

Composition Scheme and Abatement in Service Tax

Introduction

Abatement and composition scheme is often used interchangeably; however there is noticeable difference between the two. Abatement gives an option to the assessee to pay taxes on the net amount after deducting the abatement percentage (i.e. part of tax is exempted), whereas, an optional composition scheme is provided in a situation where it is not easy to find the value of service; e.g. sale or purchase of foreign exchange, air travel agent.

Generally it is assumed that if abatement is availed then the service provider cannot claim Cenvat credit, but this is not always correct. Thus one has to check all the conditions placed against the abatement rules.

Cenvat credit may be divided in three categories:

- Cenavt credit on capital goods
- Cenvat credit on Input Goods
- Cenvat credit on Input services.

Taxable Services eligible for abatement

With effect from 01.07.2012, amended with notification No. 02/2013, the following taxable services are eligible for abatement from the gross amount in the following manner:-

1. Financial leasing services- 10% taxable

Financial leasing includes hire charges but excludes operating lease. The value of taxable service would be 10% i.e. abatement of 90% has been granted unconditionally. Taxability is defined as follows:

- Interest chargeable to the extent of 10%
- Principal amount not subject to tax
- Fees based income such as lease management fees, processing fees, documentation charges and administrative fees would be fully taxable.

Distinction between financial lease and operating lease

Financial lease: A financial lease is usually a long term agreement covering the entire economic life of assets. Whole investment is recovered by lesser plus his profit. Assets are usually maintained by lessee. It is not cancellable contract the lease becomes the owner practically but not legally.

Operating lease: An operating lease is for short term. Assets may be given to more than one party on lease during the economic life of the asset. Hence cost of the assets is not recovered in one contract of lease. Usually, lesser upkeep maintains the asset. For example, a computer or furniture given on rent.



- Transport of goods by rail 30% taxable
- Abatement of 70% has been granted unconditionally.
- Transport of passenger by rail 30% taxable
- Abatement of 70% has been granted unconditionally.
- Transport of passenger by Air 40% taxable
- Abatement of 60%, this is subject to the condition that CENVAT credit on input and capital goods, used for providing the taxable services has not been.

2. Goods transport agency - 25% taxable

Abatement of 75%. This is subject to the condition that input, input services and capital goods, used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules, 2004.

- Transport of goods by road, other than GTA and courier agency, has been fully exempt as included in section 66D [p] of the ACT pertaining to the negative list.
- Contents of the consignment note have been defined under the explanation to Rule 4B.

What is good transport agency?

S. 65B [26] provides that "Goods Transport Agency" means any person who provide services in relation to transport of goods by road and issue consignment note, by whatever named called 'Goods Transport Agency' was identically defined in erstwhile section 65[50b] of the Act.

3. Transport of goods in vessel from one port to another - 50% taxable

Abatement of 50%. This is subject to the condition that input, input services and capital goods, used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules ,2004

Transportation of goods from one port to another can be through either national waterway/ inland waterway or otherwise. As transportation of goods through inland waterways [which includes national waterway] has been included in the negative list, there will be no service tax on it.

4. Tour operator services

Notification no. 26/ 2012 defines Tour operator means any person engaged in the business of planning, scheduling, organizing, arranging tours (which may include arrangement of accommodation, sightseeing or other similar services) by any mode of transport, and includes any person engaged in the business of operating tours.

- For Package tour Abatement is 75% (tax payable on 25% of gross amt charged)
- Booking accommodation Abatement is 90% (tax payable on 10% of gross amt charged)
- Service other than mentioned above 60% (tax payable on 40% of gross amount charged)

This is subject to the condition that input, input services and capital goods, used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules ,2004



5. Service provided in relation to chit -70% taxable

Abatement of 30%. Chit means transaction whether called chit, chit fund, chitty, kuri or by whatever name by or under which a person enters into an agreement with a specified number of people that every one of them shall build a certain sum of money by way of periodical installments over a definite period and that each subscriber shall, in his turn, as determined by lot or by auction or by tender or in such other manner as may be specified in the chit fund agreement, be entitled to prize amount.

6. Renting of any motor vehicle designed to carry passengers – 40% taxable

Abatement of 60%. This is subject to the condition that input, input services and capital goods, used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules ,2004.

- Rent means the act of letting out or allowing the use of something for consideration. The expression 'rent a car' is defined in the dictionary as a car rented for day, week or other contracted time, for fixed sum or according to mileage.
- There is a distinction between providing 'rent a cab service' and giving vehicle on lease / hire. If vehicle is given on lease / hire without driver, effective control over the vehicle passes to the person taking vehicle on hire. This becomes 'transfer of right to use goods' and may be taxable under VAT, since it is deemed sale of goods. If the effective control is not handed over to customer, the service will come under service tax.

Liability to pay service tax

- With abatement Under the reverse charge mechanism, the service recipient is liable to pay 100% of the tax so arrived at.
- Without abatement The Service recipient will be liable to pay 40% of the service tax so arrived at and the remaining i.e., 60% is the liability of service provider.

7. Renting of hotels, inns etc.- 60% taxable

Abatement of 40% is available. Renting of hotels, inns, guest house, clubs, campsites or other commercial places meant for residential or lodging purpose will get the abatement of 40%. It should be noted that abatement is available only to the specified immovable properties. This is subject to the condition that input and capital goods, used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules 2004.

8. Supply of food or any other article at a specially arranged place – 70% taxable

Supply of food or any other article of human consumption or any drink, in the premises (including Hotel, convention centre, club, pandal, shamiana or any other place specially arranged for organizing function) together with renting of such premises will get the benefit of abatement.



- The abatement is subject to the condition that CENVAT credit on any goods classifiable under chapter 1 to 22 of the Central Excise Tariff Act 1985 has not been taken under the provision of the CENVAT Credit Rules, 2004.
- 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-
 - the amount charged for such goods or services supplied to the service provider, if any; and
 - the value added tax or sales tax, if any, levied thereon

Note: Consideration includes free supplies to service provider.

9. Construction services – 25% taxable

Abatement of 75%. Service provided with respect to

- Construction of complex, building, civil structure and part thereof, intended for sale, wholly or partially
- Except those where entire consideration is received after issuance of completion certificate by the competent authority.
- This is subject to the condition that input used for providing the taxable services has not been taken under the provision of CENVAT Credit Rules, 2004.
- Value of land is included in the amount charged from the service recipient

Furthermore ,for the purpose of valuation, the amount charged shall be the sum total of the amount charged for the service including the fair market value of all the goods and services supplied by the recipient in or in relation to the services , whether or not supplied under the same contract or any other contract , after deducting :

- The amount charged for such goods or services supplied to the service provider, if any:
 and
- The value added tax or sales tax, if any, levied thereon

It is proposed in the **Budget 2013**, that for homes and flats with a carpet area of 2,000 sq.ft. or more or having a value of `1 crore or more, (high-end constructions), where the component of services is greater, the rate of abatement is to be reduced from 75 to 70 percent – meaning that on these types of services, service tax needs to be paid on 30% of the total value.



Composition Scheme

1. <u>Valuation of service in Restaurant or by outdoor caterer – (Rule 2C of Service Tax</u> (Determination of Value) Rules:

With effect from 1.7.2012, as per the new rule 2C of the Valuation Rules:

Food or any other article of human consumption or any drink (whether or not intoxicating) supplied in any manner as part of the activity at a restaurant or as outdoor catering, then the taxable rate is as follows

- At a Restaurant 40%(taxable percentage of total amount excluding VAT)
- Outdoor catering 60%(taxable percentage of total amount excluding VAT)

Cenvat credit of input services and capital goods is available. Cenvat credit of excise duty on food items (covered under Chapters 1 to 22 of CETA) is not available. Cenvat credit of other inputs is available.

Over lapping and conflicting between Rule 2C and abatement scheme

Rule 2C applies if food is provided in restaurant or outdoors without any other services. However, if service is provided at any other place specially arranged for organizing a function, the abatement scheme of 70% shall apply.

2. <u>Air Travel Agent – (Rule 6(7) of Service tax</u> rules)

Air travel agents have an Option to pay service tax at a flat rate on the 'basic fare' at the rate of:

- 0.6% (plus education cess) in case of domestic booking and
- 1.2% (plus education cess) in case of international booking

There is no restriction on the availment of CENVAT credit.

3. Foreign Currency – sale and purchase – (Rule 6(7B) of Service Tax Rules)

Composition scheme for such transaction is available at slab rates prescribed under rule 6(7B) on the total gross amount of currency exchanged.

There is no restriction on the availment of CENVAT credit.

4. <u>Life Insurance – (Rule 6(7A) of Service Tax Rules)</u>

Service tax at the rate 3% of net premium (excluding investment or savings part, if such amount is informed to policy holder) – If not so informed, 3% in first year and 1.5% in subsequent years is charged. There is no restriction on the availment of Cenvat Credit.

5. Lottery ticket promotion - Rule 6(7C) of Service Tax Rules

Option to pay service tax at Rs. 7,000/- or Rs. 11,000/- per Rs. 10 lakhs of tickets printed by State lottery. Under this scheme there is no restriction on availment of Cenvat Credit.



6. Works Contract Service – (Rule 2A of Service Tax (Determination of Value) Rules)

- In case of original work, service tax has to be paid on 40% of the 'total amount',
- In case of maintenance, repair, reconditioning, restoration or servicing of any goods, service tax has to be paid on 70% of the 'total amount',
- In case of all other works contract, service tax has to be paid on 60% of the 'total amount'.

The above services have been discussed in detail in the article "Works contract services".

In order to understand the complete valuation and liability towards service tax, the above write up has to be read with the articles 'Reverse Charge Mechanism,' 'Negative list' and 'Exemptions available under Service Tax,' all of them are inter linked and a number of the services mentioned in the abatement and composition scheme are also covered under reverse charge mechanism. Apart from this, a few exemptions can be availed on fulfillment of the conditions mentioned above.