have aligned service tax with the other taxes in India. As the name suggests, service tax is a tax on services. However, till now the practical scenario was that service tax was a tax on consideration received for services provided. In case no consideration was received, service tax was also not collected despite the fact service has been provided. The changes brought about by the said rules will harmonize service tax with other taxes and pave an easy way for implementation of GST.

(b) Clarifies tax rates in case of rate change

Issue of exemption notifications takes place at regular intervals in case of service tax also. This results in deviation from standard rate by changing the effective rate of tax. Till now, there was no clarity as to the rate applicable in case of rate change in absence of any specific provision dealing with this matter. However, the said rules have introduced a rule which categorically states the rate applicable in case of rate change.

5.2 Disadvantages

(a) Increase of financial burden on service provider

Indian economy is a developing economy with a large number of small-scale service providers. Moreover, services being an intangible and personal commodity, it is a well-known fact that a service recipient generally withholds release of payment till the time he is satisfied. In such a scenario, taxing services on accrual basis would increase the financial burden on the service providers. The service providers would now be required to pay service tax from their own pocket. This would lead to an increase in working capital requirements of the service provider, which in turn would increase the financial burden of the service provider and thereby stint their growth.

(b) Complicate rather than simplify

The Draft Rules of Point of Taxation in its opening paragraph state that "The purpose of these rules is to introduce clarity and certainty in the matter of levy and collection of Service Tax particularly in situations of change of rate of service tax or imposition of service tax on new services." This statement is not disputed as the said rules have brought about clarity in situations where there is change in tax rate by prescribing the applicable rates in different situations. On the other hand, it cannot be denied that the rules have complicated the payment of service tax in normal course of business. Till now, service tax levy had a one-line formula, i.e. "pay as and when you receive the consideration". However, the recent changes would complicate the situation as service tax would now have a nexus with invoicing, payment or completion of service instead of just one event, i.e. receipt of payment.

(c) No provision of bad debts

The Service Tax Rules, 1994 have been amended by Notification No. 26/2011-ST dated 31st March, 2011 to bring them in line with the Point of Taxation Rules, 2011. The said notification has amended Rule 6(3) of the Service Tax Rules, 1994, which

now states "where the amount of invoice is renegotiated due to deficient provision of service, or any terms contained in a contract" the same can be adjusted by the service provider. However, on a careful scrutiny of the above rule, it can be concluded that such adjustment shall be available in case of renegotiation of invoice, i.e. in case the invoice amount is increased or decreased amount, but it is silent in case of bad debts. Thus, in case of bad debt the service provider will not only suffer financial loss on account of loss of service revenue but also on account of non-refundable service tax already deposited.

(d) Difficulty in book keeping and accounting

Accounting Standard 9 "Revenue Recognition" issued by the Institute of Chartered Accountants of India provides an option to recognize revenue for services on proportionate method or completion method at the option of the entity, i.e. service provider. However, for implementation of recent changes the entity would be required to undergo a shift from their current accounting system. Such changes would involve heavy outlay of time, money and efforts.

(e) Taxation of advances received

Taxation of services in line with the other taxes levied in India is a welcome step. However, there exists a discrepancy in case where service tax is compared with other taxes, i.e. taxation of advances received in anticipation of provision of service. Prior to introduction of the subject rules, service tax was payable on cash basis and taxing advances in that setup was justified as the service provider had been given an additional advantage of deferring payment till receipt of consideration. However, by charging service tax on accrual basis this advantage has been taken away and service has been bought in line with other taxes. Thus, when service tax has been aligned with other taxes it is beyond logical reasoning as to why advances received are still taxable as per the old regime. Such taxation of advances is unjustified and uncalled for.

6. Conclusion

The Government's move to harmonize various taxes levied in India is a welcome move. Taxation of services in line with taxation of goods was the need of the hour. India is on a way to implement GST. GST does not differentiate between goods and services. Thus, having different taxation regime for services and goods is contradictory and could have created a bottleneck in implementation of GST. Thus, changes brought about will help in easy implementation of GST. A sudden shift in taxation of services, with introduction of GST, would have taken the masses aback and would have been resisted by them. It is only through such gradual transition that people get accustomed and accept the major change which is to follow.