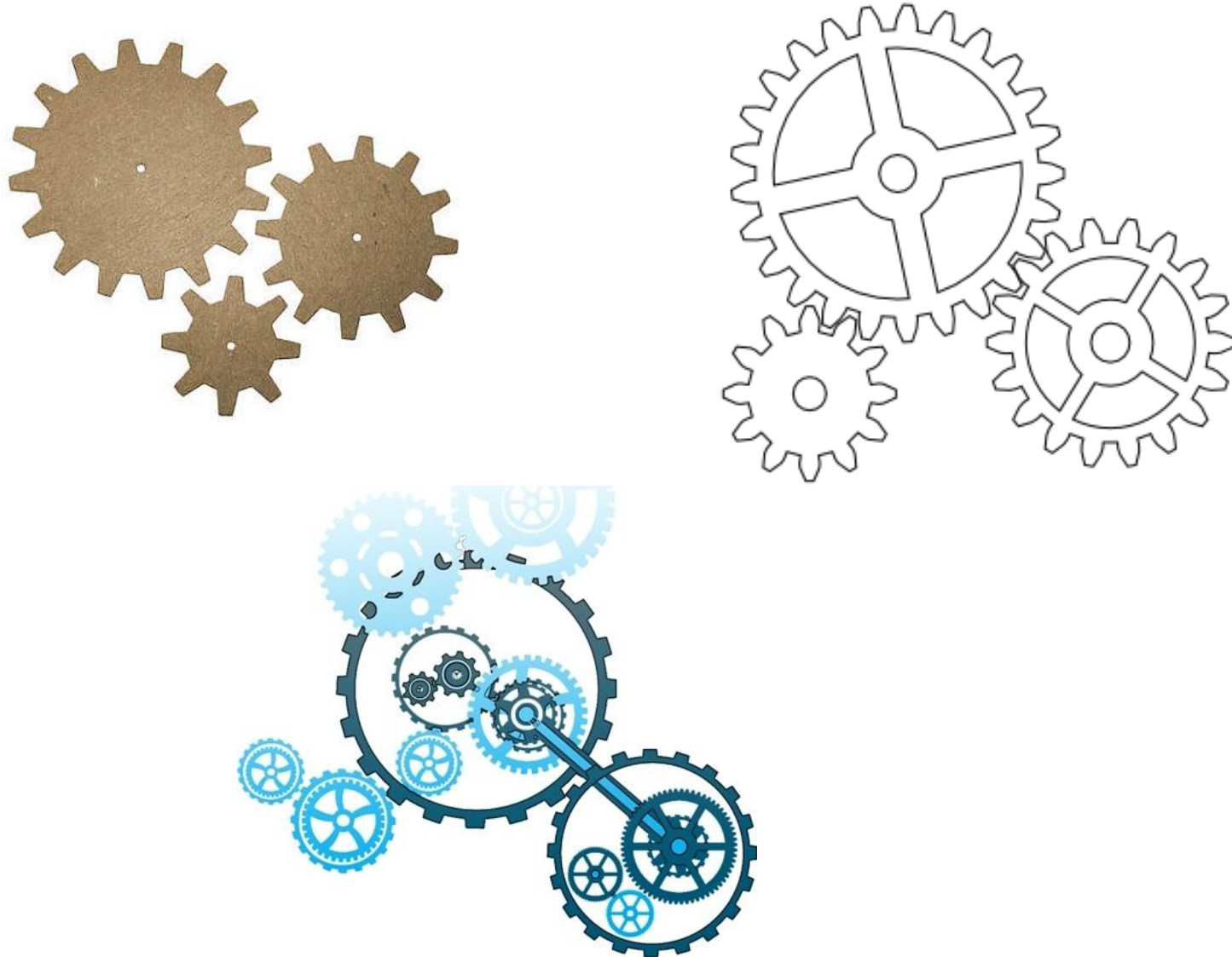


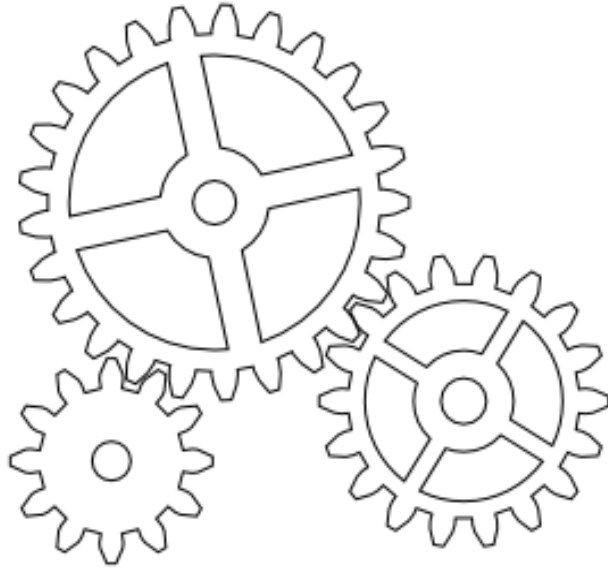


# Overlaps in Indirect Taxes

By  
Milind Sahasrabudhe.

# Understanding Concept of Overlap.





Taxes get levied in different form on the same goods.

Clear cases of overlap?

## Find overlaps here

- 'A' imports goods pays customs duty and sells the same goods locally also pays sales tax / vat.
- 'A' manufactures goods pays excise duty and sells the same goods locally also pays sales tax / vat.
- 'A' imports goods pays customs duty, uses them in manufacture pays excise duty on goods produced and sells the same goods produced locally pays sales tax / vat.



## NO REAL OVERLAP

Illusion of overlap : Taxes relate to different aspects.

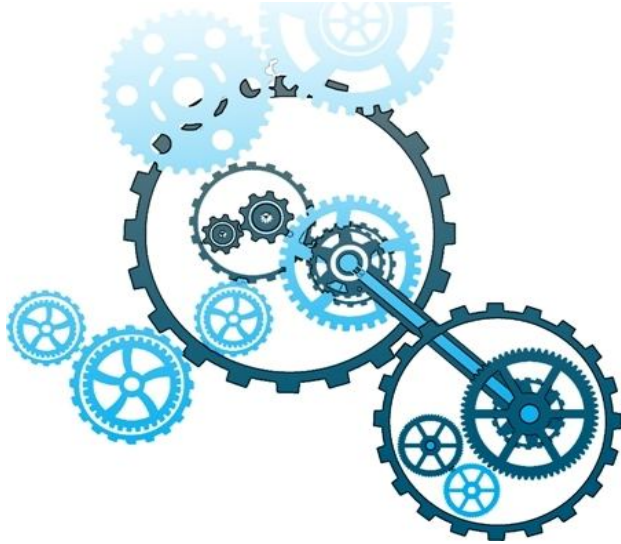
Customs Duty : Imports

Excise : Manufacture

Sales Tax / VAT : Sale

## Aspect Theory.

- On closer examination it would be clear that there is no real overlap in examples of previous slide.
- Each of the taxes specified were related to different independent aspects or events. Each independent event was subjected to tax under different law governing taxation of that independent event.
- For example there is no compulsion to sell the goods imported. Customs duty is on imports only. If manufactured goods are not sold there can be no vat only excise will apply.



When single event triggers liability to pay many different taxes, it is case of real overlap.

## **Real Overlap.**

- When multiple taxes get triggered on single taxable event it is real overlap.
- Builder enters into an agreement for sale of flat under construction – it triggers Service Tax as well as VAT liability.
- Both the taxes are triggered simultaneously on happening of same event viz. entering into an agreement for sale of flat under construction.
- This is case of real overlap.



Critical source of overlap in Indirect Taxes that warrants discussion is transactions having simultaneous involvement of goods as well as service.

## Sources of Overlap.

- If the underlying goods are same, can we think of two taxes being levied on same event related to them?
- Assuming surcharges etc. to be separate taxes triggered by same event related to same goods; would they create any legal / operational issues worth discussion?
- To my mind only transactions simultaneously involving goods as well as services in varied proportion that would create critical overlap worth discussion.



All these are other sources that create possibilities of overlap but essentially these are confusions caused by lack of clarity and these do not trigger multiple taxes unless they lead to basic source of overlap.

## Sources of Overlap?

- Classification.
- Tax Jurisdiction. (CST v VAT).
- Confusing character of underlying taxable subject especially intangibles like software.
- Wording (rather marketing jargons) used in agreements.
- Delivery over internet.
- Change in character during transit.

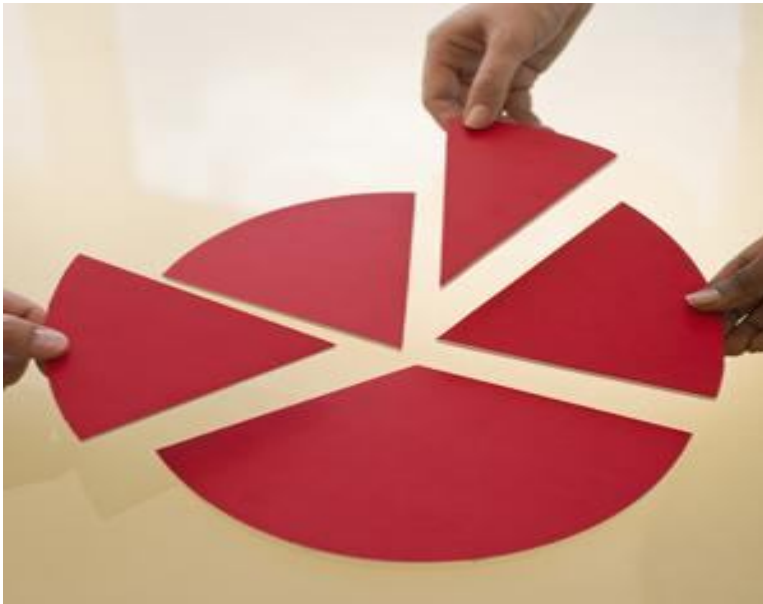


Separating value of goods from value of services that is included in lump sum price charged is key issue in taxation of overlapping transactions.

## Key Issue in taxation of Overlapping transactions.

- Groundnut Chikki. Ingredients? simple to identify ---- groundnuts and jaggery.
- Given this as final product can we identify cost of groundnuts and jaggery separately in this? [Easy?](#)
- How about identifying sale price attributable to groundnuts and attributable to jaggery separately?
- Did we get one single answer? Was any of the answers totally wrong?
- Add spice (to chikki !!)
  - Assume groundnuts and jaggery are supplied by different vendors and purchase price is to be determined as %age of respective sale price.





Actual allocation is clearly problematic.

The other methods are designed for simplification but ----.

We the Indians are creative folk ---.

## Basic Methods of Handling Overlaps.

- Actual allocation.
- Standard Deduction / Abatement Valuations.
- Reduced rate taxation on total value without separation. (Composition).



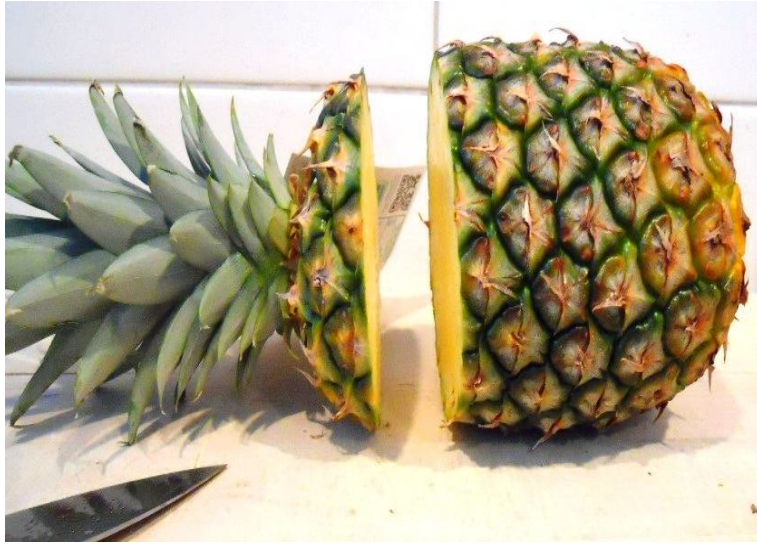
Two powerful Govts on two sides fight for that ‘hanging cheese’.

In the bargain tax payer is ‘hanged’.

Actual allocation -- messy -- gate wide open to litigation.

## Actual Allocation Issues.

- Key issue from VAT perspective is fact the Hon. Supreme Court in landmark Gannon Dunkerly Case while explaining what part of indivisible works contract could be taxed under sales tax laws resorted to specifying some deductions from total price.
- Various Governments took that as direction rather than one of the explanatory methods.
- Laws prescribe deductions, which firstly are not complete, and secondly they pre-empt the simpler method of starting with cost of goods adding direct expenses, overheads and profit margins.



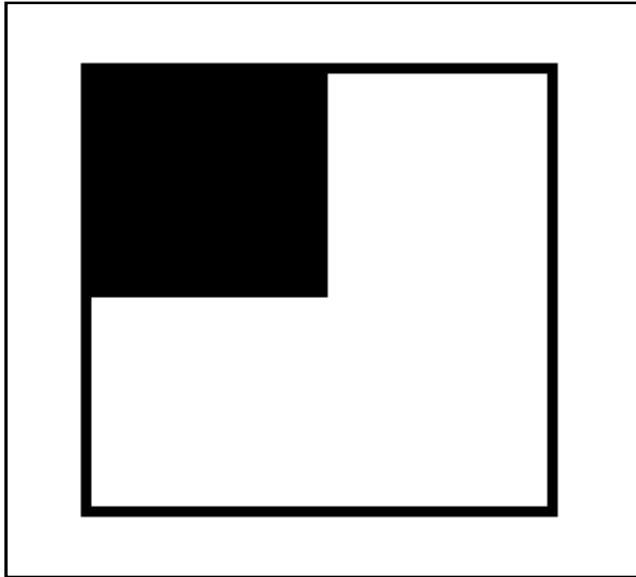
Simplification mechanism spoiled by greed.

Taxable value exceeds contract value in most of the cases.

Free issues creating फोकटमे issues.

## Standard Deductions / Abatements

- The line of cut is predefined by the Government. As is apparent every Government tries to take some piece of pineapple along with the crown. This creates overlap in total taxable value.
- Taxpayers are not far behind. They manage to devise contracts in such fashion that standard deductions exceeded the actual 'crown' portion.
- This has resulted in messing up of this mechanism for simplicity with added complexity of expanding value base beyond the concerned contract.



By far most simple mechanism to handle the key overlap issue.

Apart from expanding base issue in some cases, input credit restrictions increase effective incidence to unreasonable levels.

## Composition Schemes.

- No effort to bifurcate value.
- Lower rate fixed with reference to full contract value without split.
- Simple as far as basic calculations.
- Laws complicate it via backdoors of input credit restrictions.





Worth buying peace at  
10% extra tax?

## Real Estate.

- Service Tax refers to receipt of money or invoicing, no reference to agreement date. VAT fixes incidence on agreement.
- Standard deduction / abatement method results in total tax base of 110% of value in case of smaller units.
- Abatement method not available under Service Tax if value of land is not included in price. Then it goes by valuation rule (indirect abatement).
- No composition under Service Tax. But using composition under MVAT may result in similar tax incidence.



Use of 70% value in terms of Service Tax Valuation Rule 2A permissible along with use of actual material value in VAT?

## Repairs and Maintenance.

- Service tax follows theory of dominant intention. However for VAT Supreme Court has rejected this theory in case of Xerox Modi. This creates issue on taxable value determination in case of contracts where intention is clearly service and materials are incidental.
- Annual maintenance contracts involving insignificant material value pre-empt possibility of use of standard deduction or even composition in these cases for VAT.
- Issues as far as repairs to excise paid goods returned to factory are far more complicated.



Standard deduction: VAT and Ser.Tax results in tax on taxable value of 125%.

Much more complicated than Real Estate Sector.

## Other works contracts.

- There are excise issues for equipments and parts shifted on site for erection.
- The so called overlap on CST /VAT creates issues beyond imagination.
- Running bills / certifications are other issues.
- Final Plant is rarely exciseable so services used in assembly of plants have issues on input credit.
- Dealing with unused extra material on site is also challenge.





Extra-ordinary hike in value base in case of use of abatement.

Composition under MVAT only viable option for eateries and caterers.

## Catering and Hotels

- VAT standard deduction in all cases is 25% i.e. taxable value of 75%.
- Service Portions as per abatement / valuation rules:
  - Bundled services with premises rent 70%
  - Hotel Room Rentals 60%
  - Restaurant Food Bills 40%
  - Outdoor Catering 60%
- Interpretation of condition in case of service tax abatement for bundled premises with rent is challenge.
- Hotel Rooms category may be better off paying VAT on actuals.



Clear case of no overlap even in terms of legal definitions.

Demands not ruled out due to weird interpretations.

## Rentals and leases

- The category has been simplified by virtue of definitions which are mutually exclusive. Levy of both taxes on same transaction legally ruled out. Definition under Service Tax is not clearly worded and that can create overlap.
- Control and possession during renting period is critical attribute which has not been highlighted in the definition under Service Tax.
- Citus in case of agreement of lease in case of existing goods creates jurisdiction issues.
- Hire Purchase per se is not taxable under service tax.



Issue about online downloaded software is still fairly wide open issue from perspective of all taxes including Customs, Excise, VAT, Service Tax.

## Softwares

- Tata Consultancy Services Judgment of Supreme Court holds software inscribed on media to be goods.
- Service Tax has tried to simplify issue at definition levels by defining “Development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software” to be the declared service.
- Interpretation becomes simple if we relate the software to books.
- Jargons used in software trade make issues complicated.

# Vouchers and Recharge Cards



Complication beyond comprehension.

Difficult to deal with even from the view point of law makers.

- The Character of these type of species is difficult to decode and can acquire different colour depending upon user.
- Service tax education guide says phone recharge vouchers is not actionable claim nor goods but is service.
- What is character of this in the hands of trader who buys this at quantity discount with pure intention to resell?
- What about gift vouchers of malls?



Valuation and point of taxation both pose immense issues.

Will stand that 'tax is not applicable if the computation machinery fails' survive legal scrutiny?

## BOT Contracts

- NHAI issues contract for construction of Ahmadabad Delhi highway. Ownership of road remains with NHAI. Road is to be handed over after 15 years.
- Contractor does not get money but gets right to collect the toll for 15 years plus rights on revenue from advertisement sites along the road for that period. And there is obligation to maintain road as per specifications during this period of 15 years.
- What if service tax is not exempt?
- VAT?



GST will surely address the issues of overlap except BOT contracts.

Issues in case of interstate works contracts where materials are sourced from different States will still be open.

## Way Forward?

- Simple way to deal with overlap is remove basic cause of overlap.
- As we have seen basic cause of overlap is distinction between goods and services. If that is removed the overlap vanishes.
- GST which is Goods and Services Tax aims to achieve this basic objective.
- GST will apply irrespective of character of transaction exactly like composition scheme .



धन्यवाद

## Groundnut Chikki Fact Sheet.

	Jaggery	Groundnut	Combined / Unallocated
Godown Space	500sq. feet	5000sq. feet	2000 sq feet
Average Inventory	1 month	5 months	
Godown Rent			1,50,000/-
Fuel		5,000/-	25,000/-
Labour		25,000/-	50,000/-
Interest on Term Loan			5,000/-
Admin Management & Selling Exp			2,50,000/-
Interest on working capital			15,000/-
Basic RM price	3,00,000/-	4,00,000/-	
Final Sales Price Realised			15,00,000/-



## **Abatement Condition for Bundled Service with food.**

- The amount charged shall be the sum total of the gross amount charged and the fair market value of all goods and services supplied in or in relation to the supply of food or any other article of human consumption or any drink (whether or not intoxicating) and whether or not supplied under the same contract or any other contract, after deducting-
  - (i) the amount charged for such goods or services supplied to the service provider, if any; and
  - (ii) the value added tax or sales tax, if any, levied thereon:

Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

## **Service Tax Valuation Rule -- Repairs.**

- (i) Value of service portion in the execution of a works contract shall be equivalent to the gross amount charged for the works contract less the value of property in goods transferred in the execution of the said works contract.
- *Explanation.*- For the purposes of this clause,-
- (c) Where value added tax or sales tax has been paid or payable on the actual value of property in goods transferred in the execution of the works contract, then, such value adopted for the purposes of payment of value added tax or sales tax, shall be taken as the value of property in goods transferred in the execution of the said works contract for determination of the value of service portion in the execution of works contract under this clause.

## **Service Tax Valuation Rule -- Repairs.**

- (ii) Where the value has not been determined under clause(i), the person liable to pay tax on the service portion involved in the execution of the works contract shall determine the service tax payable in the following manner, namely:-
- in case of works contract entered into for maintenance or repair or reconditioning or restoration or servicing of any goods, service tax shall be payable on seventy percent of the total amount charged for the works contract;