

**GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF REVENUE

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D.O.F.No.334/3/2011-TRU
New Delhi, dated the 28th February, 2011.

Dear Madam/Sir,

The Finance Minister has introduced the Finance Bill, 2011 in Lok Sabha today. Clauses 71 and 72 of the Bill cover the legislative changes relating to Service Tax. Barring a few retrospective amendments, all other changes will take effect from a date that will be notified after the Bill is enacted.

1.2 Besides the legislative changes, a number of other changes have been made in rules and will become effective on the dates mentioned in the respective notifications. Point of Taxation Rules, 2011 have also been introduced by notification 18/2011-ST and made effective from 01.04.11. Fresh exemptions have been granted while a few existing exemptions have been modified. These changes are contained in Notifications No. 1/2011-ST to 17/2011-ST and will take effect on the dates mentioned in the respective notifications.

1.3 A number of changes have also been made in the Cenvat Credit Rules, 2004 vide notification 3/2011-CE (NT) and these changes will take effect on 01.04.2011, barring a few that are being given effect on 01.03.2011.

1.4 The highlights of all these changes are discussed in the following paragraphs.

2. New Services

2.1 The following two new services have been proposed:

- (i) Services by air-conditioned restaurants having license to serve liquor; and
- (ii) Short-term accommodation in hotels/inns/clubs/guest houses etc.

2.2 The scope of these services and other relevant details are given in Annexure-A.

3. Alteration or expansion in the scope of existing services

A number of existing services are being modified or substituted as follows:

3.1 Authorized Service Station's Services [section 65 (105) (zo)]: The existing service is being replaced with a new definition to cover all persons and all motor vehicles other than those meant for goods carriage or three wheeler auto rickshaw.

3.2 Life Insurance Service [section 65 (105) (zx)]: The scope of this service is proposed to be expanded to cover all services, including in relation to management of investments.

3.3 Commercial Training or Coaching Service [section 65 (105) (zzc)]: The scope of the service is proposed to be expanded to include all coaching and training that is not recognized by law irrespective of whether the institute is providing any other course(s) recognized by law.

3.4 Club or Association Service [section 65 (105) (zzze)]: The scope of the service is proposed to be expanded to include service provided to non-members as well.

3.5 Business Support Service [section 65 (105) (zzzq)]: The scope of the service is being expanded to include operational or administrative assistance of any kind.

3.6 Services by legal professionals [section 65 (105) (zzzm)]: The scope of the existing service is being expanded to include:

- (i) Services of advice, consultancy or assistance provided by a business entity to individuals as well;
 - (ii) Representational services provided by any person to a business entity; and
 - (iii) Services provided by arbitrators to business entities.
- Services provided by individuals to other individual will remain outside the levy.

3.7 Services provided by clinical establishments [section 65 (105) (zzzo)]: The existing levy on health services is proposed to be replaced as follows:

- (i) Any service provided by a clinical establishment having the facility of central air-conditioning in any part of the establishment and more than 25 beds for in-patient treatment at any time of the year;
- (ii) Diagnostic services provided by a clinical establishment with the aid of laboratory or medical equipment; and
- (iii) Health-related services provided by doctors, not being employees, providing health-related services from the premises of a clinical establishment.

3.8 The scope of these changes and other relevant details are given at Annexure B.

4. Compliance Mechanism:

4.1 The existing scheme relating to compliance has been proposed for a revamp with a view to strike a healthy balance between the interests of revenue and legitimate business and to promote voluntary compliance.

4.2 As a result a number of changes have been proposed with the following philosophy:

- (i) Improve voluntary compliance by encouraging self-correction, wherever the deviations are unintentional omissions;
- (ii) Reduced penalties may be imposed if the transactions are captured fully and truthfully in records and further abated if timely admission and payment is made;
- (iii) Intentional and unrecorded violations should be dealt with severely with no concession whatsoever.

4.3 Thus the undue advantage obtained by carrying on surreptitious activities at the cost of law-abiding business is sought to be neutralized. The revised system also encourages informed decision-making by the taxpayers at the early stages of investigation or

verification by the Department. Changes proposed in the compliance mechanism are given in the following paragraphs.

4.4 The maximum penalty for delay in filing of return under section 70 is proposed to be increased from Rs.2,000/- to Rs.20,000/-. However, the existing rate of penalty is being retained under rule 7C of the Service Tax Rules, 1994. The maximum penalty is presently reached after a delay of 40 days. The new limit will impact only those who delay filing of return for longer durations.

4.5 The provisions of section 73 (1A) and both the Provisos of section 73 (2) are proposed for deletion. As a result, the benefit of reduced penalty shall not be available in cases of fraud, mis-statement, suppression, collusion etc. in the ordinary course. However, revised benefit will be available under the new sub-section 4A of section 73 in situations where the true and complete account of transactions is otherwise available in the specified records and the assessee during the course of audit, verification or investigation pays the tax dues, together with interest and the reduced penalty. It is clarified that the assessee can also avail this benefit on his own also. The extent of penalty is being further reduced to 1% per month of the tax amount for the duration of default, with an upper ceiling of 25% of the tax amount.

4.6 Interest rate for delayed payment of service tax is being increased to 18% per annum, effective 01.04.2011 (Notification 15/2011-ST). A concession of 3% has been proposed in the Bill for tax-payers whose turnover during any of the years covered in the notice or the preceding financial year is below Rs 60 lakh.

4.7 Penalty for failure to pay tax under section 76 is being halved.

4.8 The maximum penalty under section 77 for contravention of various provisions is proposed to be increased from Rs.5000/- to Rs.10000/-. However, the daily rate of penalty, wherever applicable, is being retained.

4.9 Penalty under Section 78 is being altered from upto twice the amount of tax to an amount equal to the tax. Moreover, in situations where the taxpayer has captured the true and complete information in the specified records, penalty shall be 50% of the tax amount. The latter penalty (only) shall be further reduced to 25% if the tax dues are paid within a period of one month together with interest and reduced penalty. For assesseees with turnover upto Rs.60 lakh the period of one month shall be increased to ninety days.

4.10 Section 80 is being amended by substituting section 78 with the words “proviso to section 78” and thus the power to waive penalty shall be available only in cases where the information is captured properly in the specified records.

4.11 The revised position relating to penalties and their mitigation or waiver is summed up in the following table (portion in italics being the changes):

Situation	Position in records	Penalty & Provision	Mitigation	Complete Waiver
No fraud, suppression etc.	Captured	1% of tax or Rs 100 per day upto 50% of tax amount: Sec 76	Totally mitigated if tax and interest paid before issue of notice: Section 73(3)	On showing reasonable cause under section 80
Cases of fraud, suppression etc.	Captured true & complete position in records	50% of tax amount: Proviso to Section 78	(a) 1% per month; max of 25% if all dues paid before notice: Sec 73(4A); (b) 25% of tax if all dues paid within 30 days (90 days for small assesses): Provisos to Section 78	-do-
	Not so captured	Equal amount: Section 78	No mitigation at all	Not possible

4.12 Power to issue search warrant under section 82 is proposed at the level of Joint Commissioner and the execution of search warrant at the level of Superintendent.

4.13 Provisions relating to prosecution are proposed to be re-introduced and shall apply in the following situations:

- (i) Provision of service without issue of invoice;
- (ii) Availment and utilization of Cenvat credit without actual receipt of inputs or input services;
- (iii) Maintaining false books of accounts or failure to supply any information or submitting false information;
- (iv) Non-payment of amount collected as service tax for a period of more than six months.

4.14 There shall be no power of arrest and the prosecution can be launched only with the approval of Chief Commissioner.

5. Service Tax Rules, 1994

5.1 A number of changes have been made in the Service Tax Rules to align the provisions consequent to the introduction of Point of Taxation Rules, 2011. A new rule 5B has been introduced to provide that the applicable rate of tax shall be the rate prevailing at the time when the services are deemed to have been provided.

5.2 It has also been provided that when an invoice has been issued or a payment received for a service which is not subsequently provided, the assessee may take the credit of the service tax earlier paid when the amount has been refunded by him to the recipient or by the issue of credit note, as the case may be.

5.3 The amount stated in rule 6(4B)(iii) for adjustment of excess amount paid by an assessee is being enhanced to Rs. 2 lakhs.

5.4 A new sub-rule 6A has been introduced in rule 6 to provide that if an amount of service tax has been self-assessed but not paid, the same shall be recoverable alongwith interest under section 87 of the Act. Thus, there shall be no need to resort to the requirements of section 73 for the recovery of such self-assessed amounts.

5.5 The composition rate in sub-rule 7B of rule 6 applicable to in relation to purchase or sale of foreign currency, including money changing, has been reduced from 0.25% to 0.1% and the Proviso has been deleted. Thus, in the case of these services, option of paying service tax on billed charges will not be available.

5.6 All these changes will come into effect from 01.04.2011.

6. Point of Taxation Rules, 2011

6.1 Point of Taxation Rules, 2011 have been framed vide notification 18/2011-ST and made effective from 01.04.2011. These rules determine the point in time when the services shall be deemed to be provided. The general rule will be that the time of provision of service will be the earliest of the following dates:

- i. Date on which service is provided or to be provided
- ii. Date of invoice
- iii. Date of payment

6.2 Consequential changes have also been made in the Service Tax Rules, 1994 to alter the payment of service tax from receipt of payment to provision of service and also to permit adjustment of tax when service is not finally provided.

7. Amendments to Export of Services Rules, 2005

7.1 Globally the taxation of services across different taxing jurisdictions is increasingly moving towards destination-based levy in respect of B2B services while origin-based levy is largely applicable to B2C services. In tune with this practice, certain services are being rearranged as follows:

- (i) Service provided by builders [section 65(105)(zzzzu)] is being added to sub-rule 1(i) and will thus be considered as exported, subject to compliance with other conditions, if the immovable property is situated outside India.
- (ii) Rail travel agent [65(105)(zz)] and health check-up or preventive care [65(105)(zzzo)] are being added to sub-rule 1(ii) and will thus be considered as exported, subject to compliance with other conditions, when they are performed outside India; and
- (iii) Services of credit rating agency [65(105)(x)], market research agency [65(105)(y)], technical testing and analysis [65(105)(zzh)], transport of goods by air [65(105)(zzn)], goods transport agency [65(105)(zzp)], opinion poll [65(105)(zzs)] and transport of goods by rail [65(105)(zzzp)] are being deleted from sub-rule 1(ii) and thus the additional condition of performance outside India will stand removed. Thus they will be considered as exported, subject to compliance with the relevant conditions, if the recipient is located abroad.

8. Amendments to Taxation of Services (Provided from Outside India and Received in India) Rules, 2006

8.1 Corresponding changes, as indicated in respect of Export of Services Rules, 2005, have been carried out by way of rearrangement of the stated services under respective sub-clauses of rule 3 of the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006.

8.2 The changes will, inter-alia, make certain services taxable if the recipient of the service is located in India even when the service is performed outside India. In order to avoid inconvenience in respect of certain services, exemption has been granted vide notification 8/2011-ST to services of transportation of goods by air or road or rail provided to a person located in India when the goods are transported from a place outside India to a destination outside India. Exemption has also been given vide notification 9/2011-ST to the transportation of goods by air service to the extent air freight is included in the customs value of goods in order to avoid taxing this service twice.

9. Amendments to Service Tax (Determination of Value) Rules, 2006

9.1 A new rule (2B) has been inserted vide Notification 2/2011-ST to prescribe the value of service rendered in relation to money changing. The details are explained at Annexure B. This amendment shall come into force on 01.04.2011.

9.2 An explanation has been added after rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 clarifying that for the purpose of telecommunication service [Section 65(105)(zzzx)] the value shall be the gross amount paid by the person to whom the service is provided by the telegraph authority. Thus in case of service provided by way of recharge coupons or prepaid cards or the like, the value shall be the gross amount charged from the subscriber or the ultimate user of the service and not the amount paid by the distributor or any such intermediary to the telegraph authority. This amendment shall come into force on 01.03.2011.

10. Amendments to Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007

10.1 A new sub-rule (2A) is being added in rule 3 in the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 vide Notification 1/2011-ST so as to restrict the Cenvat credit to 40% of the tax paid on services relating to erection, commissioning & installation; commercial or industrial construction and construction of residential complex, in case tax has been paid on full value of the service after availing Cenvat credit on inputs i.e. without availing exemption notification 1/2006-ST dated 01.03.2006. This has been done to ensure that the credit on inputs is not availed of indirectly while availing of the composition scheme.

11. Amendments to Cenvat Credit Rules, 2004

11.1 A number of changes have been brought about in Cenvat Credit Rules, 2004 (Notification 3/2011-CE (NT) dated 01.03.2011). Important changes relating to Service Tax are given at Annexure C.

12. Exemptions:

12.1 Notification 26/2010-ST dated 22-6-2010 is being amended by Notification 4/2011-ST and the service tax applicable in respect of "Transport of passengers by air service" is being revised as follows:

(a)	Domestic (economy)	:	From Rs.100 to Rs.150
(b)	International (economy)	:	From Rs.500 to Rs.750
(c)	Domestic (other than economy)	:	Standard rate of 10%

12.2 Exemption is being given to services rendered to an exhibitor participating in an exhibition held outside India (Notification No. 5/ST-2011).

12.3 Exemption from service tax is being provided to 'Works contract service' when rendered for the construction of residential complexes or completion and finishing services of a new complex under Jawaharlal Nehru Urban Renewable Mission (JNURM) and "Rajiv Awaas Yojana" (Notifications No. 6/ST-2011).

12.4 Exemption has been given to the taxable service of general insurance when provided under "Rashtriya Swasthya Bima Yojna" (Notifications No. 7/ST-2011).

12.5 Exemption from service tax is being provided to works contract service rendered within a port, or other port or airport in specified areas (Notifications No. 10&11/ST-2011).

12.6 An exemption of 25% from the taxable value is being provided in respect of services rendered in relation to "transport of coastal goods" and goods transported through "national waterways" or "inland water" (Notification No.16/ST-2011).

12.7 Exemptions with retrospective effect have been given by the Finance Bill:

- (a) To an association or chamber representing commerce or industry in respect of membership fee under the 'Club or Association Service' for the period from 16.06.2005 to 31.03.2008; and
- (b) To inter-state or intra-state transportation of passengers, in a vehicle bearing contract carriage and tourist vehicle permit for the period from 01.04.2000 to 06.07.2009

12.8 These changes will come into effect on the dates mentioned in the respective notifications or when the bill is enacted and notified, as the case may be.

13. Small scale sector

13.1 Finance minister has announced in his budget speech that individual and sole proprietor assesseees with a turnover upto Rs 60 lakhs shall not be subject to audit.

13.2 Interest rate for all assesseees (including firms and corporates) upto a turnover of Rs 60 lakhs shall be 3% less than the prescribed rate.

13.3 The period for making the payment in order to avail the benefit of reduced penalty under the second proviso to Section 78 shall be 90 days for assesseees mentioned at paragraph 13.2.

14. SEZ Refunds:

14.1 Notification No. 17/2011-ST has been issued superceding notification 9/2009-ST dated 03.03.2009. The new notification has the following unique features:

- (a) Criteria for the determination of "wholly consumed" services have been laid down in the notification, borrowing from the Export of Services Rules, 2005. It has also been specified that all services received by an entity in a SEZ, which does not have any other DTA operations, will constitute "wholly consumed" services.
- (b) No service tax is required to be paid ab-initio if the same are meant to be "wholly consumed" within SEZ, including services liable to tax on reverse charge basis under section 66A.

- (c) Refund of the remaining services i.e. which are not wholly consumed shall be available on pro rata basis i.e. ratio of SEZ turnover to total turnover.
- (d) Suitable rule has been introduced in Cenvat Credit Rules, 2004 to waive the requirements of rule 6 in case of services provided, without payment of tax, to a SEZ unit for its authorized operations.

15. General

15.1 It may be noted that this letter does not set out all the changes in an exhaustive manner. It attempts to give a very broad and quick understanding of the important issues using largely words of common usage for easier understanding. The letter should thus not be used for interpreting the specific legal provisions in case it causes any ambiguity. The wordings used in the relevant statutory provisions or notifications alone have legal legitimacy.

15.2 Despite best efforts it is human to make some errors and omissions in the drafting of various provisions. I shall be extremely thankful if you could either inform me or my colleagues of such inadvertent errors as soon as possible. You may also inform about any operational, administrative or any other difficulty faced or anticipated in the implementation of the new proposals either by the trade or by the field formations. You may contact as follows:

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15.3 I shall like to acknowledge the tremendous help that I and my team have received from our seniors: by their encouragement and words of wisdom that come only with experience. It is impossible to capture adequately in words my thanks to all my colleagues in the Department or other Ministries and members of commerce and industry, who gave us a lot of fodder for thought, which set us in motion to meet the challenge that our nation faces. And lastly my very sincere thanks to all my colleagues in TRU for generating able and imaginative ideas and burning midnight lamps throughout the process of budget making while their families waited for them to arrive home only to leave after a short sleep for another day of arduous work. I can, however, well imagine the tremendous sense of satisfaction and fulfillment they would have had at the end of this engrossing exercise.

Sincere regards,

Yours sincerely,

(V. K. Garg)

To

All Chief Commissioners/Directors General
All Commissioners of Service Tax
All Commissioners of Central Excise
All Commissioners of Central Excise & Customs

Scope of New services

1. Services provided by a restaurant

1.1 Restaurants provide a number of services normally in combination with the meal and/or beverage for a consolidated charge. These services relate to the use of restaurant space and furniture, air-conditioning, well-trained waiters, linen, cutlery and crockery, music, live or otherwise, or a dance floor. The customer also has the benefit of personalized service by indicating his preference for certain ingredients e.g. salt, chilies, onion, garlic or oil. The extent and quality of services available in a restaurant is directly reflected in the margin charged over the direct costs. It is thus not uncommon to notice even packaged products being sold at prices far in excess of the MRP.

1.2 In certain restaurants the owners get into revenue-sharing arrangements with another person, who takes the responsibility of preparation of food, with his own materials and ingredients, while the owner takes responsibility for making the space available, its decoration, furniture, cutlery, crockery and music etc. The total bill, which is composite, is shared between the two parties in terms of the contract. Here the consideration for services provided by the restaurants is more clearly demarcated.

1.3 Another arrangement is whereby the restaurant separates a certain portion of the bill as service charge. This amount is meant to be shared amongst the staff who attend the customers. Though this amount is exclusively for the services it does not represent the full of value of all services rendered by the restaurants.

1.4 The new levy is directed at services provided by high-end restaurants that are air-conditioned and have license to serve liquor. Such restaurants provide conditions and ambience in a manner that service provided may assume predominance over the food in many situations. It should not be confused with mere sale of food at any eating house, where such services are materially absent or so minimal that it will be difficult to establish that any service in any meaningful way is being provided.

1.5 It is not necessary that the facility of air-conditioning is available round the year. If the facility is available at any time during the financial year the conditions for the levy shall be met.

1.6 The levy is intended to be confined to the value of services contained in the composite contract and shall not cover either the meal portion in the composite contract or mere sale of food by way of pick-up or home delivery, as also goods sold at MRP. Finance Minister has announced in his budget speech 70% abatement on this service, which is, inter-alia, meant to separate such portion of the bill as relates to the deemed sale of meals and beverages. The relevant notification will be issued when the levy is operationalized after the enactment of the Finance Bill.

2. Short-term accommodation

2.1 Short term accommodation is provided by hotels, inns, guest houses, clubs and others and at camp-sites. This service is proposed to be taxed where the continuous period of stay is less than 3 months.

2.2 Actual levy will be restricted to accommodation with declared tariff of Rs 1,000 per day or higher by an exemption notification. Once this requirement is met, tax will be chargeable irrespective of the fact that actually the amount charged from a particular customer is less than Rs 1,000. The tax will also be charged on the gross amount paid or payable for the value of the service.

2.3 Finance Minister has announced 50% abatement from the value of service. Details of the exemption will be announced at the time when the levy is operationalized after the enactment of the Finance Bill.

Amendments, substitution or expansion of existing services

1. Authorized Service Station's Services [section 65 (105) (zo)]: The existing service is being substituted with a new definition to cover:

- a) Services provided by any person i.e. whether authorized service station or otherwise;
- b) All motor vehicles, other than vehicles used for goods transport and three-wheeler auto-rickshaws; and
- c) Repair, re-conditioning or restoration - which are already taxable – and services of decoration and any other related services.

2. Life Insurance business [section 65 (105) (zx)]:

2.1 Life insurance companies provide services relating to risk cover and managing investment for the policy holders. The former is already subjected to service tax. The latter is now being brought into the tax net. Similar services rendered by way of ULIP are already subject to service tax since 2008.

2.2 When the entire premium is only for risk cover the same shall continue to be taxed even in the revised definition. However in the case of other schemes, a significant portion of the premium is used towards investment, while the rest is allocated towards various overheads and mortality. IRDA in its circular Ref: IRDA/ACT/CIR/VIP/171/2010 dated November 21, 2010 has made it mandatory for the insurance companies to share this break-up with the policy holders in the case of "Variable Insurance Policies" under the heads: premium received, deductions towards mortality, commission and expenses, interest added and closing balance. Thus amounts relating to deductions for mortality, commission and expenses are not available for investment. After the enactment of the new levy, it is proposed to amend the Service Tax Rules to give the option to pay tax at the standard rate on that portion of the premium that has not been invested and is so indicated in any of the documents given to the policy holder. Where the break-up is not indicated in any document issued to the policy holder, option will be given to pay tax @ 1.5% of the gross amount of premium.

3. Commercial Training or Coaching Service [section 65 (105) (zxc)]:

3.1 The levy in its present form keeps outside its purview unrecognized education which is imparted by an institute that issues any certificate or diploma or degree or any educational qualification recognized by law. Thus two identical courses may be treated differently merely because one of the institutes also conducts another course that is recognized by law. This anomaly is proposed to be corrected by subjecting all such unrecognized education to tax.

3.2 In the Finance Bill the definition of 'commercial training coaching centre' has been amended. Suitable exemption will be given after the enactment of the Finance bill to preschool coaching and training and to coaching or training relating to educational qualifications that are recognized by law.

4. Club or Association [section 65 (105) (zzze)]:

4.1 Services provided by a club or association to its members are already subjected to tax since 2005. When a member avails the facilities for his guest, he is already covered by the existing definition as the services are paid for by the member and not by the guest. However a number of clubs or associations allow non-members to use their facilities in their own capacity for a separate charge. Clubs also entertain members of other affiliated clubs. Such services are proposed to be brought within the revised definition.

5. Business Support Service [section 65 (105) (zzzq)]:

5.1 The scope of the service is being expanded to include operational or administrative assistance of any kind. The scope will cover all support activities for others on a contract or fee, that are ongoing business support functions that businesses and organizations commonly do for themselves but sometimes find it economical or otherwise worthwhile to outsource.

5.2 The words “operational and administrative assistance” have wide connotation and can include certain services already taxed under any other head of more specific description. The correct classification will continue to be governed by Section 65A.

6. Health services [section 65 (105) (zzzo)]:

6.1 The existing service is being substituted with a new description as follows:

- a) Services provided by a clinical establishment having the facility of central air-conditioning in whole or any part of the establishment and more than 25 beds for in-patient treatment at any time of the year; and
- b) Services provided by a clinical establishment in relation to diagnostic tests of any kind or investigative services with the help of a laboratory or medical equipment
- c) Service provided by doctors, who are not employees, from the premises of a clinical establishment.

6.2 The head will not cover an establishment under the ownership or control of government or a local authority including Primary Health Centre and ESIC hospital. Autonomous medical institutes set-up by the government by a special act of parliament are also outside the levy.

6.3 Only such doctors will be covered who provide services from the specified premises of a clinical establishment in a capacity other than as employee of such establishment.

6.4 Finance Minister has announced 50% exemption from the value of this service. The exemption notification will be issued when the new levy is enacted.

6.5 Parliament has already passed The Clinical Establishment (Registration and Regulation) Bill, 2010. The Act will apply to such States as have given their consent for the same. The Act prescribes registration of all Clinical Establishments and maintenance of prescribed records and other reporting requirements. These can be referred to the extent they are relevant for the purpose of this levy.

7. Money changing services [section 65 (105) (zm and zzk)]:

7.1 There is no change in the scope of the levy of these services. However the following changes have been made in the actual collection of tax:

- a) A new rule (2B) has been introduced in the Service tax (Determination of Value) Rules, 2006 prescribing the value of the service in terms of Section 67 of the Act. The value shall be as follows:
- (i) The difference between the buying rate or the selling rate, as the case may be, and the RBI reference rate for that currency for that day multiplied by units of currency exchanged;
 - (ii) If RBI reference rate is not available the value shall be 1% of the value of money exchanged in Indian rupees;
 - (iii) When both the currencies are not Indian rupees, 1% of the lesser of the amounts receivable if the two currencies are converted at RBI reference rate.
- b) The rate of composition under rule 6(7B) has been lowered from 0.25% to 0.1% of the gross amount of money exchanged. However, the proviso relating to paying tax on billed charges has been deleted. Thus now the assessee will have the option to pay tax @0.1% of gross amount exchanged or else at standard rate on the value of service in terms of rule 2B, as mentioned above.

Important changes in Cenvat Rules, 2004

1.1 The changes in Cenvat Credit Rules are guided, inter-alia, by the following considerations:

- a) Describe the scope of eligible inputs and input services more clearly so as to minimize disputes in their interpretations;
- b) Eliminate distortions and areas of tax avoidance arising from differential treatment of goods and services used for similar purposes;
- c) Provide a practical scheme for the segregation of Cenvat credits used in respect of final products and output services where they are partially exempted with condition that no such credits shall be taken;
- d) Liberalize the provisions in certain areas to meet the legitimate demands of business;

1.2 Details of important changes made in Cenvat Credit Rules, 2004 that impact service tax are given in the following paragraphs.

A. Input

1.3 “Input” has been defined to include, inter-alia, all goods used in a factory by the manufacturer and goods used for providing any output service;

1.4 Goods that shall not constitute input have been specifically excluded. These shall include, besides petroleum items, any goods used for construction of a civil structure (by a manufacturer as well as a service provider) excepting when they are used in the provision of any of the specified construction services. Thus, goods used by a sub-contractor for rendering services of construction to the main contractor shall constitute input.

1.5 Exclusions also cover goods such as food items, goods used in a guesthouse, residential colony, club or a recreational facility or a clinical establishment which are primarily meant for the personal use or consumption of the employees. When any of these goods are used directly in the manufacture of final products or provision of a service they will constitute input.

1.6 Goods which have no relationship whatsoever with the manufacture have also been excluded.

B. Input Service

1.7 The distinction between goods and services is diminishing and many goods can be received as services. Accordingly the definition of “input service” has been aligned with the definition of “input” such that goods that do not constitute “input” do not qualify as “input service”. Thus a service relating to construction of civil structure will not constitute “input service” unless it is provided by a sub-contractor to the main contractor.

1.8 Similarly services relating to motor vehicle i.e. rent-a-cab, use of tangible goods, insurance or repair of vehicle shall not constitute an “input service” except in respect of output services where credit on motor vehicle is permitted as “capital goods”.

1.9 On the same lines, a service meant primarily for the personal use or consumption of employees will not constitute an input service. A list of specific services has also been given by way of example in the definition. Most of these services constitute a

part of the cost-to-company package of the employee and are provided either free of charge or on concessional basis to company employees.

- 1.10 Expression “activities relating to business” has been deleted and Business exhibition and legal services added in the list of services.

3. Obligation of manufacturer and provider of services

- 1.11 Definition of exempted goods shall include such excisable goods as are covered by the notification relating to concessional duty with the condition that no credit of input and input service shall be availed. This amendment shall come into effect on 01.03.2011.
- 1.12 Similarly the definition of exempted services shall include taxable services which are partially exempted with the condition that no credit of input and input service shall be availed. Moreover it has been clarified that exempted service will include trading service.
- 1.13 Option to maintain separate accounts only in respect of inputs (and not together with input services) has also been given so that allocation as per formula given in rule 6(3A) is done only in so far as credits on input services are concerned.
- 1.14 The amount payable under rule 6(3)(i) in respect of services has been reduced from 6% to 5%. Moreover in the case of exempted services (that are partially taxed with no facility of credits) this amount shall be 5% of the exempted value of the service. Thus if the exemption on a certain service is 60%, the amount required to be paid shall be 3% (60X5%) of the full value of the service. In case of exempt goods, amount payable will be reduced by the amount paid at the concessional rate.
- 1.15 For the purpose of applying the formula under rule 6(3A) the value of trading service as well as value of services covered by composition schemes has been defined. The value of trading service shall be the difference between the sale price and purchase price of goods. The value in respect of services covered by a composition scheme will be tax amount divided by the rate of service tax applicable under section 66 read with any general exemption. As the prevalent rate is 10% the value shall be ten times the amount of service paid or payable.
- 1.16 A substantial part of the income of a bank or a life insurance company is from investments or by way of interest in which a number of inputs and input services are used. There have been difficulties in ascertaining the amount of credit flowing into earning these amounts. Thus a banking company or a financial institution, including NBFC, providing banking and financial services are being obligated to pay an amount equal to 50% of the credit availed. In case of services relating to life insurance or management of ULIPs such amount will be equal to 20% of credit availed. Other options of payment of amount under Rule 6 shall not be available for these taxpayers.
- 1.17 Consequent to the introduction of the proportionate allocation and its rationalization now, Rule 6(5) that allows full credit of 17 specified services has been deleted.
- 1.18 New sub-rule (6A) has been added to allow provision of services without payment of service tax to a unit in SEZ or to a developer in SEZ for their authorized operations, without requirement of reversal of any CENVAT credit on this account. This will help in tax-free receipt of services by units and developers in SEZs.
- 1.19 Most of the Cenvat changes will come into effect from 01.04.2011 except a few that will be effective from 01.03.2011.

C. Addition of Services under section 66A in rule 3

1.20 Service tax leviable under section 66A has been added in the list of eligible credits under rule 3 w.e.f. 18.04.2006 by a retrospective amendment in the Bill. This was already clarified by circular F. NO.345/1/2008-TRU dated 27.06.2008 but has now been done by law to settle the disputes arising due to audit objections. It shall come into force on the enactment of the Finance Bill.