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various ways, such as innovation in energy usage, or developing a more energy-efficient supply chain, each of which has its own tax consequences. But there has also been substantial growth in investments by US and EU investors and businesses in the developing countries, in projects designed to deliver carbon allowances that can be sold to EU businesses that are exceeding their carbon caps. Investment in such projects is leading to new tax issues where domestic tax legislation does not cater for the new international trade in carbon allowances. This is particularly true for VAT and VAT-type taxes, which often act as a barrier to the trade in carbon allowances and thus to the meeting of the overall policy goal of reducing global emissions of carbon.

IV. Conclusion

In summary, the attempt to reduce carbon emissions is framing much of the tax policy currently being discussed at senior levels within governments. It seems likely that new taxes, such as possible extra import duties on goods from countries with excessively high carbon emissions, and new tax allowances will emerge as governments try to change behaviour and encourage energy research.

***Frank Sangster** is the Head of the Environmental Tax and Incentive Group for KPMG.*

For further information please contact the author by email at: frank.sangster@kpmg.co.uk

1 This article was written before the delivery of the UK Budget in March 2008.

Indian Budget 2008-2009: Indirect tax implications

Advait Sethna and Harshal Shah
Nishith Desai Associates, India

The focus of this article is on the impact of the Indian Budget for the year 2008-2009 (hereafter referred to as "the Budget"), on the indirect taxes in India and the significant changes affecting particularly the international business community. The Government of India, through the present Budget has endeavored to ensure that the Indirect Tax Duty structure corresponds to the harmonisation norms set by the World Trade Organisation. Attempts are being made to encourage investments and minimise the obstacles to trade in goods and services through tariff cuts and concessions to certain sectors. The government has also expanded the service tax net to include four more services as service tax is becoming a substantial source of revenue to the exchequer. A sector-wise analysis of the amendments/changes proposed in the Budget, with respect to indirect taxes in India, is discussed in the following article.

I. Customs

A. Introduction

Customs duty is an indirect tax levied on commodities imported into India under the provisions of the Customs Act, 1962 ("Customs Act"). The rates of customs duty are prescribed in the Customs Tariff Act, 1975 and are revised from time to time by the Annual Finance Act or by various notifications. Customs duties, particularly on imports, may be a significant cost factor in an Indian project due to the generally high rates of duties, unless corresponding drawbacks (refunds) are available upon export.

Broadly speaking there are two main components of customs duties, i.e. the basic customs duty and additional duty. Basic duty is the rate of duty which is levied under the First Schedule of the Tariff Act ("Basic Duty") and an additional duty is that which is levied over and above the Basic Duty ("Additional Duty").

The valuation of imported goods and export goods for the purposes of the Customs Tariff Act, 1975 is determined in accordance with the Customs Valuation Rules, 1988 which shall be the value declared by the importer, i.e. *invoice value* or *transaction value*, as determined in accordance with the said rules. However it is within the discretion of the Customs Officer to reject the declared value, i.e. invoice value and assess the goods on the basis of transaction value.

B. Sector specific amendments – Tariff[1]

The Budget has not proposed to bring about any change in the peak rate of the basic component of customs duty and thus remains unchanged at 10 percent. However with a view to promote certain key sectors in India, the Budget proposes to insert special concessions for specific sectors as under:

a. *Project imports* – With a view to promote the development of infrastructure in India, the Basic Duty on project imports is proposed to be reduced to five percent (against the previous 7.5 percent). This would apply to certain projects such as airport development projects, metro rail projects, port development projects, railway electrification, digital cinema development projects, etc. However contrary to its own policy of development of infrastructure in India, the government has proposed to withdraw the exemption of additional duty of four percent, in case of power generation and

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b. *IT/electronic industry* – A concessional duty of five percent (basic) already available to certain electronic products such as MP3 and MPEG4 players, shall now be extended to *"Convergence Products"* which would include MP3/MP4 and MPEG players having audio and video reception facilities. In order to effectively implement the set top box regime in the television sector, the set top boxes have been granted full exemption from basic customs duty. Similarly, full exemption from basic customs duty is available to a large number of raw materials/inputs for the manufacture of specified electronic/information technology products to provide a level playing field. These concessions are basically aimed at ensuring the steady growth of the IT sector. In case of transfer or sale of equipment from Software Technology Park of India to the Domestic Tariff Area ("DTA" i.e. domestic market) the Basic Duty is proposed to be increased to 50 percent (as against the previous 25 percent) which means the government intends to discourage such transfers or sale to the DTA, by increasing the Basic Customs.

c. *Drugs and diagnostic kits* – The Government of India having recognised the importance of importing life saving drugs into India, has reduced the Basic Duty on six specified drugs/kits and bulk drugs for their manufacture to five percent (against the previous 10 percent). These are the drugs used inter alia in the treatment of cancer/ diabetes/Hepatitis B, etc. Further, specified raw materials and components for the manufacture of ELISA kits shall now enjoy a concessional duty of five percent (Basic).

d. *Dairy/poultry* – The Basic Duty has been reduced to nil from 7.5 percent on bactofuges and to 20 percent (against the previous 30 percent) on feed additives/pre-mixes.

e. *Gems and jewellery* – With a view to provide an impetus and promote growth within this sector, it is proposed to exempt rough cubic zirconia from customs duty (as against the previous five percent). Similarly, the customs duty on rough coral will be reduced to five percent (as against the previous 10 percent).

f. *Metals* – Basic Duty on iron or steel melting scrap and aluminum scrap shall be reduced to nil (as against the previous five percent).

g. *Sports goods* – Basic Duty on specified machinery for manufacture of sports goods for export shall be five percent, subject to certain specified conditions (as against the previous 7.5 percent). Similarly, Basic Duty on specified raw materials for manufacture of sports goods from exports shall be nil (as against the previous 10 percent). This concession has been granted keeping in mind the Commonwealth Games which are scheduled to happen in the year 2010.

h. *Tobacco products* – Basic Duty on cigars, cheroots and cigar rolls shall be reduced to 30 percent (as against the previous 60 percent) which is somewhat unexpected.

C. Sector specific amendments – Non-tariff

In addition to the above, some important non-tariff amendments from a business/industry perspective are summarised below:

a. Insertion of a new section which empowers the central government to recover any amount of customs duty collected in excess of the duty assessed or paid.[2]

b. Insertion of a new section to provide for payment of interest at six percent per annum in case of delayed refund of duty. The interest is payable by the taxpayer if refund is not paid within three months from date of communication of the order for payment of such refund. However no interest shall be payable if such order is stayed by a superior court or tribunal.

c. With a view to exercise stricter regulatory control, the maximum amount of penalty for contravention of any of the provisions of the Customs Act has been increased from existing INR10,000 to INR100,000 where no express penalty is provided under the Customs Act.

II. Service tax

A. Introduction

Service Tax was introduced for the first time in the year 1994 through the insertion of Chapter V in the Finance Act of 1994. It is a tax payable by the provider of the service on the services falling under the caption taxable services, which have been specifically defined under the said Finance Act. This was confined to only three services, namely telephone, stock broking and general insurance. Since then the Act has been amended year after year, to bring more services into the tax net as the services comprise 55 percent of India's Gross Domestic Product.

B. Rate of tax

There is no proposal to change the rate of service tax, which remains at 12.36 percent (including Education Cess. at three percent).

C. Exemption and registration limit

A. The threshold limit of service tax exemption for small service providers is proposed to be increased from INR800,000 to INR1,000,000 from April 1, 2008. Further hotel booking services provided by a person located outside India to a foreign customer in relation to hotel booking in India is exempt from service tax. Further, the goods transport agency service is being exempt from the payment of service tax to the extent of 75 percent of the freight.

B. As a result of the increase in the threshold exemption limits, the limit for obtaining service tax registration has also been increased from INR700,000 to INR900,000 with effect from April 1, 2008.

D. New taxable services

a. *Management of investment under the Unit Linked Insurance Plan ("ULIP").*[3] The service provided to a policy holder by a life insurer in relation to the management of investment portion of the ULIP Scheme is brought within the service tax net. The proposed service enables levy of service tax in relation to management of investment portion of the ULIP premium. Service tax is liable to be paid on an amount to be charged from the policy holder.

b. *Internet telecommunication services.*[4] With the introduction of the Finance Act, 2008 a new category of taxable service will be introduced, i.e. *"Internet Telecommunication"*. This category has been formed by the consolidation of six different taxable services provided in relation to telecommunication which would include the following services:

   1. Internet backbone services including carrier service of internet traffic by one internet service provider to another.

2. Internet access services including provision of direct connection and space for the customer.
3. Providing telecommunication services over the internet, i.e. telephony, audio and/or video conferencing.

c. *Information technology software services.*[5] The taxable services falling within the above would include development and design, up gradation or enhancement, provision of advice or consultancy, acquisition of the right to use the information technology software, provided in the course of business or commerce. However, when such services are provided to individuals for their personal use, they fall outside the scope of service tax.

d. *Services provided by recognised stock exchanges and processing and clearing houses in relation to securities.*[6] Services provided by a recognised stock exchange or a commodity exchange or a clearing corporation in relation to processing, clearing and periodical settlement of transactions for or relating to sale and purchase of securities, goods or forward contracts, delivery and payment thereof or any other incidental or connected services will now be liable to pay service tax.

e. *Services in relation to supply of tangible goods, where no VAT is applicable.*[7] This service is proposed to cover those services which are provided in relation to supply of tangible goods including machinery and equipment, for use without transferring the right of possession and/or effective control of such goods. However the service tax would not be leviable where VAT is payable. The services which fall within the ambit of the new services may include transactions such as wet and dry lease and hire purchase.

E. Expansion in the scope of existing services

In the definition of taxable services (39 in number) the term "client" or "customer" is replaced by the term "any person" resulting in an expansion of the scope of such services. Following is the summary of the changes in existing services:

a. *Banking and other financial services/foreign exchange broker's services.* The Budget proposes to increase the scope of this service to cover purchase or sale of foreign currency including money changing by an authorised dealer. As per the government clarification, the service provider will be liable to pay service tax at a presumptive rate of 0.25 percent of the gross amount of currency bought or sold by him.

b. *Business auxiliary services.* A clarificatory explanation has been inserted stating that any service provided in relation to promotion or marketing of games of chance including lottery, etc. organised or conducted or promoted by a client is covered under the term "Business Auxillary Service".

c. *Cargo handling services.* The scope of the said service has been expanded to include packing with transportation of cargo or goods. The services of packers and movers will now be covered under this category.

d. *Internet telephony services.* This category of service has been merged with the new category "Internet Telecommunication Services" which is discussed above.

e. *Renting of immovable properties.*[13] An explanation is inserted clarifying that renting of immovable property, which is now taxable, includes allowing and permitting use of space in immovable property, irrespective of transfer of possession or control of immovable property. The constitutional validity of the provision which seeks to levy the service tax on such transfer, i.e. renting of immovable property is challenged and is pending before various courts in India, inter alia before the Bombay High Court[14] for decision/outcome.

f. *Consulting engineer's services.*[15] An explanation is inserted clarifying that advice, consultancy or technical assistance in the discipline of computer hardware and computer software engineering is covered under this category.

g. *Technical testing and analysis*[16] *and technical inspection and certification services.*[17] The scope of the said services is enlarged to inter alia include testing, analysis, inspection and certification of information technology software.

h. *Tour operator's services.*[18] The scope of the said service is proposed to be widened so as to include services provided in relation to a journey from one place to another in a vehicle having a contract carriage permit vehicle. However the services provided for use by an educational body, other than commercial training or coaching centers, shall be excluded.

III. VAT and GST

In a much needed move, the Budget has proposed to reduce the Central Sales Tax (CST) to two percent (as opposed to three percent) in order to facilitate the transit from sales tax to a uniform platform in the form of comprehensive GST, which will be effective from April 1, 2010, in sync with the prevailing international practices.

IV. Central excise

A. Introduction

Excise duty is an indirect tax imposed on the manufacturer of excisable products, under the Central Excise and Salt Act, 1944 which is levied on a wide variety of commodities manufactured in India, and is an important source of revenue for the central government.

Rates of the excise duty vary depending on the type of commodity, and even for the same type of commodity the rates often differ depending on circumstances such as end-use and taxability of inputs. Excise duty must be paid before the goods are cleared from the factory. Small-scale industries enjoy exemption from excise tax up to the specified value of goods cleared. The state governments are also empowered to levy excise duty on a few commodities, such as liquor, if they are not taxed by the central government. Excise drawback is available if the goods manufactured are exported.

B. Rate

General Central Value Added Tax ("CENVAT") rate has been reduced to 14 percent as opposed to the previous 16 percent.

C. Sector specific amendments

Sector specific amendments are as follows:

- *Information technology and communication sector:* The excise duty on packaged software has been increased to 12 percent (as against the previous eight percent).
- *Export oriented units:* The effective rate of excise duty applicable to clearances of goods to domestic tariff area from export oriented units, software technology parks,

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electronic hardware technology parks etc. has been increased to 50 percent of the basic custom duty and excise duty payable on like goods as opposed to the previous 25 percent.

- *Drugs and pharmaceuticals:* The general rate of excise duty on certain drugs has been reduced to eight percent from 16 percent. Further, excise duty has been fully exempt on the anti-AIDS drug ATAZANVIR and bulk drugs used for its manufacture.
- *Automobiles:* The excise duty on small cars has been reduced from 16 percent to 12 percent. The excise duty on large cars will continue to remain at 24 percent. "Hybrid cars" will be subject to excise duty at a concessional rate of 14 percent and electrically operated vehicles enjoy a concessional rate of eight percent. The excise duty on buses and vehicles for the transport of more than 13 persons has been reduced from 16 percent to 12 percent. Similarly the duty on chassis of such vehicles has also been reduced to 12 percent and INR10,000. The excise duty on two wheelers and three wheelers has also been reduced to 12 percent.
- *Food processing sector:* Certain food products like tender coconut water, milk, sugar, etc. shall be fully exempt from excise duty. The rate of excise duty on packaging material used mainly for packaging of processed foods shall be eight percent (as against the previous 16 percent).
- *Cigarettes:* Excise duty rates on non-filter cigarettes have been enhanced to 819 (per 1000) (as against 168 per 1000) to bring them at par with filter cigarettes of corresponding length.
- *Paper and paper products:* Excise duty on writing paper, printing paper and packing paper shall be reduced to eight percent (as against the previous 12 percent).
- *National Calamity Contingent Duty ("NCCD"):* NCCD of one percent on polyester filament yarn has been withdrawn. However, NCCD at the rate one percent will be imposed on mobile phones. Further, the CENVAT Credit Rules have been amended to provide that input or capital goods credit of other duties of excise cannot be utilised for payment of this NCCD.

V. Concluding remarks

The Honourable Finance Minister has definitely moved a step forward in the introduction of Goods and Services Tax, effective from April 1, 2010. The budgetary changes also reflect upon the determination/need to harmonise the tariffs/duties to ensure compliance with the international standards set by the WTO. Having said that, much needs to be achieved in terms of this objective, mainly because of the overlap in the nature of the existing indirect taxes in India, leaving room for proper and efficient indirect tax planning.

__Advait Sethna__ and __Harshal Shah__ may be contacted by email at: advait@nishithdesai.com and harshal@nishithdesai.com

1 Most of the above proposed changes will be effective from the midnight of February 29/March 1, 2008 vide Circular No.334/1/2008-TRU dated February 29, 2008.

2 The new section is proposed to be inserted after Subsection 1 of Section 28B, which deals with recovery of customs duty from the assessee.

3 Section 65 (105) (zzzzf) of the Finance Act 1994, as amended in 2008.

4 Section 65 (105) (zzzu) of the Finance Act 1994, as amended in 2008.

5 Section 65 (105) (zzzze) of the Finance Act 1994, as amended in 2008.

6 Section 65 (105) (zzzzg), Section 65 (105) (zzzzh), Section 65 (105) (zzzzi) of the Finance Act 1994, as amended in 2008.

7 Section 65 (105) (zzzzj) of the Finance Act 1994, as amended in 2008.

8 Section 65 (105) (zm) and Section 65 (105) (zzk) of the Finance Act 1994, as amended in 2008.

9 Section 65 (105) (zzb) of the Finance Act 1994, as amended in 2008.

10 Section 65 (105) (zr) of the Finance Act 1994, as amended in 2008.

11 Section 65 (105) (zzzu) of the Finance Act 1994, as amended in 2008.

12 Please see Information Telecommunication Services under "New Taxable Services".

13 Section 65 (105) (zzzz) of the Finance Act 1994, as amended in 2008.

14 Retailer Association & Others v. Union of India through Commissioner of Central Excise & Service Tax & Others (case pending).

15 Section 65 (105) (g) of the Finance Act 1994, as amended in 2008.

16 Section 65 (105) (zzh) of the Finance Act 1994, as amended in 2008.

17 Section 65 (105) (zzi) of the Finance Act 1994, as amended in 2008.

18 Section 65 (105) (n) of the Finance Act 1994, as amended in 2008.