No tax is deductible at source from service-tax included in a bill

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- By S.K.Tyagi

The Finance Act, 1994, provided for levy of service-tax in respect of '*Taxable services'*. Section 68 of the aforesaid Act lays down that the provider of taxable services shall be liable for payment of service tax, at the specified rate. The relevant provisions in this regard are section 68 of the Finance Act, 1994, as also Rule 6 of the Service-Tax Rules.

Of late, I have been approached by a number of clients with a query as to whether tax is required to be deducted at source from the service-tax included in a bill, in respect of the services rendered by the service provider. At the outset, it may be stated that service-tax cannot be considered as part of income of the service provider, just because the service-tax has been added in the bill raised for services rendered by the service provider. The service provider collects the service-tax on behalf of the Government and thereafter, pays the same to the Government. Therefore, no element of income is embedded in the service-tax being included in the bill, for the services rendered by the service provider.

At times, however, the Income-Tax officials have insisted that tax is required to be deducted at source, in respect of the service-tax which is included in the bill, for the services rendered by the service provider. In view of the aforesaid reasons, a serious controversy has arisen in regard to the issue as to whether tax is deductible at source, in respect of service-tax included in the bill, for the services rendered by the service provider.

Further controversy has been added in this regard, because the IT Department has expressed two views on the aforesaid issue.

In view of the aforesaid reasons, it would be necessary to deal with the aforesaid issue in a detailed manner, in order to set at rest the aforesaid controversy. For this purpose, the relevant provisions of the Income-Tax Act, 1961 (the Act), Finance Act, 1994 and legal precedents will have to be examined. The same are discussed as follows:

I. Two contrary views expressed by the IT Department on the issue.

The Central Board of Direct Taxes (CBDT) had, for the first time answered this query in the affirmative, vide letter FNO275 / 1 / 2006-IT(B), dated 21.7.2006, addressed to the Chief Commissioner of Income-Tax, Mumbai. The aforesaid letter reads as follows :

"*Chief Commissioner of Income-Tax,*

Aayakar Bhavan, M.K. Road

Mumbai-20.

Subject : Issue relating to inclusion of service-tax for the purposes of TDS under section 194C/194H/194J of the Income-Tax Act.

Madam,

I am directed to refer to your letter No.CCIT-4/MUM/Query-VSNL/2006-07, dated July 6, 2006, on the subject mentioned above and to say that tax deduction under section 194J would be required to be made on the sums payable by the deductors inclusive of any tax including service-tax.

Yours faithfully

(Sd.)…….

R.K.Sagar,

Under Secretary (Budget)"

What has been stated in the context of section 194J of the Act, would also apply to other sections such as sections 194C, 194H, 194-I, etc.

Thereafter, the CBDT issued Circular No.4 of 2008, dated 28.1.2008, by way of clarification on TDS on service-tax component on rental income, under section 194-I of the Act. For the sake of ready reference, the aforesaid Circular is reproduced as follows :

Clarification on deduction of tax at source (TDS) on service-tax component on rental income under section 194-I of the Income-Tax Act.

Representations / letters have been received in the Board seeking clarification as to whether TDS provisions under section 194-I of the Income-Tax Act will be applicable on the gross rental amount payable (inclusive of service tax) or net rental amount payable (exclusive of service tax).

2. *The matter has been examined by the Board. As per the provisions of 194-I, tax is deductible at source on income by way of rent paid to any resident. Further rent has been defined in 194-I as "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any, -*

(a) land; or

(b) building (including factory building); or

(c) land appurtenant to a building (including factory building); or

(d) machinery; or

(e) plant; or

(f) equipment; or

(g) furniture; or

(h) fittings,

whether or not any or all of the above are owned by the payee.

3. *Service-tax paid by the tenant doesn't partake the nature of "income" of the landlord. The landlord only acts as a collecting agency for Government for collection of service tax. Therefore, it has been decided that tax deduction at source (TDS) under sections 194-I of Income-Tax Act would be required to be made on the amount of rent paid / payable without including the service tax.*

4. *These instructions may be brought to the notice of all officers working in your region for strict compliance.*

5. *These instructions should also be brought to the notice of the officers responsible for conducting internal audit and adherence to these should be checked by the auditing parties.*

[F.No.275 / 73 / 2007-IT(B)]

As per the aforesaid letter, no tax is required to be deducted at source on service-tax component of rental income, under section 194-I of the Act. In this regard, special reference is invited to the contents of para (3) of the aforesaid Circular. From the language of para (3) of the aforesaid Circular, it is clear that service-tax does not partake the nature of income, as the person adding the service-tax in the bill for various services provided by him, will act only as a collecting agent for the Government, for collection of service-tax. In view of the aforesaid reasons, no tax is required to be deducted at source on the service-tax component included in the bill, for various services provided by a service provider. The aforesaid Circular will equally apply to other sections, viz. 194C, 194H, 194J, etc.

From the aforesaid letter and the Circular of the CBDT, it may be seen that it has expressed two contrary views on the aforesaid issue. Apparently, the aforesaid letter addressed by the CBDT to the Chief Commissioner of Income-Tax is based on incorrect appreciation of the relevant provisions of the Act and the legal precedents concerning TDS. This clearly proves that no tax need be deducted at source from service-tax included in the bill, for services rendered by the service provider, because the service-tax cannot partake the nature of income, by any stretch of imagination.

In order to reach the correct conclusion in this regard, it would be necessary to consider the other relevant provisions, as stated earlier.

II. Relevant provisions regarding service-tax under the Finance Act, 1994.

The Finance Act, 1994, under Chapter V introduced the concept of '*Service-tax'* [207 ITR (St.) 86]. A reading of various provisions of Chapter V of the Finance Act, 1994, indicates that the assessee is the collecting agent of the service-tax and it is the consumer who has to bear this liability. This legal position may be gauged from the various provisions of the aforesaid Chapter V, relating to the levy of service-tax. The same are discussed as follows :

1. Section 65 of Finance Act, 1994.

Section 65 of the Finance Act, 1994 provides definitions of various terms. Some of these definitions are examined as follows :

(i) *Section 65(2) of the Finance Act, 1994.*

Sub-section (2) of section 65 defines '*Assessee*' to mean a person responsible for collecting the service-tax, payable under the provisions of this Chapter and includes his agent.

(ii) *Section 65(7) of the Finance Act, 1994*.

As per sub-section (7) of section 65 of the Finance Act, 1994, '*Person responsible for collecting the service-tax'* means a person who is required to collect service-tax under this Chapter, or is required to pay any other sum of money under this Chapter and includes every person in respect of whom any proceedings under this Chapter have been taken.

(iii) *Section 65(16) of the Finance Act, 1994.*

Sub-section (16) of section 65 of the Finance Act, 1994 defines '*Taxable service'*. For the sake of ready reference, the aforesaid sub-section (16) is reproduced as follows :

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(16) "taxable service" means any service provided, -

(a) to an investor, by a stock-broker in connection with the sale or purchase of securities listed on a recognized stock exchange ;

(b) to a subscriber, by the telegraph authority, in relation to a telephone connection;

(c) to a policy-holder, by an insurer carrying on general insurance business, in relation to general insurance business;

From the aforesaid provisions of section 65(16), it is clear that '*Taxable service'* is related to the recipient of the service and not the provider of the service.

From the aforesaid provisions of section 65, it may seen that the recipient of the service or the consumer has to bear the service-tax liability, whereas the service provider acts only as a collecting agent of service-tax.

2. Section 66 – Charge of service-tax.

For the sake of ready reference, section 66 of the Finance Act, 1994, is reproduced as follows :

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66. Charge of service-tax.

On and from the commencement of this Chapter, there shall be charged a tax (hereinafter referred to as service-tax) at the rate of five per cent of the value of the taxable services provided to any person by the person responsible for collecting the service-tax.

From the aforesaid provisions also, it is quite clear that service-tax is chargeable on the taxable service provided to the recipient thereof and the provider of the service is only responsible for collecting the service-tax.

3. Section 68 – Collection and recovery of service-tax.

For the sake of ready reference, section 68 of the Finance Act, 1994, is reproduced as follows :

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68. Collection and recovery of service tax –

(1) Every stock-broker, the telegraph authority or the insurer who is providing taxable services to any person shall collect the service-tax at the rate specified in section 66.

(2) The service-tax collected during any calendar month in accordance with the provisions of sub-section (1) shall be paid to the credit of the Central Government by the 15th of the month immediately following the said calendar month.

(3) Any person, responsible for collecting the service-tax, who fails to collect the tax in accordance with the provisions of sub-section (1), shall, notwithstanding such failure, be liable to pay the tax to the credit of the Central Government in accordance with the provisions of sub-section (2).

In this connection, Rule 6 of Service-Tax Rules is also relevant. The aforesaid Rule 6 deals with '*Payment of service-tax'*. For our purpose, Rule 6(1) is relevant.

"***6. Payment of Service-Tax***

(1) The service-tax shall be paid to the credit of the Central Government by the 5th of the month immediately following the calendar month in which payments are received, towards the value of taxable services :

Provided *that where the assessee is an individual or proprietary firm or partnership firm, the service-tax shall be paid to the credit of the Central Government by the 5th of the month immediately following the quarter in which the payments are received, towards the value of taxable services :*

Provided further *that notwithstanding the time of receipt of payment towards the value of services, no service-tax shall be payable for the part or whole of the value of services, which is attributable services provided during the period when such services were not taxable :*

Provided also *that, the service-tax on the value of taxable services received during the month of March, or the quarter ending in March, as the case may be, shall be paid to the credit of the Central Government by the 31st day of March of the calendar year".*

Explanation – For the removal of doubt it is hereby clarified that in case the value of taxable service is received before providing the said service, service-tax shall be paid on the value of service attributable to the relevant month, or quarter, as the case may be.

From the aforesaid provisions of section 68, it is clear that service-tax has to be paid in the manner as prescribed in Rule 6 of Service Tax Rules. A plain reading of Rule 6 would show that the service provider becomes liable to make the payment of service-tax by the fifth of the month, immediately following the calendar month, **in which the payments are received towards the value of taxable service. Thus, the liability to make the payment arises, only if the service provider has received the payment.**

Therefore, if there is no liability to make payment to the credit of the Central Government, because of non receipt of payments from the receiver of the services, then it cannot be said that such service-tax has become payable.

From the aforesaid provisions of sections 65, 66 and 68 of the Finance Act, 1994, it is clearly established that the service-tax is payable by the recipient of the service and not by the provider of the service. As regards the provider of the service, he is required to act only as a collecting agent in respect the service-tax.

Besides, the provisions of Rule 6 of the Service-Tax Rules, according to which the liability to make payment of service-tax arises, only if the service provider has received the payment; also establish

that the service provider only acts as a collecting agent and the service-tax is to be borne by the recipient of service.

Therefore, the service-tax collected by the service provider by inclusion of the same in the bill raised on the recipient of service, is payable by the service provider to the Government of India. In view of the aforesaid reasons, the service-tax can never form part of the income of the service provider and it is for this reason that the service provider is not required to pass the entries in respect of service-tax through his profit and loss account.

III. Service-tax is absolutely different from sales-tax and excise duty, etc.

In this context, it may be understood that service-tax is basically different from sales-tax, excise duty, etc., because sales tax is payable by a dealer, as per Central Sales-Tax Act and various State Sales-Tax Acts, irrespective of the fact whether the payment is received by the dealer or not. The liability would arise as soon as the incident of sale is completed. Similarly, the liability to excise duty is attracted, the moment the goods are removed from the warehouse or godown. In contrast, service-tax becomes payable only when it is received from the client.

In the light of the aforesaid reasons, service-tax is never a part of income or turnover of an assessee.

IV. Tax is deductible at source, only in respect of income and not any tax.

The relevant provisions of the I.T. Act, 1961, will also prove that tax is deductible at source, only in respect of income. As regards service-tax payable to the Government, it cannot be regarded as '*Income*' and therefore, no tax can be deducted at source, in respect of service-tax.

In other words, service-tax which is added by a tax-payer in a bill for the services rendered, can, by no stretch of imagination, constitute income of the service provider and accordingly, it cannot be subjected to TDS. This view clearly emerges from the reading of the TDS provisions in the Act. Some of such provisions are discussed as follows :

(i) Section 4 – Charge of income-tax.

For the sake of ready reference, section 4 of the Act is reproduced as follows :

Charge of income-tax.

4. *(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :*

Provided *that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*

(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

From the aforesaid provisions of section 4(2), it is quite clear that income-tax is deductible in respect of income chargeable to tax, under section 4(1) of the Act.

(ii) Section 2(24) – Definition of 'Income'.

Section 2(24) of the Act, defines the term '*Income*' in an inclusive manner. It takes within its sweep (i) profits and gains, (ii) dividends (iii) perquisite or profit in lieu of salary, (iv) any sum chargeable to income-tax under sections 28, 41 and 59, and (v) any capital gains chargeable under section 45, etc.

From the aforesaid definition of the term '*Income*', it is abundantly clear that it cannot include any sum which partakes the nature of any tax, including service-tax. In this context, it must be clearly understood that there cannot be any element of profit / income involved in any tax including service-tax, because the same is payable to the Government, even if the payee includes it in the bills raised on the payer of income.

(iii) Section 190 – Deduction at source and advance payment.

For the sake of ready reference, section 190 is reproduced as follows :

Deduction at source and advance payment.

190. *(1) Notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year, the tax on such income shall be payable by deduction or collection at source or by advance payment or by payment under sub-section (1A) of section 192, as the case may be, in accordance with the provisions of this Chapter.*

(2) Nothing in this section shall prejudice the charge of tax on such income under the provisions of sub-section (1) of section 4.

From the aforesaid provisions of section 190, it is clear that tax is deductible at source, in respect of any income. Thus, the provisions of section 190 also makes it clear that tax is

deductible at source, only in respect of an amount which partakes the nature of income and not otherwise.

(iv) Section 191 – Direct payment of tax by the payee.

For the sake of ready reference, section 191 is reproduced as follows :

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191. Direct payment –

In the case of income in respect of which provision is not made under this chapter for deducting income-tax at the time of payment, and in any case where income-tax has not been deducted in accordance with the provisions of this chapter, income-tax shall be payable by the assessee direct.

Explanation – For the removal of doubts, it is hereby declared that if any person referred to in section 200 and in the cases referred to in section 194, the principal officer and the company of which he is the principal officer does not deduct the whole or any part of the tax and such tax has not been paid by the assessee direct, then, such person, the principal officer and the company shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default as referred to in sub-section (1) of section 201 in respect of such tax.

From the aforesaid provisions of section 191, it may be seen that in the case of income in respect of which provision is not made under the provisions of Chapter XVII of the Income-Tax Act, for deducting income-tax at the time of payment, and in any case where income-tax has not been deducted in accordance with the provisions of the said chapter, income-tax shall be payable by the assessee direct.

The Act has inserted an Explanation in the said section to clarify that if the principal officer or the company referred to in section 194 or the person referred to in section 200, does not deduct the whole or any part of the tax, he or it shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default as referred to in sub-section (1) of section 201, in respect of such tax unless such income-tax has been paid directly by the assessee himself.

In this context, it may be understood that in case the tax deductible at source is not so deducted, the same shall be payable by the assessee / payee direct. Obviously, the assessee will not include any tax including service-tax as part of his income and if such a tax is included in the bills raised by him, the same will be required to be deducted therefrom, in order to arrive at the income assessable in his hands.

If this is the position, in case the assessee has to pay his tax directly, then as a logical corollary, the tax-deductor will also be required to deduct tax at source on the income, as computed in the aforesaid manner, viz. the income after deducting or excluding any tax including service-tax from the sums payable by him to the payee.

From the aforesaid discussion, it may be safely concluded that no tax is required to be deducted at source in respect of any tax including service-tax, which is added in the bills raised by the assessee / payee on the payer thereof.

V. Legal precedents in support of the view that tax is to be deducted only from income.

There are a number of legal precedents, which support the view that tax is deductible at source, only in respect of the portion of the amount payable, which represents income or profit chargeable to tax under the Act. Some of these legal precedents are as follows :

(i) CIT Vs. Superintending Engineer, Upper Sileru [1985] 46 CTR (AP) 238 : [1985] 152 ITR 753 (AP)

It was held in this case that as per the scheme of TDS, tax is to be deducted at source only on the portion of the amount payable, which represents income or profit.

The relevant observations are as follows :

Having reframed the question as above, we answer the same to the following effect :

(1) The respondent assessee, who made the payments to the three non-residents above-referred, was under an obligation to deduct tax at source, under section 195 of the Act, in respect of the sums paid to them under the contracts entered into.

(2) The obligation of the respondent assessee to deduct tax under section 195 is limited only to the appropriate proportion of the income chargeable under the Act, forming part of the gross sums of money paid to the three non-residents above-referred.

(3) While the Income-Tax Officer was correct in the determination of tax under section 195, in respect of the payments made to M/s. Sacheron Works Ltd., in RC No.204, he was in error in determining the tax deductible under section 195, in respect of the gross sums of money paid to M/s. Charmilles Engineering Works Ltd., in RC No.203 and M/s. Oerlikon Engineering Company in RC No.205.

From the aforesaid judgement, it is clear that tax is to be deducted at source, only in respect of the appropriate portion of income chargeable under the Act, forming part of the gross sums of money paid to the tax-deductee or the payee. In the present case, it is absolutely clear that the service-tax charged in the bill for services, is to be paid by the service provider to the Government and such service-tax can never become a part of income of the tax-deductee or the payee / assessee. Therefore, in the light of the aforesaid judgement, no tax is deductible at

source, in respect of service-tax included in the bill, for services rendered by the service provider.

(ii) *Transmission Corporation of A.P. Ltd. Vs. CIT [1999] 155 CTR (SC) 489 : [1999] 239 ITR 587 (SC).*

In this case, the Supreme Court has affirmed the aforesaid judgement of the Andhra Pradesh High Court by observing that : In this view of the matter, the answers given by the High Court that (i) the assessee who made the payments to the three non-residents was under obligation to deduct tax at source under section 195 of the Act in respect of the sums paid to them under the contracts entered into; and (ii) the obligation of the respondent assessee to deduct tax under section 195 is limited only to the appropriate proportion of income chargeable under the Act, are correct.

From the aforesaid judgement of the Apex Court also, it is clear that the obligation of the tax-deductor is limited, only to the appropriate proportion of income chargeable under the Act. As already pointed out, the service-tax can never form part of the income of the tax-deductee or payee. Therefore, no tax is deductible at source in respect of the same.

(iii) *Hyderabad Industries Ltd. Vs. ITO [1991] 95 CTR (Kar) 164 : [1991] 188 ITR 749 (Kar)*

It was held in this case that amounts exempt under section 10 of the Act, do not constitute income for the purpose of section 195 and therefore, no tax is deductible at source in respect of such amount. The relevant observations are as follows :

"The construction sought to be placed by the respondents is based on a distinction which has no substance in it. It is not understandable as to why a benefit which will not be included in the total income of a person, should be considered as "*income*" for the purpose of deduction of tax at source at all. The purpose of deduction of tax at source is not to collect a sum which is not tax levied under the Act. The interpretation put on those provisions by the respondents would result in collection of certain amounts by the State which is not a tax qualitatively. Such an interpretation of the taxing statute is impermissible".

From the aforesaid observations, it is clear that a benefit or amount which will not be included in the total income of a person, should not be considered as "*income*" for the purposes of deduction of tax at source, at all. Obviously service-tax will not be included in the total income of the payee or the service provider. Therefore, as per the aforesaid judgement of the High court, no tax is deductible at source, in respect of the service-tax.

(iv) *ITO Vs. Dr.Willmar Schwabe India (P) Ltd. [2005] 95 TTJ (Del.) 53.*

It was, *inter alia*, held in this case that tax was not deductible at source, in respect of reimbursement of conveyance expenses to the consultant, under section 194J of the Act, where bill for such expenses has been separately raised.

The factum of a separate bill having been raised in respect of the conveyance expenses, is not, at all, relevant. Such expenditure or tax included in the bill for the services, obviously has no element of income embedded therein and therefore, no tax is deductible at source in respect thereof, irrespective of the fact whether a separate bill is raised in respect thereof or not.

From the aforesaid legal precedents, it s quite clear that if there is no element of profit or income involved in the amount included in the bill, no tax is deductible at source in respect thereof. As regards service-tax, it can never form part of the income of the payee and therefore, applying the aforesaid principle, no tax is deductible at source in respect of the same.

VI. Conclusion

In the light of the discussion in the preceding paragraphs, it is quite clear that :

(i) Service-tax is never a part of income or profit of the service provider.

(ii) The service provider acts only as a collecting agent, in respect of the service-tax.

(iii) The service-tax is payable by the consumer or recipient of the service.

(iv) As service-tax is not part of income or profit of the service provider, no tax is deductible at source therefrom, even if the same is included in the bill raised by the service provider on the recipient of service, in respect of the taxable service.

In the light of the aforesaid reasons, it is clearly established that no tax is deductible at source, from the service-tax included in the bill for the taxable services, raised by the service provider on the recipient of service.

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