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## E-circular dt 5<sup>th</sup> August 2015

# Service tax on Reimbursements

Clarification : it is “Compulsory”

(with some Exceptions)

Sangeet Kr Gupta, FCA

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Lesser known law, recently clarified,  
and “must be followed”



# Question from two members :

- Dear I am SME of India Team,
- We are an Architect firm. We do designing and project consultancy for construction contracts. We hear that service tax is now levied even on the travel, hotel and food expense we incur for visiting the clients. Is this true ?”.
- Please advise.
- Thanks and Best Regards,  
M/s. ABC, Faridabad.

Dear Mr Rajiv Chawla,  
Our Vendor , being a C and F Agent, for arranging our imported raw material from China and Taiwan, has started asking for Service tax on his re-imburesements like Haulage Charges, Consultant Charges, Documentation Charges etc  
Is he correct ? Is there a recent change in law ?

Regards, M/s XYZ, Ludhiana.

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# The Common Answer :

## Executive Summary

- This law existed for more than 10 years. However, there was confusions and court cases.
- This year, Government has changed the law itself to act as a “clarification”.
- Some “conditions” are yet to be prescribed, so for time being old rules (of 2006 continue )

### So, Now, in our view

- w.e.f. 1<sup>st</sup> April 2015, If it is a Pure Agent , and all 8 conditions, are satisfied, then no service tax, ELSE, Tax is levied.
- And for period upto 31<sup>st</sup> March 2015, the matter is sub-judice in the Supreme Court of India.

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Now, let us discuss in a detailed way.....



# Root Reason for this clarification

- Some people had innocently, or deliberately, started innovative billing, to reduce the tax liability.
- Example : Repair / Installation charges / Consultants were giving billing in two parts. A contract of Rs 50,000 was being broken into Rs 10,000 as service fee, and Rs 40,000 as Re-imbursment of Travel, Salaries, Food, subcontractors etc.
- And thus, service tax was being paid to Government on only Rs 10000. Government found that this was wrong.... Hence the law clarified.



### Three parts of this Publication :

## Service Tax on Re-imbursements

- (a) Valuation Rules, 2006, on this topic
- (b) Delhi High Court Decision
- (c) Latest change in Law, Finance Act, 2015

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# First Source :

- See the Government Rules in this regard
- **Service Tax (Determination of Value) Rules, 2006**
- Source :
- <http://www.servicetax.gov.in/value-rules.htm>

## Rule 5(1) says

- “.....Rule 5: Inclusion in or exclusion from value of certain expenditure or costs.–
- (1) Where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service.
- .....”

# Opinion, at this stage

- If we follow the Rule 5(1), in case of a C and F Agent,
- It is clear that all the expenses C and F Agent, makes to get the shipment done, including all expenses whatsoever,
- Are covered
- **However, Govt gives a big exception**

# Rule 5(2) : Rules for “Exception”

- (2) Subject to the provisions of sub-rule (1), the expenditure or costs incurred by the service provider as a pure agent of the recipient of service, shall be excluded from the value of the taxable service if all the following conditions are satisfied, namely:-
  - (i) the service provider acts as a pure agent of the recipient of service when he makes payment to third party for the goods or services procured;
  - (ii) the recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service;
  - (iii) the recipient of service is liable to make payment to the third party;

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# Conditions (contd.)

- (iv) the recipient of service authorises the service provider to make payment on his behalf;
- (v) the recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party;
- (vi) the payment made by the service provider on behalf of the recipient of service has been separately indicated in the invoice issued by the service provider to the recipient of service;
- (vii) the service provider recovers from the recipient of service only such amount as has been paid by him to the third party; and **(( NO PROFIT ))**
- (viii) the goods or services procured by the service provider from the third party as a pure agent of the recipient of service are in addition to the services he provides on his own account.

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# Pure Agent Means ?

- **Explanation 1.**—For the purposes of sub- rule (2), “pure agent” means a person who—
- (a) enters into a contractual agreement with the recipient of service to act as his pure agent to incur expenditure or costs in the course of providing taxable service;
- (b) neither intends to hold nor holds any title to the goods or services so procured or provided as pure agent of the recipient of service;
- (c) does not use such goods or services so procured; and
- (d) receives only the actual amount incurred to procure such goods or services.

# Official Example in the Rules



- **Illustration 1.**— X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement in television. Y billed X including charges for Television advertisement and paid service tax on the total consideration billed. In such a case, consideration for the service provided is what X pays to Y.
- Y does not act as an agent behalf of X when obtaining the television advertisement even if the cost of television advertisement is mentioned separately in the invoice issued by X.
- Advertising service is an input service for the estate agent in order to enable or facilitate him to perform his services as an estate agent

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## Official Example 2



- **Illustration 2.**– In the course of providing a taxable service, a service provider incurs costs such as traveling expenses, postage, telephone, etc., and may indicate these items separately on the invoice issued to the recipient of service.
- In such a case, the service provider is not acting as an agent of the recipient of service but procures such inputs or input service on his own account for providing the taxable service.
- Such expenses do not become reimbursable expenditure merely because they are indicated separately in the invoice issued by the service provider to the recipient of service.

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# Official Example 3



- **Illustration 3.**– A contracts with B, an architect for building a house.
- During the course of providing the taxable service, B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., to enable him to effectively perform the provision of services to A.
- In such a case, in whatever form B recovers such expenditure from A, whether as a separately itemised expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B.
- Value of the taxable service for charging service tax is what A pays to B.

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# Official Example 4



- **Illustration 4.**– Company X provides a taxable service of rent-a-cab by providing chauffeur-driven cars for overseas visitors.
- The chauffeur is given a lump sum amount to cover his food and overnight accommodation and any other incidental expenses such as parking fees by the Company X during the tour.
- At the end of the tour, the chauffeur returns the balance of the amount with a statement of his expenses and the relevant bills. Company X charges these amounts from the recipients of service. The cost incurred by the chauffeur and billed to the recipient of service constitutes part of gross amount charged for the provision of services by the company X.

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**however ...**

# Some Exceptions given in Law

- (2)** Subject to the provisions contained in sub-rule (1), the value of any taxable service, as the case may be, does not include—
- (i) initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;
  - (ii) the **airfare collected** by air travel agent in respect of service provided by him;
  - (iii) the **rail fare collected** by [rail]<sup>2</sup> travel agent in respect of service provided by him; and
  - (iv) **interest on loans.**

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# Summary .... At this point

- The summary at this point was that reimbursements are taxable, except those covered in the explicit exemptions
- But, people were not clear
- And cases were going in litigations

Then,

- There was a Court Case
- Delhi High Court decided...



# Delhi High Court Decision

- Name of Writ Petition : “Inter continental Consultants and Technocrats Ltd vs Union of India”, decided in Nov 2012, reported in [2013 (29) STR 9 (Del.)].
- In this case the Assessee won the case, against section 5(1) and the High Court said “section 5(1) is ultra vires the Act”.

# But the Govt did not agree

- And Government took two steps
- First, the Government Filed an appeal in the Supreme Court . So, there is no relief till Supreme Court agrees to High Court order.
- Second, the Government Amended the Act itself.
- So, now even the Supreme Court cannot do anything for future years ( current year 2015-16)



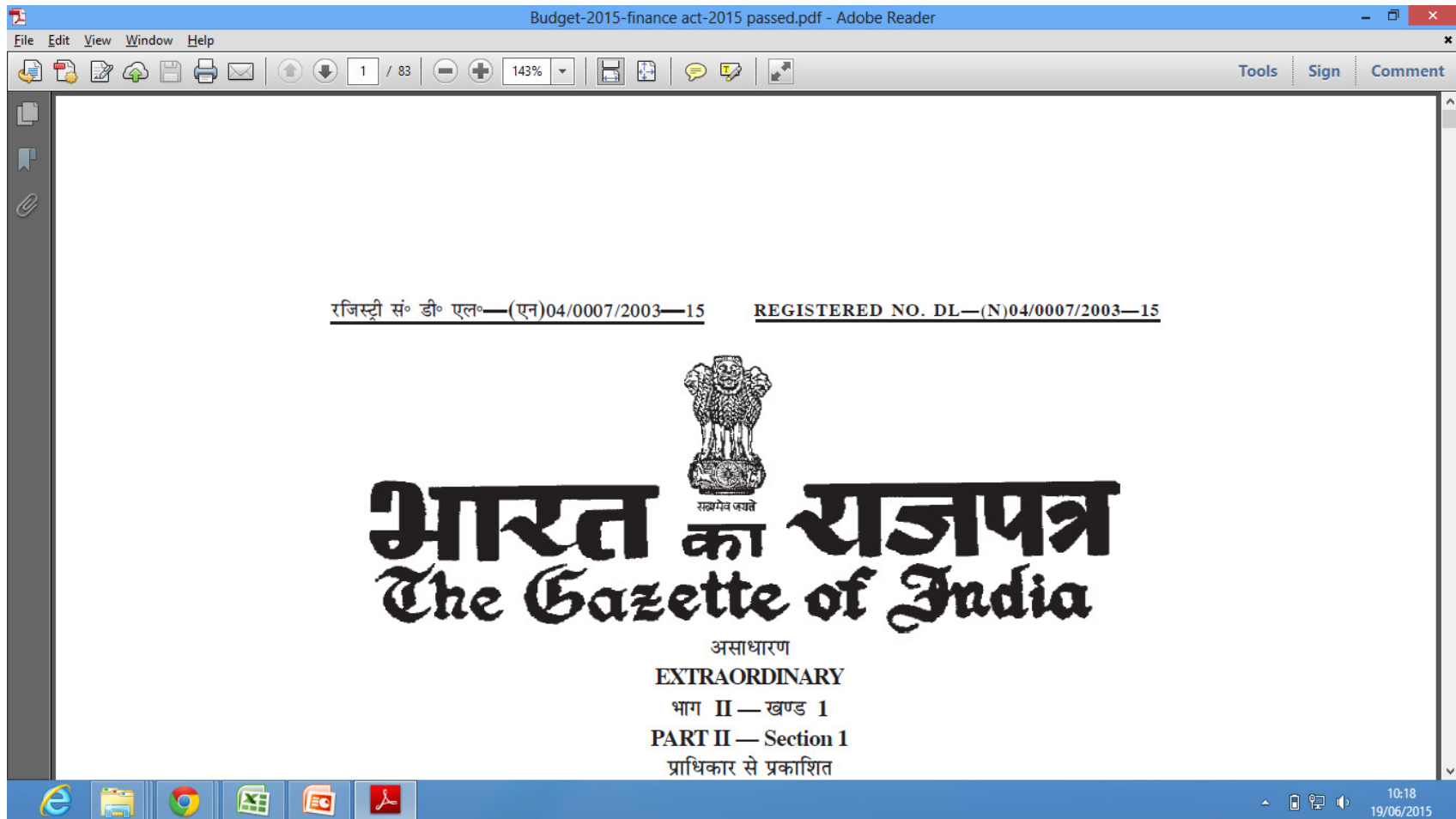
These Changes were done in Budget 2015



Union Budget 2015

Specifically, changed the definition of Service itself

# Source : Finance Act 2015



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# The Finance Act 2015 says

**111. In section 67 of the 1994 Act, in the *Explanation, for clause (a), the following***

- clause shall be substituted, namely:—
- ‘(a) “consideration” includes—
- (i) *any amount that is payable for the taxable services provided or to be provided;*
- (ii) **any reimbursable expenditure or cost incurred by the service provider** and charged, in the course of providing or agreeing to provide a taxable service,
- except in such circumstances, and subject to such conditions, as may be prescribed;

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# Govt internal Note to its officers

- **Relevant Extract from [D.O. Letter from JS\(TRU-II\)–F. No. 334/5/2015-TRU- D.O.F. No. 334/5/2015-TRU, dated February 28th, 2015](#)**
- *“...(iv) Section 67 prescribes for the valuation of taxable services. It is being prescribed specifically in this section that consideration for a taxable service shall include:*
- *(a) all reimbursable expenditure or cost incurred and charged by the service provider. The intention has always been to include reimbursable expenditure in the value of taxable service. However, in some cases courts have taken a contrary view. Therefore, the intention of legislature is being stated specifically in section 67. ....”*

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# Now, this is a BIG Problem



# Service tax on “Re-imbursement” ?



## Old Position

- No Clarity, Different opinions

## New position

- Made clear. Service tax is YES.

But, Cost increases.....,

- if you don't get Input Credit on re-imbursement services

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Based on this, our opinion

**our**  
**OPINION**

---

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# Opinion of Legal World -1

- “.....Thus, after the amendment there is no doubt that any expenditure incurred by the service provider for providing any taxable services has to be included in the value of taxable services unless specifically excluded and Service Tax would be chargeable on the total value including the reimbursable expenses incurred by the service providers. – .....”
- See more at: <http://taxguru.in/service-tax/analysis-service-tax-proposals-budget-20152016.html#sthash.geogeGhn.dpuf>

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## 2<sup>nd</sup> Opinion of Legal World -2

- That opinion draws from the 2006 Rules
- Which says, that “Pure Agent” Expenses can and should still be excluded
- If ALL the 8 conditions prescribed are fulfilled

## Rule 5(2) : Exceptions, see them again

(2) Subject to the provisions of sub-rule (1), the expenditure or costs incurred by the service provider as a pure agent of the recipient of service, shall be excluded from the value of the taxable service if all the following conditions are satisfied, namely:-

- Editor Note 1 : “All Conditions” is Highlighted.
- Note 2 : In the examples, We will see these conditions from the point of view of a C and F Agent, say, M/s. CFA

- Condition no 1 to 3
- (i) the service provider acts as a pure agent of the recipient of service when he makes payment to third party for the goods or services procured; ( OK, yes, Customs duty is paid by CFA )
- (ii) the recipient of service receives and uses the goods or services so procured by the service provider in his capacity as pure agent of the recipient of service; ( OK, yes, this is the case at CFA, he has no personal interest in this customs duty )
- (iii) the recipient of service is liable to make payment to the third party; (yes, actual liability is of the end-customer / consignee)

- Condition no 4 to 6
- (iv) the recipient of service authorises the service provider to make payment on his behalf; **(( This should always be made this a part of contract document))**
- (v) the recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by the third party; **(( This should always be made a part of contract document))**
- (vi) the payment made by the service provider on behalf of the recipient of service has been separately indicated in the invoice issued by the service provider to the recipient of service; **(( CFA usually do so, in their invoices ))**

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- Condition no 7 to 8
- (vii) the service provider recovers from the recipient of service only such amount as has been paid by him to the third party; and (( **Note :** **You cannot earn any “PROFIT” --- so, no hidden profit please, else service tax is YES, due.))**
- (viii) the goods or services procured by the service provider from the third party as a pure agent of the recipient of service are in addition to the services he provides on his own account. **((This is ok, since CFA charge his own bill also))**

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# Pure Agent Means ?



- ***Explanation 1.***—
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# Examples of Pure Agent

- Customs Duty, Dock Dues, Transport Charges
- Demurrage Charges
- Octroi paid by CHA / Transporter on behalf of
- Entry Fees paid by CHA
- Freight, Labour, Godown charges

=====

- Provided all 8 conditions are fulfilled ( especially, no profit element, as in case of customs duty )

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## However, Big question :

- In light of Amended Section 67, even these are covered,
- But, since Customers are not agreeing
- Since, (after taking the risk) we can still use the benefit of 2006 valuation Rules ( they are not withdrawn ).
- Then, if all the 8 points are valid,
- Only then, can we safely assume those charges to be with NIL service tax



# The Solution / the Advice



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## The Advice, for All C and F Agents

- Proper Contract with customers, specifically including the 8 points
- Remember, DO NOT make any profit on those charges.
- This above is also applicable to some other service providers, who are working as “pure Commission agents” with transparent profit percentage.

# The Advice, for Consultants, CA, Architects, ISO 9001, Lean Mfg Consultants etc

- Your case comes squarely in the ambit of Illustration 2 and 3 given by the Government. ( given on slide 10 and 11 of this Powerpoint ).
- Government says, “When you buy Travel, Hotel, Food Services, you are consuming them yourself, in order to give your service to end-customer.”
- In light of Amended Section 67, all re-imbursments are covered so, there is a really BIG RISK on non-compliance.
- The penalties and prosecution risk are too much.
- But, It will be difficult to defend your case in light of specific example given by Government in the Rules and the specific Amendment to the law.

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## Is there any Loss to end-customer ?

- Most of your Customers are Excisable /Service Tax registered companies, and can get Input Tax Credit of all service tax paid.
- So, not much worry on that front.
- The only people who lose will be very small non-excisable units and traders.
- Manufacturers will never have a problem, since they will get MODVAT anyway.

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# Final Word

- To keep yourself safe, you must start making “an Invoice” instead of “Debit Note”.
- And start charging the Service tax, as per the revised law.

# Important Note

- Each case may be different based on different set of circumstances in that individual case, hence feel free to contact capable professionals to handle your specific case, before you take any decision.



**For queries, suggestions and feedback , you can e-mail us**

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