

**AN OVERVIEW OF SERVICE TAX ORIGINATION IN DIFFERENT COUNTRIES  
WITH REFERENCE TO INDIA**

**Dr Vitthal Kumar Saraff**

Guest Faculty, Department of Commerce, Magadh University, Patna.

**Introduction**

The word 'tax' is derived from the Latin word *taxo*, which means "I estimate". A tax is a charge, usually monetary, imposed by the government on persons, entities, transactions or property to yield public revenue.<sup>1</sup> However, the Supreme Court of India has observed that tax is a compulsory extraction of money by a public authority for public purposes, the payment of which is enforced by law.<sup>2</sup> Tax is a payment, which, without the force of law, cannot be collected by the Government; and even if it is collected by the Government, it has to be refunded.<sup>3</sup> Tax is the result of charging provision in the statutes, which creates a charge. If there is no provision in the tax statute, no tax can be imposed.

**Services Sector in India**

In India, there was a marked acceleration in the growth of services sector in the eighties and nineties. Since liberalisation in the early 1990s, the growth process in India has been marked by a remarkable performance by the services sector (including construction) by contributing 67.3 per cent of the GDP as per advance estimate for the year 2013-14, 34 which is highest among all sectors in the Indian economy.

**Service Tax in Other Countries**

**New Zealand**

GST was introduced in New Zealand (NZ) in 1986<sup>39</sup> with its most comprehensive base and a single rate. It turned out to be a landmark in the evolution of VAT by bringing up what could be regarded as an ideal to emulate and a benchmark to use for evaluating the VAT systems in operation. What enabled the proponents of GST in NZ to go forward were its key features, viz.: (i) simplicity with a single rate of 10 per cent and no exemption, (ii) revenue neutrality (no additional revenue was budgeted in the year of its introduction), (iii) a wider reform programme comprising income tax cuts, (iv) abolition of the antiquated wholesale sales tax and increase in welfare payments to offset the impact of GST on pensioners and low income groups, and (v) wide consultation.

**Canada**

The Federal government in Canada has, in theory, unlimited powers of taxation.<sup>40</sup> But in practice, both Federal and Provincial governments have concurrent jurisdiction to collect tax on goods and services. In Canada, service tax is a multi-staged value added tax. The Federal rate for most of goods and services is 7%. However, Provinces may have different rates of service tax. For example, Quebec levies 7.5% as Provincial Service Tax, whereas the service tax rate of other provinces, like Prince Edward Island, British Columbia, Saskatchewan, Manitoba are 10%, 7.5%, 6% and 7 % respectively.<sup>41</sup> In contrast, in India, the Constitution assigns tax bases clearly either to the Union or to the State.

### **Australia**

In Australia, the Central Government has the power to levy all taxes and the States have concurrent powers, except in the case of customs and excise duty. However, the Inter-Governmental Agreement (IGA) Implementation (GST) Act 2000, 42 provided for new national tax system. This Agreement led to the implementation of GST, which is at present, levied at 10%. According to the Agreement, the Commonwealth collects tax on behalf of State governments and fully returns to them. The GST revenue sharing arrangements do not have Constitutional force, as they are based on IGA.

### **Hong Kong**

In Hong Kong, it was proposed that Goods and Services Tax (GST) would be levied as a value-added tax. It was further proposed that GST would have a temporary, modest impact on household living costs. For example, with a 5% GST, the one-off, short-term price increase is estimated to be approximately 3%. 43 It was suggested by Henry Tang, the then Financial Secretary, the Government of Hong Kong Special Administrative Region, that for many years its economy was overly reliant on a limited number of widely-fluctuating, cyclical sources of revenue and therefore, reforming tax system was essential. A period of around nine months was provided to discuss a broad range of options for all members of the Government to consider that Goods and Services Tax was a viable option for Hong Kong. It was also suggested that this would secure the long-term sustainability of their revenue base and their capacity to meet public expenditure needs.

However, after a fierce and hot debate amongst local taxpayers, lawmakers, journalists, politicians and lack of public support, the need for the levy of such tax was dropped in 2006.

### **Singapore**

Goods and Service Tax was introduced in Singapore on 1st April, 1994. In Singapore, GST is a broad-based consumption tax levied on the import of goods (collected by Singapore Customs), as well as nearly all supplies of goods and services in Singapore. The only exemptions are for the sale and lease of residential properties, the importation and local supply of investment precious metals and the provision of most financial services. Export of goods and international services are zero-rated. In some countries, GST is known as the Value Added Tax (VAT). 45 The rate of GST was increased from initial 3% to 7% with effect from 1 July, 2007. Currently, GST is charged at 7% on all local sales of goods and services unless the sale can be zero-rated or exempted under the GST law. In Singapore, exemption from registration has been granted on the basis of annual turnover of an assessee, i.e., if taxable supplies do not reach the prescribed threshold. Nevertheless, businesses can apply to be registered voluntarily.

## Service Tax in India

The levy of Service Tax was recommended in early 1990 by the Tax Reforms Committee headed by Professor Dr. Raja J. Chelliah. In its interim report submitted to the Government in December 1991, the Committee recommended introduction of a tax on services. This recommendation was in keeping with the overall philosophy of the report that the tax system should be broad based, simple and have moderate rates. In their view, the indirect tax system must cover as many transactions as possible and be neutral in relation to production and consumption. They, therefore, recommended that indirect taxes should move towards a Value Added Tax covering both services and commodities. 46 Dr. Raja J. Chelliah opined that introduction of value added tax would eliminate cascading and cost escalation effect of indirect taxation. However, this objective would not be achieved unless services were also brought within the ambit of tax and taxes on services and goods were integrated to form one general value added tax<sup>47</sup>. This integration of taxes will lead to widening of tax base and generation of more revenue for the government, which will further result into reduction of rates of taxes. The service tax was introduced in India on the basis of recommendations in the interim report of the Tax Reforms Committee, which inter alia reads as follows: "We have throughout the report emphasized the need for broadening the base of the tax system, which would make possible a lowering of rates. In respect of indirect taxes, such broadening has to take the form of covering (a) almost all commodities other than raw produce of agriculture, (b) many, if not most services and (c) all stages of production or transactions. This is accomplished under the ideal system of VAT. In our present context, the major steps to be taken are to extend the coverage of commodities under excise, on which we have already made recommendations and to make a beginning with the taxation of services".<sup>48</sup> In the report, it was stressed that from the economic point of view, there is little difference between the taxation of commodities and that of services. In both cases, the principle of value added tax can be applied to tax the final users. As an economy develops, the services sector expands relatively to the commodities sector. Multifarious services are produced for the benefit of the consumers as well as producers. Exclusion of services from indirect taxation tends to create distortions just as the exclusion of major commodity groups. It was also pointed that the substantial broadening of the base through the taxation of services would enable the lowering of rates of commodity taxation. It was suggested in the report that a general value added tax levied even at 10 per cent, covering imports and domestically produced commodities and services plus a selective excise at a limited number of higher rates on a few commodities should be able to fetch sufficient revenues.<sup>49</sup> In the report, it was suggested that to have a unified and rational system of taxation of services applicable to the whole country, services tax must be part of a value added tax in course of time and should be levied at the central level. In the report, it was stressed that the cascading type of service tax should be avoided at all costs and it was envisaged that as the Union excise on commodities gets gradually transformed into a value added tax at the manufacturing level, the Service Tax will get woven into that system and therefore tax could be levied also on services that enter into the productive processes.<sup>50</sup> In the end of the report, the manner in which the Modvat system should be gradually converted into the comprehensive value added tax at the manufacturing stage was indicated. It was suggested that once this is done, it would be possible to introduce a fairly comprehensive system of taxation of services also on the basis of the value added principle so that the entire system of indirect taxation at the Central level would be devoid of cascading and would cause no distortion in costs or in the allocation of resources.<sup>51</sup> It was also suggested that for the time being only a few selected services should be subjected to service tax; and the services to be selected for the purpose must be those, which do not enter into productive processes in any substantial way.

These included the following services: a. Advertising services; b. Services of stock brokers; c. Service of automobile insurance d. Service of insurance of residential property, personal effects and jewellery; and e. Residential telephone services.<sup>52</sup> It was proposed that in all the cases above except for telephone services, the tax will be levied at 10 per cent of the value of the transaction. i.e., the value of the turnover in the case of advertising and brokerage services and the value of the insurance policy in the case of insurance services. The same basis could be applied also to the taxation of the residential telephone services. However, in order to limit the incidence and because of the difficulty of separating out business and nonbusiness telephone calls made from residences, it was recommended that annual telephone service tax, on every residential telephone connection, of Rs 1,000 be levied on those in whose names telephones are installed in residential premises. It was further, suggested that for purposes of this tax, connections in places other than the non-residential premises of public limited companies, non profit organisations and government offices will be treated as residential telephones.<sup>53</sup> Further, it was proposed that the telephone department should be asked to collect the tax along with the telephone charges in bound equal instalments. However, in case of senior employees with one or more telephone connections in their residences, meant to be used for official purposes, also generally used for calls on personal account often without any restriction as to the number of calls, such telephone connections should also be made subject to the telephone service tax. However, in their case, the tax can be collected only from the employers because the telephone connections would be in their names. However, in case such connections are in the name of the employer-the Government, public-sector company, private sector company or non-profit organisation, as the case maybe - the tax should be collected from the employer. <sup>54</sup> On the recommendations of the Committee, Dr. Manmohan Singh, the then Union Finance Minister, in his Budget speech for the year 1994-95, introduced the new concept of service tax by observing, "There is no sound reason for exempting services from taxation; therefore, I propose to make a modest effort in this direction by imposing a tax on services of telephones, non-life insurance and stock brokers."<sup>55</sup>

### **Conclusion:**

On the inception of service tax in the year 1994, it was initially made a part of Central Excise, with the responsibility of collecting and administering the tax entrusted to the Central Board of Excise and Customs (CBEC). The scope of service tax has been enlarged to a great extent on an annual basis, by adding new services to the service tax net almost every year. Considering the significantly increased workload due to the expanding coverage of service tax, it was decided to centralise all the work and entrust the same to a separate unit supervised by a very senior officer. Accordingly, the office of Director General (Service Tax), headed by the Director General (Service Tax) was formed in 1997.

**References:**

Ian Dickson and David White, Tax Design Insights From The New Zealand Goods And Services Tax (GST) Model, Working Paper Series Working Paper No. 60 Page 5 April 2008, available at : <http://www.victoria.ac.nz/sacl/cagtr/working-papers/WP60.pdf>, (accessed on May 20, 2013).

C.Rangarajan and D.K. Srivastava, Fiscal Transfers in Canada: Drawing Comparisons and Lessons, page 10, available at: [http://www.nipfp.org.in/newweb/sites/default/files/wp04\\_nipfp\\_018.pdf](http://www.nipfp.org.in/newweb/sites/default/files/wp04_nipfp_018.pdf), (accessed on May 20, 2013).

Inter-Governmental Agreement Implementation (GST) Act 2000, available at: [http://www.austlii.edu.au/cgibin/download.cgi/au/legis/nsw/consol\\_act/iaia2000490](http://www.austlii.edu.au/cgibin/download.cgi/au/legis/nsw/consol_act/iaia2000490), (accessed on May 20, 2012).

Executive Summary, available at: [http://www.taxreform.gov.hk/eng/pdf/Executive\\_Summary.pdf](http://www.taxreform.gov.hk/eng/pdf/Executive_Summary.pdf), (accessed on May 21, 2014).

A Letter from the Financial Secretary, available at: [http://www.taxreform.gov.hk/eng/pdf/FS\\_letter.pdf](http://www.taxreform.gov.hk/eng/pdf/FS_letter.pdf), (accessed on May 21, 2014).

Inland Revenue Authority of Singapore, For GST- Registered Businesses “How does GST work”, available at: <http://www.iras.gov.sg/irasHome/page04.aspx?id=1780>, (accessed on May 26, 2014).

Raja Jesudoss Chelliah Tax Reform Committee Interim Report, Government of India, Ministry of Finance, Department of Revenue, 1991, extracted from Bangalore Branch of SIRC Newsletter Vol. XXIV, Issue 6, and August 2009 at page 15.

Implied from Raja Jesudoss Chelliah Tax Reform Committee Interim Report, supra note 46

Raja Jesudoss Chelliah Tax Reform Committee Interim Report, Government of India, Ministry of Finance, Department of Revenue, 1991, extracted from In Re M/s Intas Biopharmaceuticals Limited OIO No. 13/STC/AHD/ADC(JSN)/2013-14, para C3, page 18.

Rustagi T.R., Indirect Tax Reforms in the Indian Economy, available at: [http://www.vikalpa.com/pdf/articles/1998/1998\\_jan\\_mar\\_047\\_059.pdf](http://www.vikalpa.com/pdf/articles/1998/1998_jan_mar_047_059.pdf), (accessed on May 24, 2014).

Service Tax was imposed vide Chapter V (Sections 64 to 96) of the Finance Act, 1994 by initially making three services taxable, viz., Telephone, Stock Brokers & General Insurance with effect from 01.07.1994. The service tax is applicable all over India. However, due to national interest and for the betterment of the people, it is waived off in the State of Jammu & Kashmir.