

## **Negative list for taxing services – Moving forward**

**By Kapil Sharma and Shivam Mehta**

Recently, the Ministry of Finance, Government of India, unveiled the revised Concept Paper on taxation of services based on negative list after considering feedback from stakeholders on the Concept Paper released a few months ago. The revised Concept Paper has reduced the categories of services which would be out of purview of tax net as compared to the proposals contained in the earlier list. It is presumed that taxation of services under a negative list would lead to expansion of tax base for Service Tax in comparison to charging Service Tax on selectively defined services as is in vogue.

As suggested in the revised Concept Paper, the feedback received from industry and other stakeholders is indeed motivating for the beginning of paradigm shift towards negative list based taxation. However, there is an eminent need to identify various sectors which should justifiably find place in the negative list of services and should be outside the purview of tax net. This article is intended to analyze the essential features of newly ushered revised Concept Paper vis-à-vis various issues which need due attention while implementing the new regime based on negative list of services.

### **Salient features of the revised Concept Paper**

#### ***Definition of ‘service’***

The revised Concept Paper has retained the definition of the term ‘service’ to mean anything which does not constitute supply of goods, money or immovable property. This definition indicates ‘services’ would have included transactions even when the essential feature of *quid pro quo* was absent. This lack of economic consideration in the definition of service has been taken note of in the revised Concept Paper which proposes a new charging provision to restrict the levy only to services provided by the taxable persons. It is further provided that the term ‘taxable person’ would cover any individual who carries out any economic activity and these changes would automatically take care of the need of *quid pro quo* without amending the definition of service.

An easier route to put an end to this debate would have been to place the expression ‘consideration’ in the definition of service where the definition would have read:- “Service means anything which does not constitute supply of goods, money or immovable property but is provided for a consideration.” By this inclusion the definition of service would have made life easier by automatically taking out all the activities done gratuitously or for free of charge from the ambit of tax net.

In so far as the charging provision is concerned, the revised Concept Paper has retained the characteristics and influence of existing provisions. This proposed provision seeks to impose a tax on all transactions undertaken by a taxable person. A strict construction of this proposal would indicate that there is no bifurcation of the transactions undertaken in

different capacity by a taxable person. For instance, a musician playing music in a hotel for a consideration is a taxable person. Nevertheless, when the same musician plays music in public without any obligation to do so, he might not be construed as taxable person for reason of absence of *quid pro quo*. The legal provisions should clearly accommodate and provide for such situations where a taxable person also undertakes the activity in the capacity of non-taxable person.

In addition, the proposed charging provision continues to retain the conspicuous absence of taxable event i.e. the event leading to applicability of Service Tax - a concept which still awaits clarity for the triggering event whether it will be rendition of service or receipt of advance towards rendering of service.

### ***Components of negative list***

One of the crucial exclusions from the tax net as highlighted in revised the Concept Paper pertains to 'statutory fines and penalty'. In this context it has been clarified that commercial demurrages/damages for the extended use of service will be considered taxable. Historically, the demurrages/damages paid or charged for the failure to meet the agreed condition has been considered to be in the nature of damages for failure and not as consideration for any service. However the revised Concept Paper has not dwelled upon the treatment of demurrages/damages arising out of failure to meet the contractual obligations and are not in nature of extended use of service. In the absence of specific exclusion for demurrages other than those owing to the extended use of service, the proposed regime may impose tax in both the situations (i.e. demurrages for extended use of service as well as demurrages for failure to meet contractual obligations). This would be in contrast with the practice prevailing in current regime as well as adopted and accepted internationally.

Let us take an illustration of a tenant who has been served with a notice to vacate the property within one month and who failing to do so is saddled with damages after due process of law. The issue which would now arise is whether the amount of demurrage/damage paid for not vacating the property will be considered as consideration for services or the said amount will be treated as damages for failure as the tenant will not be enjoying the lawful possession of property as a tenant.

The revised Concept Paper also seeks to make a few deletions from the negative list as proposed in the previous Concept Paper. One of the noteworthy deletions is that of services provided directly in relation to agricultural, horticultural and animal husbandry. Traditionally the services rendered directly in relation to agricultural, horticultural and animal husbandry have found themselves to be outside the purview of Service Tax either by way of exclusion from the scope of the definition of taxable service or by way of specific exemption. However the reason cited for deletion that being that such services are largely provided by small scale sector which might fall below threshold, appears to be strange.

Given the background of the Indian economy and importance given to the above sectors, this exclusion is likely to face some resistance from the stakeholders. The fact that agriculture and animal husbandry are priority sectors of Indian economy is well recognized in the revised Concept Paper and it is stated that there will be neutralization scheme in place for such sector in this regard. However, one has to wait and watch as to what sort of scheme would be floated to offset the tax which will be charged on such services.

With regard to financial sector, an entry in the proposed negative list has been expanded to include transactions relating to mutual funds and actionable claims. However, the treatment regarding interest element involved in the leasing transaction still awaits clarity.

Another notable exclusion relates to construction services provided in relation to a building or civil structure for Government which are not engaged in business or commerce, hospitals, educational institutions, shelter for the homeless, orphanage, old-age home, etc. This exclusion has been justified on the pretext that granting such exemption would create definitional issues and would amount to end use exemption which could not be encouraged under GST regime. However, clarity is awaited as to whether such services would be treated as zero rated and thus, entitled to refund of tax credit on input supplies or will be subject to tax. Similarly, the revised Concept Paper has also changed the entry pertaining to infrastructure projects such as roads, railways, bridges, dams, tunnels, etc to include specified infrastructure projects in the negative list. This proposal has kept the entry wide for interpretation as to what would constitute an infrastructure project for larger public good.

Amongst the inclusions made in the negative list, advertisement assumes special mention. Advertisement other than advertisement published in newspaper, broadcast by radio or TV or displayed in electronic media is included in the negative list on the ground that it is covered in the State list of the Indian Constitution. This would mean that advertisement published in newspaper would come under the tax net. As of now, there is no levy of Service Tax on the advertisement in the print media which includes newspaper. However, with specific exclusion of advertisement published in the newspaper from the entry in the negative list pertaining to advertisement, the activity of advertisement in the print media might find itself in the tax net.

It is, therefore, clear that even after the revised Concept Paper the Department of Revenue needs to ponder over unresolved issues and consider providing more clarity before providing for the transition into the new regime. It would be expedient to provide a solution to the glaring issue currently faced by the industry - multiple taxation of a same transaction treating the supply as being of both of goods as well as service. For instance, the inclusion of 'temporary transfer or permitting the use or enjoyment of any intellectual property right' within the residuary definition of service, could lead to double taxation, as several VAT legislations treat transfer of intellectual property right as 'goods' and thus subject such supply to VAT. Clarity is also required in respect of composite transactions

involving supply of both goods and services wherein it has been proposed to tax such transactions based on dominant intention.

### **Way forward...**

The net impact of transition of Service Tax to a negative list regime would mean that barring the enumerated services contained in the list, all other services would come under the tax net, thereby broadening the Service Tax base considerably. The increased base for the revenue combined with the present input credit regime would mean larger outflow of taxes for businesses. As the introduction of the negative list is seen as a step towards the advent of GST, the optimal approach which will be consistent with introduction of the negative list based taxation should also be to liberalize the input credit scheme so as to enable to the businesses to neutralize the overall tax burden.

The proposed change being aimed towards bringing the Indian law on par with other international taxation regimes is definitely a positive move. However, numerous operational, administrative and other issues need to be addressed for a smooth transition into the new regime. As the preparatory period before the introduction of particular regime is the most crucial time both for the Government as well as for the stakeholders to address the concerns and the issues, further public debate and thoughtful consideration of suggestions of various stakeholders is the need of the hour before putting legislation in place. It is hoped that the Government would examine these considerations in the correct perspective.

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