Service tax under reverse charge – Branch Payments

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"Service" has been defined as an activity between two persons. In normal course the principle of "mutuality" is applied and there can be no tax when one deals with oneself. However an exception has been created in the Service tax law for dealing with a branch outside India.

The Place of Provision of Services Rules 2012 has deemed certain locations as the place of provision. This depends on the nature of activity. Where the place is outside India, no service tax is payable.

The transactions between the foreign branch and the HO therefore in certain casesbe liable to service tax on reverse charge.

In case of multinational companies, transactions between various branches across the world are quite common. There are numerous tax laws which are to be complied with in case of such transactions such as income tax, service tax etc. In this article an effort has been made to analyse the service tax implication on transactions between the HO &foreign branch under reverse charge mechanism.

What is reverse charge?

Under the service tax law, every person providing a taxable service is required to pay service tax at prescribed rate. However, in certain cases the service recipient is made liable to pay service tax on the services received. Since the person receiving services is made liable to pay service tax, the mechanism of collection of such tax is called as reverse charge mechanism (RCM). This concept is set out in service tax law by virtue of Section 68(2) by empowering the Central Government to notify services on which the said RCM would apply. To support this, the person liable to pay service tax as defined in Rule 2(1)(d) of the Service Tax Rules, 1994 also includes service recipients. Please note that such concept was in place even before introduction of the new scheme of negative based taxation from 01.07.2012.

As per Section 68(2) read with Notification no.30/2012-20.03.2012, in respect of any taxable services provided or agreed to be provided by any person who is located in a non taxable territory and received by any person located in the taxable

territory, the person who is receiving service shall be liable to discharge the service tax. Section 66A, which existed prior to 01.07.2012, in addition to the then main charging Section 66, under the old law gave the statutory backing for levy of service tax on import of services.

Liability of service tax on branch payments

As per explanation to clause (44) of section 65B, an establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons. Similar provision existed in erstwhile Section 66A (2)]. In subsequent paragraphs, we have analysed different types of scenarios in case of branch payments and the service tax impact.

Concept of mutuality and its implication in branch payments

As per Section 65B (44), "service" means any activity carried out by a person for another for consideration, and includes a declared service. One cannot make profit or provide service to oneself. The principle of mutuality is based on the theory that a person cannot make profit out of himself. Applying this ratio, it could be understood that the transactions between office in India and branch outside India are mutual and there is no distinct person. However, due to the deeming provision as discussed earlier, braches outside India needs to be considered as distinct persons under service tax law until judicially decided as not liable

Fund transfers from Head office to Branches

On many occasions it may so happen that head office in India would be taking care of day to day working capital needs of the branch outside India. Such working capital could be utilised by branch towards payment of salaries, rent, marketing etc. The service tax department has been demanding service tax on such reimbursements.

Based on the deeming fiction that branches are distinct persons, department has been demanding service tax from assessee.In the MumbaiTribunal décision in case of *KPIT Technologies Vs. CCE [2014 (36) STR 1098]* itwasheldthatexpenditure which hasbeen reimbursed by the head office to its branch office by way of salaries or other expensescannot be said to be consideration paid for any service rendered by branch to head office. It was also held that Section 66A is for taxing theimport of services and not for taxing monetary transactions betweenbranch and head office.

Such transactions are beyond the taxing jurisdiction ofthe Indian authorities. This ratio could be applied even now and it could be argued that funds transferred from Indian office to branch office to meet regular expenses are not taxable even under the new law.

One more alternative argument could be that actual reimbursements are not liable for service tax as held in *Intercontinental Consultants & Technocrats Pvt Ltd. Vs. UOI 2013 (29) STR 9 (Del.)*. In this case, the High court has held that expenditures incurred in course of providing taxable services cannot be a consideration liable for service tax. Rule 5(1) of Service Tax (Determination of Value) Rules 2006 which provides for taxation of reimbursement was held ultra vires by the High court. However, to overcome the impact of this decision, Section 67 of the Finance Act 1994 has been amended from 14th May 2015 to provide that the definition of consideration includes any reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service.

Services procured and consumed outside India

There may be a scenario wherein the services are procured and consumed by the branches outside India but payments for the same are made by office in India. Even on these types of payment, service tax is being demanded by department. Service tax on such payments need not be discharged where one could take following contentions:

a) As per the deeming provision, establishment of a person located in taxable territory and another establishment of such person located in non-taxable territory are treated as establishments of distinct persons. Therefore, it could be argued that the service tax received by branch is nowhere related to office in India and the provisions of RCM not applicable.
b) Another argument which could be taken in this regard is that the services would not actually be received by office in India. Instead services are received by branch outside India for which only funding would be done by office in India.

Taking similar contentions, the tribunal in case of *Infosys BPO Ltd Vs. CST [2014-TIOL-1847-CESTAT-BANG]* has held that if the services are provided outside India and also received & utilised outside India, unless it could be established that the services are received in India, service tax would not be payable. The tribunal also

held that the treatment of branch as separate establishment for levy of service tax and treating the same as part of office in India for levy of service tax on services received outside India is not correct.

Service tax liability on sharing of expenses among branches

There may be a situation where a branch charges office in India towards a sum representing the latter's share of expenses. It could be argued that pure cost allocation without there being a service, would not be liable in the hands of the Indian office. However, when there is a service which is also received in India, then it would be ideal to discharge the service tax. Otherwise the usage in India being reimbursed would need to be established.

Services provided by branches to office in India

The branches situated outside India are treated as separate establishments.Services which are provided by such branch to office in India could be liable for service tax. However, one should refer the Place of Provision of Service Rules 2012 to determine the place of provision of service. The liability would arise only when place of provision of service is in taxable territory (whole of India except state of Jammu and Kashmir) and also recipient of service is in taxable territory. If these conditions are not satisfied, the liability of service tax under RCM does not arise.

In situations where liable, the assessee shall ascertain the category of service for payment of service tax after claiming eligible deductions, abatements if any.

Conclusion:

Service tax is still evolving and the introduction of negative list based taxation also has not addressed many practical issues, the branch payments are not free from dispute. There are different views among professionals and even among departmental officers. A prudent assessee should not hesitate to express his views and intimate the department about the view and reasons thereof when he chooses not to pay the ST on RCM. Here he needs to seek the confirmation of his understanding from the revenue. Assessee should also consider the option of discharging the service tax in cases where liability is not clear to be on the safer side. This option would be feasible especially when assessee could avail the Cenvat credit of service tax paid on branch payments. If no credit is available then he may pay under protest again under intimation to revenue.