No Service Tax on Tax Deducted at Source - An Interesting Proposition

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The issues involving interplay of direct and indirect tax laws are often complex, as one is a tax on income while the other is a transaction tax. For resolving such issues, the concept of one law cannot simply be borrowed and applied to the other, yet the respective authorities interpret their respective law to maximize the tax revenues. Resultantly, the assessee is left in quandary for adopting an appropriate tax position.

One such issue is levy of service tax on the amount deposited as Tax Deducted at Source ('TDS') by the service recipient on remittances to overseas service providers where the service recipient is required to deposit service tax on reverse charge basis.

In order to comprehend this issue, at the outset, it is pertinent to refer to the relevant provisions of the Income-Tax Act, 1961 ('IT Act') and the Finance Act, 1994 ('Finance Act').

IT Act

- IT Act levies tax on the total income of every person. For non-residents, the total income includes all income from whatever source derived which is (i) received or is deemed to be received in India; or (ii) accrues or arises or is deemed to accrue or arise to him in India.

- As per Section 195 of IT Act, the service recipient is liable to deduct and deposit TDS on payment made to non-resident.

- In a situation where the contract between resident and non-resident provides for payment 'net of tax', Section 195A deems that the income of non-resident shall be grossed-up (increased by the amount of deduction for the purpose of determining TDS amount). For instance:

Invoice Value	*$ 100*
TDS Rate	*20%*
Total income, if amount is to be paid net of tax	*$ 125*
TDS	***$ 25***

Finance Act

- Section 67 of the Finance Act provides the manner of determining value of service chargeable to service tax. In case where the consideration for provision of service is solely in monetary terms, the value of the service is the gross amount charged.

- The term 'gross amount charged' has been defined in the Explanation to Section 67 to include payment made by cheque, credit card, deduction from account etc. Thus, the value of service is the amount paid by the service recipient to the service provider as the definition of 'gross amount charged' incorporates the principle of actual consideration.

Pertinent to note that, in contrast with the IT Act, the Finance Act does not contain a deeming provision for enhancing the 'gross amount charged' by TDS amount. Accordingly, in cases of 'net of tax' payments, the 'gross amount charged' under the Finance Act is the amount paid by the service recipient and the same cannot be enhanced by the TDS amount for determination of value of service. Thus, the value of service shall be **$ 100** in the above example i.e., the amount charged by the service provider on its invoice / bill.

This rationale holds true for one more reason. TDS amount is actually not a consideration flowing from resident to non-resident and it is effectively a discharge of liability of the resident. Thus, it should not be construed towards the consideration for a service. Therefore, on the issue of TDS deposited by service recipient, the principles of IT Act differ with the Finance Act. While IT Act recognises TDS as income of service provider, it is not included in the value of service under the Finance Act.

Recently, Mumbai CESTAT had an occasion to deal with this issue in the case of ***Magarpatta Township Development & Construction Company Limited*** **[TS-90-CESTAT-2016-ST].** In this case, the assessee received architect services from an overseas service provider. The assessee paid consideration for the service "net of tax" and the assessee deposited TDS liability from its own pocket. The assessee paid service tax under reverse charge mechanism on the amount paid to the service provider excluding TDS amount. The revenue contended that service tax is also payable on the TDS amount. Tribunal analysed the provisions of Section 67 of the Finance Act read with *erstwhile* Rule 7 of the

Service Tax (Determination of Value) Rules, 2006 and held that service tax is payable on the actual consideration charged for the service or in other words, the amount charged on the invoice / bill of the service provider. Since the invoice of foreign architect indicates the actual consideration, it was held that the assessee has rightly not discharged service tax on TDS amount.

For the above stated reasons, Mumbai CESTAT has rightly interpreted the provisions of Finance Act. At the same time, the Tribunal has reignited the issue that was earlier settled in favour of the Revenue by Chennai CESTAT in the case of ***TVS Motor Company Limited***. In this case, the Tribunal fastened service tax liability on TDS deposited by the service recipient.

In this context, it is also useful to note the ruling of Larger Bench of Tribunal in the case of ***Bhayana Builders (P) Limited***. Though this judgment was rendered in a different context but the ratio of the same is important. It was held that the consideration for a service is the value received by the service provider from the service recipient.

It would be interesting to see how the higher Courts interpret the provisions of IT Act and Finance Act in a holistic manner and develop a harmony between the two on this issue. Also, it is important to note that Supreme Court in the case of ***Moriroku UT India (P) Ltd.*** held that the deeming fictions and notional additions of one legislation cannot be borrowed in the other legislation.

One thing is for certain that the litigation on this issue has just begun as the revenue in all probabilities will contest this ruling. As always, the assesses will be in the midst of another tax controversy.