

**Service Tax – Growth and Emergence Perspective**

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**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.

**Brief History of Tax**

It is widely recognised that taxes are of modern origin, but in some form or the other, taxes were levied even in primitive and ancient communities. Nearly 2000 years ago, there went out a decree from Caesar Augustus that entire world should be taxed.<sup>5</sup> Even in Greece, Germany and Roman Empires, taxes were levied either on the basis of turnover or sometimes on occupations. The revenue from taxes went to the Monarch for many centuries. In Northern England, taxes were levied on land and on moveable property, such as the Saladin title in 1188, which were later supplemented by introduction of poll taxes and indirect taxes known as "Ancient Customs". The revenue generated from various taxes and levies was utilised to meet the needs of the Governments for their military and civil expenditure. The expenditure on military made sure the safety needs of the subjects while the civil expenditure was done to meet the common needs of the citizens, like maintenance of roads, administration of justice and such other functions of the State.

In India, the system of direct taxation has its references both in *Manu Smriti* and *Arthashastra*. Manu, the ancient sage and law-giver, stated that according to *Shastras*, the king could levy taxes on his subjects, but the burden of taxes should be imposed depending upon the income and expenditure of the subject. He also suggested that there should be a balance between the two situations, namely complete absence of taxes or exorbitant taxation. He suggested that the structure for collection of taxes should be well balanced and the subjects should not feel the pinch of paying taxes. In the ancient times, the taxes were paid in the shape of gold-coins, cattle, grains, raw-materials and also by rendering personal service.

Kautilya's *Arthashastra* deals with the system of taxation in an elaborate and planned manner.<sup>8</sup> Kautilya devoted a major portion of *Arthashastra* to financial matters including financial administration. According to him, the collection of land revenue formed an important source of revenue to the State. Taxes were collected both in cash and kind. While *kara* was tax paid in cash, *pratikara* was tax paid in kind. For example, in case of manufactured jewellery, a payment of 20% was the value added and taken in cash, while in case of butchers, farmers and fishermen, the tax was generally paid in kind in the form of their production share. Apart from this, the State also levied water rates, octroi duties, tolls and customs duties. The Salt Tax, which was collected at the place of its extraction, was an important source of revenue. Forest-produce and mining of metals, etc., was also subject to tax. He explained in detail the trade and commerce with foreign countries, and also favoured levy of taxes on import and export of goods from other countries. He also emphasised that the King was only a trustee of the land and his duty was to protect it and to make it more and more productive so that land revenue could be collected as a principal source of income for the State. According to him, tax was based on Dharma and it was the King's sacred duty to protect its citizens in lieu of the tax collected and if the King failed in his duty, the subjects had a right to stop paying taxes, and even to demand refund of the taxes paid.

The canons of taxation in ancient India reveal certain maxims, which are akin to the principles of Adam Smith. These canons are followed even in the modern regime of taxation. The first and foremost canon is that “taxation was compulsory and each individual was required to contribute to the State revenue or render service in lieu of taxes in proportion to his ability”, which is somewhat akin to the canon propounded of Adam Smith, who says, “the subjects of every State ought to contribute towards the support of the government as nearly as possible, in the proportion to their respective abilities; that is, in proportion to the revenue, which they respectively enjoy under the protection of the State.

The second canon, as elaborated by Kautilya, is that “the taxes had to be certain and the tax payers must know the amount of tax, articles to be taxed and the time to pay them, otherwise the tax collectors could realise more than what is prescribed and appropriate a part of collection for their own benefit.” This maxim of certainty in the Hindu fiscal thoughts appear close to the second principle of Adam Smith, i.e. “the tax, which each individual is bound to pay, ought to be certain and not arbitrary. The time of payment, the manner of payment, the quality to be paid, ought all to be clear and plain to the contributor and to every other person.

The third canon, according to Kautilya, was that “taxes should be collected at a time and place most suited for the tax payers.” Even, according to Adam Smith’s third canon, “every tax ought to be levied at the time and manner, which is most likely to be convenient for the contributor to pay it.

The fourth maxim of Hindu taxation emphasises that “a reasonable margin should always be left with the State exchequer after meeting the cost of tax collection.” Kautilya advised the King for appointment of trustworthy tax officials for collection purposes.<sup>13</sup> Adam Smith’s fourth and the last canon of taxation provided that “every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the State.”

## **Emergence and Growth of Service Sector**

### ***What is Service?***

In common parlance, “Service” may be understood as a type of economic activity that is intangible and not storable and not capable of being owned.

Interestingly, the word “Service” was not defined in Chapter V of the Finance Act, 1994.<sup>16</sup> In the absence of any definition in the primary statute, secondary sources can be resorted to for ascertaining the meaning of any term.

According to Black’s Law Dictionary, “Service” means an intangible commodity in the form of human effort such as the use of labour, skill or knowledge for the benefit of another.<sup>17</sup>

However, under Consumer Protection Act, 1986, “Service” means service of any description, which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, boarding or lodging or both, housing construction entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service.

The Supreme Court of India has held that “Service” means work done or duty performed for another or others; a serving; as professional service, repair service, a life devoted to public service. An activity carried on to provide people with the use of something, as electric power, water, transportation, mail delivery, telephones, etc. Anything useful as maintenance, supplies, installation, repairs, etc., provided by a dealer or manufacturer for people who have bought things from him.

Finally, the definition of “Service” for the purposes of Service Tax was settled, accepted and inserted in Section 65B(44) of the Finance Act 2012.

Accordingly, “Service” means any activity carried out by a person for another for consideration, and includes a declared service. The exclusions are -

(a) an activity which constitutes merely:

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or

(ii) such transfer, delivery or supply of any goods, which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution or

(iii) a transaction in money or actionable claim;

(b) a provision of service by an employee to the employer in the course of or in relation to his employment;

(c) fees taken in any Court or tribunal established under any law for the time being in force.<sup>21</sup>

**Further exclusions are:**

(A) the functions performed by the Members of Parliament, Members of State Legislative, Members of Panchayats, Members of Municipalities and Members of other local authorities who receive any consideration in performing the functions of that office as such member; or

(B) the duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or

(C) the duties performed by any person as a Chairperson or a Member or a Director in a body established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of this section.

It is important to note that transaction in money shall not include any activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which separate consideration is charged.

**Service 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,<sup>34</sup> which is highest among all sectors in the Indian economy.

**Services Sub-Sectors Annual Growth and % Share in GDP**

- Share is based on constant prices (2004-05)

- Growth rates are based on constant prices (2004-05)

- CAGR is estimated for 2003-2013

From the above table, it can be seen that this performance of service sector can be attributed to some fast growing sub-sectors, viz. transport, storage and communications and financing, insurance, real estate and business services and community, social and personal services comprising many services, which have recorded a growth rate of 6.01%, 10.74% and 5.31% respectively against the total GDP growth rate of 4.50% in the year 2012-13. However, CAGR for all the sectors, except community, social & personal services, has remained above the CAGR of GDP from the period 2003-04.

Trade, hotels and restaurants and financing, insurance, real estate and business services are the largest groups accounting for 16.10% and 19.10% respectively of the national GDP in 2012-13 and the community, social and personal services category accounts for 12.8% share, followed by transport, storage and communication, which accounts for 10.70% share for the same period.

In terms of employment, this sector is occupying second place, next only to agriculture.<sup>35</sup> Further, unlike agriculture sector, which employs skilled and semi skilled workers, this sector provides job opportunities to workers ranging from highly skilled to unskilled due to

a variety of activities. Further, its respectable share in FDI inflows as well as total exports makes it the engine of economic growth, which gave rise to innovation and higher exports from the services sector.

### Conclusion

Thus, Indian government is always on the lookout for alternative sources of revenue generation. In this background, it was felt by the economists that contribution of service sector towards GDP was constantly increasing on one hand without any substantial contribution to the government revenue, while the whole burden of revenue was being borne by the already oppressed industrial sector. The government wanted an easy option that is transparent in nature, and which can generate considerable revenue for the nation. The imposition of service tax, a form of indirect tax, applicable to the services provided an easy solution to the government for combating this problem.

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