Export of Service & associated benefits:

The introduction of new rules governing export of service and the associated benefits are a welcome step as they are expected to bring more certainty and clarity, which are essentials of an optimum taxation system

Service Tax, like most other indirect taxes, is a consumption based tax. Accordingly, Service Tax is charged in the territory where the service is consumed. Based upon this principle, the Government has devised a policy of export of the goods and services, not the taxes. As per this policy, in case of exports, no element of taxes, whether input tax or output tax, should be exported. In simple words, the entire effect of tax is completely neutralised and the export price is made tax-free. For this purpose, the Government does not levy output tax on goods and services to be exported. As far as input tax is concerned, the Government has adopted various methods such as rebates, refunds or duty drawback, as the case may be.

In Budget 2012, the Government has overhauled the Service Tax regime of the country. During this Budget, the provisions relating to export of service and its associated benefits have undergone a major change. This article provides a basic understanding of export of services and the benefits associated with it. The first part deals with *'What Constitutes an Export of Service'* and the latter part deals with *'Benefits Related to Export of Services'*.

What Constitutes an Export of Service?

Prior to Budget 2012, export of services was governed by Export of Services Rules, 2005. In Budget 2012, the Government has inserted Rule 6A titled *'Export of Services'* in the Service Tax Rules, 1994 ('STR 1994') vide Notification No. 36/2012-ST, dated 20.06.2012. This Rule 6A has replaced the erstwhile Export of Services Rules, 2005. The said Rule provides conditions which must be satisfied to constitute a provision of service as export of service, and, states as under:

"(1) The provision of any service provided or agreed to be provided shall be treated as export of service when-

(a) the provider of service is located in the taxable territory ,

(b) the recipient of service is located outside India,

(c) the service is not a service specified in Section 66D of the Act,

(d) the place of provision of the service is outside India,

(e) the payment for such service has been received by the provider of service in convertible foreign exchange, and

(f) the provider of service and recipient of service are not merely establishments of a distinct person in accordance with item (b) of Explanation 2 of Clause (44) of Section 65B of the Act

(2) Where any service is exported, the Central Government may, by notification, grant rebate of service tax or duty paid on input services or inputs, as the case may be, used in providing such service and the rebate shall be allowed subject to such safeguards, conditions and limitations, as may be specified, by the Central Government, by notification."

Rule 6A (1) lays down the conditions which need to be fulfilled by a service to constitute it as an export of service. Rule 6A(2) provides for rebate of service tax or duty paid on input services or inputs, respectively, used in provision of such export service, subject to fulfilment of conditions notified.

For a service to constitute as an export of service, it must satisfy the conditions laid down by Rule 6A(1), which are explained as below.

a. Service Provider should be Located in Taxable Territory

To understand this condition, it is necessary to understand the concept of Taxable Territory. A combined reading of Section 64, Section 65B(27), and Section 65B(52) of Finance Act, 1994, would help in understanding as to what constitutes Taxable Territory for the purpose of Service Tax. The Taxable Territory for the purpose of Service Tax consists of the landmass of India; its territorial waters, continental shelf, and exclusive economic zone; the seabed and the subsoil underlying the territorial waters; the air space above its territory and territorial waters; and the installations, structures and vessels located in the continental shelf of India and the exclusive economic zone of India, for the specified purposes. Generally speaking, for the purpose of export, a Service Provider should be located in India.

Having elaborated as to what constitutes a Taxable Territory, we need to check the location of Service Provider as per Place of Provision Rules, 2012 ('PPR 2012'). The PPR 2012 is a recently notified set of Rules which help in determining the location where a service is provided. These Rules inter alia incorporate provisions which help in determining the location of Service Recipient and Service Provider. The location of Service Provider is governed by Rule 2(i) of PPR 2012, which is explained as under:

A. In cases where the Service Provider has obtained a single Service Tax registration, the location of the Service Provider would be the premises for which such registration has been obtained. The fact that such single Service Tax registration is for single premises or for centralised billing, has no impact on operation of this clause.

B. In cases where the service receiver has not obtained such registration, as mentioned above, location of Service Provider is determined in the following manner:

i. The location of Service Provider would be the location of his business establishment. A business establishment is a place where essential decisions related to general management are taken. For instance, Company A is engaged in beauty services. All board meetings of the Company take place at their office in Mumbai. In such a case the location of business establishment would be Mumbai and therefore, location of Company A would be Mumbai.

ii. However, in cases where services are provided from a place other than the business establishment, i.e. a fixed establishment, elsewhere, the location of Service Recipient would be location of such establishment. A fixed establishment is a place (other than the business establishment) which has the permanent presence of human and technical resources to provide a service. For instance, Company A provides all services from its branch situated at New Delhi. In such case, since the services are provided from fixed establishment located in New Delhi, location of Company A would be New Delhi.

iii. There is a possibility that a single service is provided from more than one establishment. These establishments may either be fixed establishment or business establishment. In such cases, location of Service Provider would be the establishment most directly concerned with the provision of the service. For instance, Company A enters into an agreement with a modelling agency to provide beauty services to its models situated all across India. As per the agreement, beauty services are provided at various establishments. However, location of Company A would be the establishment which is most directly concerned, will depend on the facts and supporting documentation, specific to each case. For example, factors which may be considered are consideration payable at each establishment, number of man hours spent at each establishment etc. Based upon these factors location of Company A would be determined.

iv. However, in the absence of any of the above places, the location of Service Recipient would be the usual place of residence of the Service Provider. Further, explanation to Rule 2(i), deems the location of Service Provider in case of a body corporate as the place where it is incorporated or otherwise legally constituted.

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In Budget 2012, the Government has overhauled the Service Tax regime of the country. During this Budget, the provisions relating to export of service and its associated benefits have undergone a sea change. This Article aims in understanding these changes by explaining them in a simple language.

To constitute an export of service, it is essential that the location of Service Provider in terms of Rule 2(i) of PPR 2012 is in the Taxable Territory, i.e., India.

b. Service Recipient should be located outside India;

Another essential condition for export of service is that location of Service Recipient should be outside India. To determine the location of Service Recipient, we refer to Rule 2(h) of the PPR 2012. This Rule 2(h) is applied in the same manner as Rule 2(i) of PPR 2012. The only difference between these two Rules is that while the former helps in determining the location of Service Provider, the latter helps in determining the location of Service Recipient.

c. Service to be exported should not be covered in the Negative List u/s 66D

'Negative List', as used in this Rule 6A of STR 1994, is a recent concept introduced in Budget 2012. With the introduction of this concept, a comprehensive approach was adopted for taxation of service whereby all services have become taxable other than those which are specified in the said Negative List. The Negative List provides an exhaustive list of services which are not chargeable to Service Tax. In case a service is covered by the Negative List, provision of the same would not be considered as export of service, irrespective of the fact that all other conditions laid down in this Rule 6A are satisfied.

d. Place of Provision of Service should be outside India

Generally, place of provision of service is based on the principle of consumption based taxation, i.e., tax the service where it has been consumed. Accordingly, as per Rule 3 of the said Rules, the place of provision would be the location of Service Recipient. Before reaching a conclusion, it is advisable to also refer to other rules of PPR 2012. Beside Rule 3, PPR 2012 also incorporates specific rules, depending upon the nature of the service, for determination of the place of provision of the service. Some of these specific services are, performance based services, services in relation to immovable property, services related to event, etc. The Place of Provision in each case has to be determined taking into account the nature of service provided in that case.

e. Payment to be received in convertible Forex

The Rule requires that consideration for such export of service should be received in convertible foreign currencies that are notified by the Customs Department. At present, some of the notified foreign currencies include the US Dollar, Australian Dollar, Euro, Swiss Franc etc.

It is pertinent to note that often there are cases where the exporter of service receives consideration indirectly after conversion of foreign currency into Indian Rupees. For example, A provides a service of procurement of goods from India on commission basis to buyer located abroad, say B. At the time of payment of commission, B pays the entire amount including commission to the Indian supplier. The Indian supplier in turn pays A, his commission in equivalent Indian Rupees. In such cases it may be argued that as A did not receive the consideration in foreign currency, therefore, the service provided does not constitute an export of service. This view does not appear to be correct. The fact that commission is received directly from B or Indian supplier, on instructions of B, after conversion into equivalent Indian currency should not have any impact on fulfilment of the condition. The condition of receipt of foreign currency should be given a liberal construction and should not be interpreted too strictly so as to dilute the main purpose of the Scheme, i.e., earning of foreign currency. In such cases, however it is advisable that proper documentation is maintained to prove that commission received in Indian currency pertains to export of service. This view is substantiated from a recent decision of the Ahmedabad Tribunal in the case of *Commissioner of Central Excise, Rajkot vs. Shelpan Exports*[1] wherein it was held that payment received by the Respondent through Indian exporting manufacturer, who had in turn received consideration for goods exported in foreign currency, has to be treated as receipt in foreign currency only.

f. The Service Provider and Service Recipient are not distinct entities merely in terms of Explanation 2(b) to Section 65B(44)

This explanation is inserted in the definition of 'service' under Section 65B (44). This explanation replaces erstwhile Section 66A (2)

and Section Explanation to Section 65. As per this explanation, (i) an establishment of a person located in Taxable Territory and another establishment of such person located in Non-Taxable Territory and (ii) an unincorporated association or body of persons and members thereof, are treated as distinct persons.

Only upon fulfilment of all the conditions enlisted above, the provision of service is considered as an export of service, in terms of Rule 6A of STR 1994.

Benefits related to Export of service

Once an export of service has been completed, the question of treatment of taxes paid on inputs and input services arise. It is essential that these taxes are also neutralised. The Government, for the purpose of neutralisation of the burden of such input taxes provides following options to the exporter of service. Both methods are mutually exclusive and only one of them can be adopted by the exporter of service.

1. **Rebate under Rule 6A, STR 1994**
   An exporter of service may claim rebate of inputs and input services under sub-Rule (2) of Rule 6A of STR 1994. For the purpose of this rebate, the Government has issued Notification No. 39/2012-ST, dated 20.06.2012. The exporter of service may claim rebate of excise duty and service tax paid on inputs and input services respectively, provided that CENVAT has not been availed on such inputs and input services. For the purpose of claiming rebate, the exporter of service should file a declaration with jurisdictional Assistant/Deputy Commissioner who would on verification, if necessary, accept the declaration. Upon completion of export of service, as per Rule 6A, the exporter of service should file a claim for rebate in form ASTR-2 alongwith the following supporting documents:

a. copies of invoices issued under Central Excise Rules, 2002 or STR 1994, for inputs and input services
b. documentary proof of receipt of payment against service exported, payment of duty on inputs and service tax and cess on input services, and
c. declaration that service has been exported in terms of Rule 6A and documents evidencing such export of service.

It is advisable that rebate claims aggregating to less than one thousand rupees are not filed as the same are not acceptable.

2. **Refund of Service Tax under Rule 5 of CENVAT Credit Rules, 2004**
   The exporter of service tax may claim refund of CENVAT of excise duty and service tax based on following formula :

$$\text{Refund amount} = \frac{\text{(Export turnover of goods + Export turnover of services)}}{\text{Total turnover}} \times \text{Net CENVAT credit}$$

The expressions used in the formula are defined in the said Rule itself. Further, the Government has issued Notification No. 27/2012-CE (NT), dated 18.06.2012, which provides the safeguards, conditions and limitations relating to refund of CENVAT under the said Rule.

The exporter of service should file not more than one claim per quarter under the said Rule, wherein, the first quarter begins with 1st of April of every year. The amount that is claimed as refund under the said Rule should be debited by the exporter of service, from its CENVAT credit account at the time of making the claim. In case, the amount sanctioned is less than amount claimed, the difference should be credited back to the CENVAT account of the exporter of service.

The refund claim should be filed in Form A alongwith documentary evidence of export of service. Further, a Certificate in Form A-I, from the Auditor certifying the correctness of refund claimed in respect of export of services should also be enclosed. On verification of the refund claim, the jurisdictional AC/DC would grant the refund. However, it is pertinent to note that refund claimed should not be more than the amount lying in balance at the end of quarter for which refund claim is being made or at the time of filing of the refund claim, whichever is less.

Conclusion

Taxation of export of services depends on the location where a service has been provided. Unfortunately, despite such exports being crucial to Indian economy, taxation of export of services was always a grey area. The introduction of PPR 2012 shall not only help in determining the exact location where a service has been rendered but also help to test other conditions relevant for taxation of export of services.

The introduction of new rules governing export of services and the associated benefits are a welcome step as they are expected to bring more certainty and clarity, which are essentials of an optimum taxation system. These changes would help in reducing disputes with the Department regarding export of service. Prior to these changes, there was inordinate delay in processing of CENVAT refund claims, which is also admitted by the Department*, as the old Rule required co-relation of various inputs and input services with the goods exported or services exported.

The new Rule would ensure fast and hassle-free processing of refund of duties. With more certainty on taxation and easier procedures for claiming associated benefits, one may expect an increase in exports. An increase in export of services brings related benefits which include increase in foreign currency earning, generation of employment opportunities, and stimulation of growth of ancillary industries.

[1] 2010 (19) S.T.R. 337 (Tri. - Ahmd.) *Circular No. 120/01/2010-ST F.No.354/268/2009-TRU