Service tax on services received and consumed abroad

13 March 2014

Background

In this case[1], the appellant is engaged in the activity of rendering IT/ITES services, apart from rendering the other taxable services. The output services were also exported to various countries. The following important issues are decided in this case, apart from the other issues:

- Whether service tax is leviable under the reverse charge mechanism, with respect to the services received abroad from the sub-contractors/branches located outside India, which are consumed outside India?
- Whether credit can be claimed with respect to service tax paid on group health insurance of employees, when the said insurance covers even the family members of the employees?
- Whether International Private Leased Circuit (IPLC) services received from a person located outside India is taxable under the reverse charge mechanism?

Service tax on services received abroad from the sub-contracts/branches located outside India

Background

The appellant had overseas branches and renders services to overseas clients through these branches. The branches in turn used the services of sub-contractors located outside India for the purpose of rendering services to clients.

The payments to the overseas branches were made by the appellant through their EEFC account in foreign currency and the overseas branches have in turn paid the sub-contractors.

Grounds of demand

The service tax authorities have demanded service tax from the appellants under the reverse charge mechanism, on the following grounds:

- The appellant has received the services from sub-contractors located outside India, through their overseas branches.

[1] Infosys Limited v. CST, Bangalore, TS-64-Tribunal-2014 (Bang)

- Even assuming that, the services are received by their overseas branches and not by the appellants, it may be said that, the overseas branches in turn have provided the services to the appellant. The overseas branch is considered as a separate person for the purpose of service tax levy on import of services[2], and accordingly the services received from overseas branch is taxable in the hands of the appellant.

Contention of the appellant

The appellant has contended the case on the following grounds:

- The overseas branches have received the services from sub-contractors abroad and consumed the services abroad, thus Section 66A[3] has no application.

- The overseas branches have directly entered into the contracts with overseas sub-contractors and such sub-contractors have raised invoice only on the overseas branches, thereby not rendering the overseas transactions liable to tax in India.

- Section 64 of the Finance Act, 1994, makes it clear that the Act applies to India. Foreign territories cannot be brought under the taxable jurisdiction of the Indian Government, by virtue of the above mandate read with the provisions of the Indian Constitution.

- A foreign branch is treated as a separate entity in terms of Section 66A, accordingly the services rendered to such a separate entity outside of India's jurisdiction, cannot be subjected to tax in India.

- The impugned orders are wrong in assuming that the branches have rendered services to the appellant. In fact, the branch merely performs the same activity at the behest of the appellant, and the appellant instead of exporting from India, has an extended arm in the form of branches to perform on-site activities which cannot be taxed in India.

- There is no consideration paid to the branches to assume that there is a contract of service under which the overseas branches have rendered services to the appellant.

Decision of the CESTAT

In this background, the CESTAT has held as follows:

- If the service has been rendered outside India and received and utilised by the branch office outside India, unless the Revenue is able to show that the service has been received in India, or the benefit of service rendered abroad has been received in India, service tax would not be payable.

- In the present case, the appellant has provided services through their branches abroad. Therefore, it is not a case of the appellant receiving the services, but it is a question of rendering services abroad.

- Further, the appellant has not made any payments for the receipt of any services. On the contrary, the appellant has received proceeds of the services rendered abroad by their branches, after deduction of expenditure incurred for rendering of services abroad. Therefore, prima facie, the provisions of Section 66A are not at all attracted.

- If the branch office has to be treated as a separate person for the purpose of Section 66A, when the contract is entered into between the branch office and the service provider, it cannot be said that such contract has been entered into by the company located in India.

- For the purpose of levy of service tax in the hands of receiver, the branch office is treated as a separate person, but for the purpose of determining as to who has received the service, the branch office is treated as a part of the appellant, which is not correct.

Accordingly it is held that, as the Revenue has not been able to show that the services have been received through their branch office in India, there is no taxable event, and therefore there is no liability on the appellant to pay tax.

Cenvat Credit on ground health insurance

Background of the issue

In this case, the appellant had claimed Cenvat Credit of service tax paid on the insurance premium in respect of Group Health Insurance Scheme for its employees. The service tax authorities have denied the same on the grounds that, these services are received and used by the employees and not by the appellant company, and hence it could not be said to be an input service.

Decision of the CESTAT

In this regard the CESTAT has held that, Cenvat Credit can be availed in case the insurance policy covers the employees of the appellant. However, if the insurance policy also cover the persons other than employees (such as family members of the employees), the service tax paid on insurance to the extent attributable to persons other than the employees will have to be reversed on a proportionate basis.

[2] As per Section 66A (2) of the Finance Act, 1994
[3] Which deals with service tax levy on the services received from a person located outside India

Service tax on IPLC services received from person located outside India

Background of the issue

In this case, the appellant had received the International Private Leased Circuit (IPLC) services from the overseas service providers. The service tax department has demanded service tax on the same, under the reverse charge mechanism.

Decision of the CESTAT

In this regard the CESTAT has held that, the IPLC services received is classifiable under the category of 'telecommunication services' and such services are taxable during the relevant period (i.e., April 2009 to September 2011) when the same is provided by person who has been granted a licence under Indian Telegraph Act, 1985. As the foreign service providers are not licensed under the said Act, the demand is not sustainable.

However, with the introduction of negative list based levy of service tax which is effective from 1 July 2012, the condition of possessing a license under the Indian Telegraph Act, 1985, by the service provider, so as to render the services a 'taxable service' has been done away with.

Accordingly, this decision is not applicable for the IPLC services received in India, from an overseas service provider post 1 July 2012, which would be subject to the levy of service tax under the reverse charge mechanism.

Our comments

In the IT industry, it is not an uncommon arrangement to render the on-site services to overseas clients through the sub-contractors/branch offices located outside India. In such a scenario, a question could come up as to whether the payments made to overseas sub-contractors/branch offices, are subject to the levy of service tax under the reverse charge mechanism, by contending that the service recipient is located in India and accordingly the benefit of the service has accrued in India.

In this regard, the CESTAT has answered the question in favour of the service providers located in India, and thereby providing clarity to the IT industry.

In case of Micro Labs Limited[1], the Karnataka High Court has held that, although a Group Insurance Health Policy is also a welfare measure, it is an obligation which is cast under the statute that the employer has to obey, and accordingly Cenvat Credit may be claimed with respect to the service tax paid on insurance premium.

However, while following the decision of the High Court, this decision has distinguished the same on the ground that, if the insurance policy also covers the family members of the employees, it cannot be said that the insurance provided to the family members of the employees is relatable to output services provided by the appellant and accordingly, Cenvat Credit to that extent is proportionately required to be reversed.

With the introduction of negative list based levy of service tax which is effective from 1 July 2012, the condition of possessing a license under the Indian Telegraph Act, 1985, by the service provider, has been done away with. Accordingly, the IPLC services received in India from the overseas service provider post 1 July 2012 would be subject to the levy of service tax.

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