In and Out - Section 66A and Explanation to Section 65(105)!

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When everyone was expecting a "revalidation", our FM surprised us with "invalidation"! Maybe sensing the lack of legal validity, the Finance Bill 06 has gracefully decided to omit the said Explanation and the same is going to be out of the statute book, once the Finance Bill 2006 is passed! But don't rejoice, dear brethren! In a more polished, refined and stronger version, it is going to be back in the form of Section 66 A of the Finance Act, 1994.

Let us delve a bit deep into the issue.

Ever since the proposed introduction of an Explanation under Section 65 (105) of the Finance Act, in the Finance Bill 2005 and its subsequent enactment with effect from 16.06.2005, heated debates were going on in all indirect tax journals / websites, about the legislative competence of the Union Government, to levy service tax on the services rendered outside India, for the simple reason that the service recipient is in India. Much water has flown under the bridge, in terms of discussions on Constitutional validity of the provision, the presence or otherwise of the "territorial nexus", whether the provision is prospective or retrospective and what not! To top it all, the Hon'ble High Court of Madras has also stayed the provisions for four weeks, in a writ petition filed.

And, the Explanation is going to have its natural death. But, this death of Narakashura is no Diwali to celebrate as it is going to be back with full vigour, in the form of Section 66 A. Before, proceeding further, we must hail those officers who were behind the drafting of Section 66 A, which reveals the amount of discussion, that might have been gone through, before this draft is finalized. Kudos to those babus!

Now on to Section 66 A.

The said section is reproduced below:

> 66A. (*1*) Where any service specified in clause (*1*05) of section 65 is,—
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> (*a*) provided or to be provided by a person who has established a business or has a fixed establishment from which the service is provided or to be provided or has his permanent address or usual place of residence, in a country other than India, and
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> (*b*) received by a person (hereinafter referred to as the recipient) who has his place of business, fixed establishment, permanent address or usual place of residence, in India,
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> such service shall, for the purposes of this section, be taxable service, and such taxable service shall be treated as if the recipient had himself provided the service in India, and accordingly all the provisions of this Chapter shall apply:

Provided that where the recipient of the service is an individual and such service received by him is otherwise than for the purpose of use in any business or commerce, the provisions of this sub-section shall not apply:

Provided further that where the provider of the service has his business establishment both in that country and elsewhere, the country, where the establishment of the provider of service directly concerned with the provision of service is located, shall be treated as the country from which the service is provided or to be provided.

(*2*) Where a person is carrying on a business through a permanent establishment in India and through another permanent establishment in a country other than India, such permanent establishments shall be treated as separate persons for the purposes of this section.

Explanation 1.— A person carrying on a business through a branch or agency in any country shall be treated as having a business establishment in that country.

Explanation 2.—Usual place of residence, in relation to a body corporate, means the place where it is incorporated or otherwise legally constituted.';

The following are the highlights of this provision.

If the service providers' fixed business establishment / permanent address / usual place of residence are outside India and if such service is received by a person who has his business establishment / permanent address / usual place of residence in India, the service recipient shall be deemed to be the service provider. The following issues have to be noted in this regard.

- Under the maligned Explanation, **any service** rendered by such person is deemed as a taxable service. But, in the present Section 66A, it is limited to those services, which are made taxable, under section 65 (105) of the Act.
- The service recipient is deemed as the "service provider" himself and not merely as "person liable for payment of service tax". There is no need to resort to Rule 2 (1) (d) (iv) of the Service Tax Rules, 1994, for this purpose.

The exemption hitherto available in respect of individuals where the service is received and consumed not for the purposes of commerce or business, contained in Notification 25/2005 Dated 07.06.2005, has been incorporated in the Section itself.

As per Rule 2 (1) (d) (iv) ibid, the service recipient would be considered as the person liable for payment of service tax, only if the foreign service provider, did not have any office in India. This has been made more stringent. As per the new provisions, even if the service provider has an office in India, the service recipient shall continue be considered as the service provider, if the provision of service is directly concerned with the foreign premises of the service provider. In other words, if the local branch office of the Foreign Service provider has got nothing to do with the service rendered by its foreign office to the Indian client, the liability for payment

of service tax is not on the Indian branch of the Foreign Service provider, but on the service recipient.

Another beautiful provision is contained in sub section (2) of Section 66 A. If an Indian Company has a foreign branch, and if such foreign branch is having a permanent establishment in such country, the Indian branch and the foreign branch, shall be considered as **separate persons**. As a result of this provision, if any service is consumed by the foreign branch of an Indian establishment, the Indian branch shall not be liable for payment of service tax, provided the foreign branch has got a permanent establishment, in such foreign country. The clear absence of territorial nexus in this case has been efficiently observed and intelligently provided for.

By enacting a codified mechanism, the Government has made it clear that it is firm on taxing services received in India from a country other than India.

But the larger question of legislative competence of the Union Government to levy service tax on services rendered outside India, still lingers, waiting for judicial interpretation.