

LEGAL CONSULTANCY SERVICES

EXPLANATION AND ANALYSIS

(UPDATED TILL FINANCE BILL, 2016)



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Legal Consultancy Services

Explanation and Analysis – Updated till Finance Bill, 2016

Service Tax was first brought in through the Finance Act, 1994. This Act is itself amended each year in the Budget to carry out the amendments in the Service Tax Law.

Service tax is a form of indirect tax which is levied on provision of services. However, there are a series of tests that need to be performed on the activity undertaken to understand whether it falls within the ambit of service tax levy.

Definition of a service

The first test that is to be performed in order to determine the levy of service tax is if the activity falls within the definition of service.

Service has been defined as per the provisions of Service Tax Law as any activity which is carried out by one person for another person in exchange for consideration. Subject to certain exclusions, if the following three elements as per the definition are satisfied, it falls within the definition of service:

- a) An activity,
- b) For person to another person
- c) There is an involvement of consideration.

If the activity does not fall within the definition of service, then there is no involvement of service tax in that case.

In the above context, if any activity is covered by the definition of service, it needs to be determined if that service is covered under Legal Consultancy service.

Definition of Legal Consultancy Services

Legal consultancy service refers to any service provided or to be provided:

- (i) to any person, by a business entity, in relation to advice, consultancy or assistance in any branch of law, in any manner;
- (ii) to any business entity, by any person, in relation to representational services before any court, tribunal or authority;
- (iii) to any business entity, by an arbitral tribunal, in respect of arbitration.

Negative List

Once, any service falls within the ambit of Legal consultancy services, it needs to be determined if it falls within the negative list as per Section 66D of the Finance Act, 1994. The list specifying the services which are not taxable is termed as negative list in the Service Tax law. Thereby, this will be the second test to determine if the service tax is leviable or not. Legal Consultancy services do not form part of the negative list and is considered to be part of taxable services.

Taxable Territory

The next test that needs to be performed is if the services have been provided in the taxable territory. Taxable territory extends to the whole of India except Jammu and

Kashmir. Services which are provided in the non-taxable territory i.e. outside India or within Jammu and Kashmir is excluded from service tax. However, if the legal consultancy services are performed within the taxable territory, then it will be said to have cleared this test as well.

Exemption

The final test that needs to be performed is if the taxable services are covered by any exemption or abatement from service tax. With regard to the legal consultancy services, the following activities were covered by entry 6 of the mega exemption notification no. 25/2012 dated 20/06/2012 and were exempt from tax:

“6. Services provided by-

(a) an arbitral tribunal to -

(i) any person other than a business entity; or

(ii) a business entity with a turnover up to rupees ten lakh in the preceding financial year;

(b) an individual as an advocate or a partnership firm of advocates by way of legal services to-

(i) an advocate or partnership firm of advocates providing legal services ;

(ii) any person other than a business entity; or

(iii) a business entity with a turnover up to rupees ten lakh in the preceding financial year; or

(c) a person represented on an arbitral tribunal to an arbitral tribunal;”

As per Notification no. 9/2016 dated 01/03/2016, clause (b) and (c) of entry 6 of the notification no. 25/2012 dated 20/06/2012 have been substituted with the following:

“(b) a partnership firm of advocates or an individual as an advocate **other than a senior advocate**, by way of legal services to-

(i) an advocate or partnership firm of advocates providing legal services;

(ii) any person other than a business entity; or

(iii) a business entity with a turnover up to rupees ten lakh in the preceding financial year; or

(c) a **senior advocate** by way of legal services to a person other than a person ordinarily carrying out any activity relating to industry, commerce or any other business or profession;”

The notification shall come into force on 1.4.2016.

Advocate and Senior Advocate have been defined as follows:

“**Advocate**” has the meaning assigned to it in Section 2(1)(a) of the Advocates Act, 1961, i.e. ‘an advocate means an advocate entered in any roll under the provisions of this Act’.

“**Senior Advocate**” has the meaning assigned to it in section 16 of the Advocates Act, 1961 (25 of 1961) i.e. ‘An advocate may, with his consent, be designated as senior

advocate if the Supreme Court or a High Court is of opinion that by virtue of his ability or standing at the Bar or special knowledge or experience in law he is deserving of such distinction.”

As per Section 65B(17) of the Finance Act, 1994, 'Business entity' means "any person ordinarily carrying out any activity relating to industry, commerce or any other business or profession"

Before the Finance Bill, 2016, the services provided by advocates or partnership firm of advocates to another advocate, partnership firm of advocates, non-business entities and business entities having turnover upto Rs. 10 lacs in the preceding financial year were exempt. Only business entities having turnover greater than Rs. 10 lacs in the preceding financial year were liable to service tax.

After the Finance Bill, 2016, the exemption of the advocates and partnership firm of advocates apart from senior advocates still remains the same. The services provided by a senior advocate will be chargeable to service tax except when the service receiver is a non-business entity in which case service tax will continue to be exempt. If the legal consultancy service is not exempt as per the mega exemption notification above, then service tax will be chargeable.

Chargeability of Service Tax

As per the chargeability section 66B of the Finance Act, 1994, there will be a levy of 14% (excluding Swachh Bharat Cess and Krishi Kalyan Cess) on the value of services provided by one person to another in the taxable territory.

Rate of service tax

Apart from the levy of 14%, there are two other cesses which are to be charged alongside service tax – Swachh Bharat Cess and Krishi Kalyan Cess.

Swachh Bharat Cess

As per Finance Act of 2015, Section 119 was inserted which prescribed for levy of Swachh Bharat Cess through a notification in the official Gazette by the Central Government. The Government, vide Notification No. 21/2015 and 22/2015 – ST dated 6th November, 2015 notified the levy of Swachh Bharat Cess @ 0.5% on all taxable services w.e.f 15th November, 2015. **So the effective rate of Service Tax from 15.11.2015 is 14.5%**

Krishi Kalyan Cess

As per clause 158 of Finance Bill 2016, a cess called Krishi Kalyan Cess will be levied as service tax on all or any of the taxable services at the rate of 0.5%. It will come to force from 01.06.2016. **So, the effective rate of Service Tax from 01.06.2016 will be 15%.**

Valuation of Service Tax

With regard to the value of services as per the chargeability section, section 67 of the Finance Act, 1994 states that the gross amount charged by the service provider for provision of service will be considered.

Who is liable to pay service tax?

As per section 68(1), the service provider is liable for paying service tax after collecting it from the service receiver. This mechanism is called forward charge.

However, as per section 68(2), in respect of certain services notified by the Central Government, the person liable for paying service tax will be a person other than the service provider. The person who will be liable in these cases has also been stated in the Service Tax Rules. This payment mechanism is known as reverse charge.

Notification no. 30/2012 covers all the services on which any person other than the service provider is liable to pay tax and also the extent to which that person is liable to pay tax. The relevant extract of the Notification no. 30/2012-ST dated 20/06/2012 which shows the service on which reverse charge is applicable has been reproduced below:

“ The taxable services,-

(A)(iv) provided or agreed to be provided by,-

(A) an arbitral tribunal, or

(B) an individual advocate or a firm of advocates by way of legal services,”

Sl.No.	Description of a service	Percentage of service	Percentage of service tax payable by service provider	Percentage of service tax payable by any person liable for paying service tax other than the service provider
5	In respect of services provided or agreed to be provided by individual advocate or a firm of advocates by way of legal services	Nil	0%	100%

As per the Notification No. 18/2016 dated 1st March, 2016, in sub-clause (iv), for item (B), the following has been substituted, namely:-

“(B) a firm of advocates or an individual advocate **other than senior advocate**, by way of legal services, or”

Also against Sl. No. 5, for the entry under column (2), the following has been substituted:

“in respect of services provided or agreed to be provided by a firm of advocates or an individual advocate **other than a senior advocate** by way of legal services”;

The notification shall come into force from 01/04/2016.

Rule 2(1)(d)(i) of the Service Tax Rules, 1994 talks about the person who is liable to pay service tax in case he is covered under Section 68(2) of the Finance Act, 1994.

As per Item (D) of this rule, the person liable for paying Service Tax ;

“in relation to service provided or agreed to be provided by,-

(I) an arbitral tribunal, or

(II) an individual advocate or a firm of advocates by way of legal services,

to any business entity located in the taxable territory, will be the **recipient** of such service;”

As per notification no. 19/2016 dated 1st March, 2016, in the Service Tax Rules, 1994, Sub-item (II) of Item (D) of Rule 2(1)(d)(i) of Service Tax Rules, 1994 shall be substituted with:

“(II) a firm of advocates or an individual advocate **other than a senior advocate** by way of legal services”

This amendment will come into force on 01.04.2016

Hence, before the Finance Bill, 2016 combining the Section 68(2) of the Finance Act, 1994, Notification no. 30/2012 and Rule 2(1)(d)(i) of the Service Tax Rules, 1994, any taxable service provided by an advocate or a partnership firm of advocates to any person was liable to service tax under reverse charge in the hands of the service receiver. Since, business entities having turnover greater than Rs. 10 lacs in the preceding financial year were taxable, only they were liable to pay tax under reverse charge. All the other entities viz. non- business entities, business entities having a turnover of less than Rs. 10 lacs in the preceding financial year were exempt.

After the Finance Bill, 2016, the position of all the advocates apart from senior advocates remain the same. The senior advocates will be covered by forward charge and will be liable to make the payment of service tax as service providers.

Point of Taxation

Section 67A of the Finance Act, 1994 states that the rate of service tax, value of taxable service and rate of exchange should be taken on the date when the taxable services are provided or agreed to be provided.

Under Section 94(2) of the Finance Act, 1994, the Point of Taxation rules were issued. Point of Taxation rules deals with the date when the taxable event occurs and the date of determination of rate of service tax.

Before the Finance Bill, 2016, there were a number of situations like effective change of rate of service tax, taxation of new levy etc. when Section 67A and the Point of Taxation rules conflicted with each other. This was because Section 67A and the Point of Taxation Rules contained different provisions for determination of the rate

of tax. However, there was no reference in the Service Tax Law as to which provision to follow in case of a conflict. This has caused a number of litigation over the years.

The long standing dispute has been put to rest by insertion of sub-section (2) in section 67A through Finance Bill, 2016. This subsection now clearly states that Point of Taxation rules need to be followed in order to determine the rate of service tax. A similar provision has been inserted in the Point of Taxation Rules which refers to Section 67A and confirms that the Point of Taxation rules need to be followed for determination of rate of service tax.

Rule 5 of Point of Taxation rules needs to be followed for the transition phase when a new levy is introduced or when a service taxable for the first time. This will be applicable when the services of the senior advocate becomes taxable from 01/04/2016 and also at the time of levy of Krishi Kalyan Cess from 01/06/2016.

As per Rule 5 of the Point of Taxation Rules, service tax will not be levied when:

- a) Both the date of invoice and the date of payment is before the date from which the service becomes taxable/ new levy becomes applicable
- b) The date of payment is before the date when the service becomes taxable/new levy becomes applicable and the invoice date is within 14 days from the date when the service becomes taxable/new levy becomes applicable

However, as per Notification no. 21/2016 dated 30/03/2016, a new proviso has been inserted in Rule 7 of the Point of Taxation Rules, 2011. This proviso is applicable to a person who is liable to pay tax under reverse charge and there is a change in the liability of the person after he receives an invoice but before he makes the payment. In such a situation, the point of taxation will be the date of invoice even if the payment is made after the change in the liability.

So, if the business entities liable to make payment under reverse charge to senior advocate, do not make such payment before 01/04/2016 inspite of receiving the invoice before 01/04/2016, they will be liable to make the payment of service tax under reverse charge.

Since, the business entities will make the payment on reverse charge on such transactions, these transactions will not be leviable to service tax again on forward charge basis.

Also, the business entities having already paid on reverse charge will not pay the service tax amount to the senior advocates for deposit on forward charge by the senior advocate. Since, the senior advocate will not be able to collect the service tax from the service receiver, he will not be able to deposit it with the Central Government either.

However, Rule 5 requires the senior advocate to make payment of service tax if the payment is realized from the service receiver after the service becomes taxable even if the invoice is raised before such date.

Because of this conflict between Rule 5 and Rule 7 of Point of Taxation Rules, a number of unnecessary showcause notices from the Service Tax Authorities and litigations might arise.

With reference to senior advocate services, if the date of payment is before 01/04/2016 and the invoice is issued on or before 15/04/2016, no service tax will be levied. However, if the payment is received after 01/04/2016 or if the payment is received on or before 31/03/2016 but the date of invoice is after 15/04/2016, service tax will be leviable.

For determining the date of payment, Rule 2A of the Point of Taxation Rules needs to be looked at. It states that the date of payment will be the earlier of

- a) the date of entry of payment in the books of accounts
- b) the date of credit in the bank account

However, the date of payment will be considered to be the date of credit in the bank account and not the date of entry of payment in the books in the following situations:

- (i) there is a change in effective rate of tax or when a service is taxed for the first time during the period between such entry in books of accounts and its credit in the bank account.
- (ii) the credit in the bank account is after four working days from the date when there is change in effective rate of tax or a service is taxed for the first time.
- (iii) the payment is made by way of an instrument which is credited to a bank account

After the transition phase, Rule 3 of Point of Taxation Rules will apply to the said service. This states that if invoice is issued within 30 days of the provision of service, then the point of taxation will be date of payment or date of issue of invoice whichever is earlier. However, if the invoice is not issued within 30 days of the provision of service, then the point of taxation will be date of completion of service or date of payment whichever is earlier. Whenever any advance amount is received, it will be considered to be a separate Point of taxation and the tax is leviable accordingly. The date of payment is to be determined as per Rule 2A of the Point of Taxation Rules as described above.

In case of continuous supply of service, the date of completion of every event as per the contract which requires payment to be made will be considered as the date of completion of service.

For small receipts upto Rs. 1000 in excess of the invoice, the point of taxation will continue to be the date of invoice if issued within 30 days of completion of service or the date of completion of service if not issued within the time limit.

Place of Provision

In order to determine the place where the services have been provided, Place of Provision of Service Rules, 2012 was notified by the Central Government. It is important to determine this because only services provided or agreed to be provided in the taxable territory are subject to levy of service tax as per section 66B which is the charging section.

When both the service provider and service receiver are located in the taxable territory, the place of provision will be the location of recipient of service as per Rule 8 of Place of Provision Rules, 2012.

When either the service provider or the service receiver is located outside India, then there is no specific provision under Rule 4 to Rule 12 of Place of Provision Rules, 2012. The Place of provision will be determined under Rule 3 of Place of Provision Rules, 2012 which is the general provision. The general provision is applicable where no specific provision is in place for a particular case. Rule 3 of Place of Provision Rules, 2012 states that the place of provision will be the location of the service recipient.

However, if the location of the service receiver is not available in the ordinary course of business, then the location of the service provider will be considered.

Payment of Service Tax

- 1) In case of an individual, proprietary firm, or a partnership firm (including LLP) or a one person company, the duration for payment will be quarterly. For rest of the concerns, the duration of the payment will be monthly.
- 2) Individuals, proprietorship firm, partnership firm (including LLP) or a one person company have an option to pay service tax on receipt basis till the value of services is upto Rs. 50 lakhs in the current financial year if the aggregate value of services provided in the previous year is less than Rs. 50 lakhs in the previous financial year.
- 3) The service tax is to be mandatorily submitted through internet banking unless a specific permission for manually depositing the service tax is obtained from the Assistant/Deputy Commissioner after recording the reasons in writing.
- 4) The tax has to be paid to the credit of the government by 6th of the month immediately following the quarter/month in which the services has been deemed to be provided in case of payment through internet banking and 5th of the following quarter/month in any other case. For the quarter/month ending 31st March, the last day would be the 31st of March itself.
- 5) There are 120 Accounting codes for payment. It includes the codes for 119 taxable services prevalent before 01-07-2012 and 1 category as 'other services'. The assessee has to pay service tax under appropriate category (i.e. Legal Consultancy Services) by selecting the appropriate code.

6) A specific sub-head has also been created for payment of "penalty" under various descriptions of services.

7) The sub-head for payment "other receipts" is meant only for payment of interest payable on delayed payment of service tax.

Non-provision of service or renegotiation of invoice

There are instances when the assessee has already charged service tax as part of his output tax liability and later, there is no provision of service or deficient provision of service or any change in the terms and conditions of contract. Due to this, the gross value charged as part of original terms and conditions can be reduced. In such a situation, the difference between the original tax liability and final tax liability can be taken as CENVAT credit as per Rule 6(3) of the Service Tax Rules, 1994.

However, if the service provider has already received the service tax amount from the service receiver, then he is liable to refund the payment to the service receiver. The service provider cannot keep the service tax collected with himself as per the Principle of Unjust Enrichment.

If the invoice has already been issued by the service provider in respect of the services so provided, then he should issue a credit note in respect of the difference between the price as per the original invoice and the renegotiated price.

Invoice

As per Rule 4A of the Service Tax Rules 1994,

- 1) An invoice, bill or challan should be issued within 30 days of completion of service or receipt of payment whichever is earlier.
- 2) In case of continuous supply of service, these should be within 30 days of the date of each event which requires any payment to be made as per the contract.
- 3) It should contain the name, address and registration number of service provider, name and address of service receiver, description of the services provided and the breakup of value of taxable service and service tax payable on it.
- 4) It should be serially numbered.
- 5) It should be signed by an authorized signatory.

Records

As per Rule 5 of Service Tax Rules, 1994,

- a) The assessee needs to maintain records for a minimum period of five years after the year to which they pertain.
- b) Computerized records are also recognized by the Service Tax Department
- c) In case of computerized records, every page of the records should be duly authenticated through a digital signature.

- d) At the time of submission of first return, the assessee should submit records relating to provision of service, transactions of input, input services and capital goods and other financial records to the Superintendent of Central Excise.

Returns

As per Rule 7 of the Service Tax Rules, 1994:

- 1) Every person who is registered and liable to pay service tax is required to furnish a half yearly return in Form ST-3 electronically through ACES system.
- 2) The return due dates are 25th October and 25th April for the period April-September and October-March respectively.
- 3) A return can be revised for a period of 90 days from the date of filing original return.
- 4) The contents of the return are:
 - Particulars of assessee viz. name, registration number, address, etc
 - Particulars of taxable services viz. Nature;
 - Particulars of period viz. financial year, half year period (April-September or October-March)
 - Particulars of value of taxable services viz. amount received, advance received, details of exempted services, abatement/exemption claimed, etc.;
 - Particulars of Service Tax viz. service tax payable, various cesses payable, details of payment, interest or penalty paid, payment of excess collection of service tax, if any, etc;
 - Particulars of Cenvat Credit viz. opening balance available, availed, utilized, closing balance, etc

Cenvat Credit

As per the relevant provisions of Cenvat Credit Rules, 2004:

- 1) Cenvat Credit is available on inputs, input services and capital goods as defined under Cenvat Credit Rules, 2004 which are used for providing taxable output service.
- 2) As per Rule 6(l) of the Cenvat Credit Rules, 2004, the provider of exempt output services is not entitled to the Cenvat Credit on inputs/input services which are attributable to the use in providing the exempt output service.
- 3) Cenvat Credit is available on input services on receipt of invoice from the service provider. As per Rule 4(7) of the Cenvat Credit rules, if the service receiver does not pay the invoice amount within 3 months from the date of invoice, the Cenvat Credit is required to be reversed. Once the payment is made after the period of 3 months, credit can be availed once again.
- 4) In respect of payment made by the service recipient under reverse charge as per rule 4(7) of the Cenvat Credit Rules, 2004, the service recipient can take the credit of the input services after he has paid the service tax to the credit of Central

Government. Even if the payment is not made to the service provider, the said credit is available.

(This is an initiative to present provisions of the Finance Act 1994 in a simpler form. This article involves personal interpretations and may deviate from the actual facts. S.Khaitan & Associates claims no liability for any losses arising to anyone on the basis of this document.)