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Dear Professional Colleague,

Krishi Kalyan Cess – Applicability & Open Issues

Pursuing with an objective to finance and promote initiatives to improve agriculture and farmer welfare, the Government announced a new cess namely 'Krishi Kalyan Cess' ("KKC"), to be levied at 0.5% on the value of all taxable services w.e.f June 1, 2016. In this regard, a new Chapter VI was inserted in the Finance Bill, 2016, containing relevant provisions, which are applicable with enactment of the Finance Act, 2016 on May 14, 2016.

Hence, after levy of KKC, Service tax rate will increase from 14.5% to 15%, effective from June 1, 2016. An illustration showing levy of Service tax and Swachh Bharat Cess ("SB Cess") & KKC is given below assuming Rs. 1,000/- as value of a taxable service:

Particulars	Tax/ Cess (Rs.)
Value of taxable service: (a)	1,000/-
Add: Service tax @ 14% on (a)	140/-
Add: SB Cess @ 0.5% on (a)	5/-
Add: KKC @ 0.5% on (a)	5/-
Total:	1,150/-

The Central Government vide **Circular No. 194/4/2016-ST dated May 26, 2016** has notified accounting codes for payment of KKC in the following manner:

KKC (Minor Head)	Tax Collection	Other Receipts (Interest)	Deduct Refunds	Penalties
0044-00-507	00441509	00441510	00441511	00441512

Now, the Central Government has issued following Notifications to clarify on calculation of value of taxable services under Reverse Charge Notification/ Abatement Notification/ Valuation Rules, Rebate of KKC on input services used for provision of export of services, Refund of KKC paid on specified services used in SEZ, calculation of Alternate rate of Service tax in specified cases, availability of Cenvat credit of KKC etc.:

A. Clarifications on various aspects of KKC

KKC along with Service tax & SB Cess shall be paid on Services under Reverse Charge Mechanism – Notification No. 27/ 2016-ST dated May 26, 2016:

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The Reverse Charge Notification No. 30/2012-ST dated June 20, 2012 (“**Reverse Charge Notification**”) prescribes the specified services under full reverse charge wherein 100% Service tax to be paid by the Service Recipient and under partial reverse charge wherein both the Service Provider and Service Recipient has to pay specified percentage of Service tax.

Now, the Central Government vide Notification No. 27/2016-ST dated May 26, 2016, has amended/clarified that the Reverse Charge Notification shall be applicable mutatis mutandis for the purposes of KKC also. In other words, KKC along with Service tax shall be paid on taxable services under Reverse Charge and Partial Reverse Charge Mechanism as well.

Notification No. 28/2016-ST dated May 26, 2016 (“Notification No. 28”):

No KKC on services specified under the Negative List of services or otherwise exempted by a Notification/ Special Order issued under Section 93(1)/ Section 93(2) respectively of the Finance Act, 1994

The Central Government vide Notification No. 28 has provided that KKC shall not be leviable on services which are exempt from Service tax by a Notification issued under Section 93(1) or Special Order issued under Section 93(2) of the Finance Act, 1994 (“**the Finance Act**”) or otherwise not leviable to Service tax under Section 66B thereof.

Therefore, KKC @ 0.5% will be levied on value of all taxable services except the following:

- Activity excluded from the definition of Service under Section 65B(44) of the Finance Act;
- Negative List of Services under Section 66D of the Finance Act;
- Services exempted by a notification issued under Section 93(1) of the Finance Act i.e.
 - Services exempted under Mega Exemption Notification vide Notification No. 25/2012-ST dated June 20, 2012.
 - Services exempted, as specified to specified percentage under the Abatement Notification No. 26/2012-ST dated June 20, 2012;
- Services exempted by Special Order issued under Section 93(2) of the Finance Act.

KKC@ 0.5% will be levied on value of all taxable services after availing abatement:

Notification No. 28 further clarifies that KKC will be levied on value of taxable services after availing the benefit of abatements by way of an exemption provided vide Abatement Notification No. 26/2012-ST dated June 20, 2012 i.e. KKC would be computed on abated value of taxable services.

For example, in case of GTA services (other than used household goods), presently, abatement of 70% is available and accordingly, Service tax is required to be paid on 30% of

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value of taxable service after exemption (abatment) of 70% as provided under the said Abatement Notification. The effective rate of Service tax including SB Cess and KKC would be 4.50% (i.e. 30% of 15%).

Value of taxable services for the purposes of KKC shall be the value as determined in accordance with the Service Tax (Determination of Value) Rules, 2006 (“the Service Tax Valuation Rules”):

Notification No. 28 furthermore clarifies that value of taxable services for the purposes of KKC shall be the value as determined in accordance with the Service Tax Valuation Rules. Thus, KKC would be levied in the following manner:

- a. Computation of tax under Works contract: In terms of Rule 2A of the Service Tax Valuation Rules, Service tax along with SB Cess and KKC needs to be applied on taxable value. Accordingly, effective rate of Service tax would be as under:
 - ✓ In case of original works: 6% (15%*40%); and
 - ✓ Other than original works: 10.50% (15%*70%)
- b. Computation of tax on Restaurant and Outdoor catering services: In terms of Rule 2C of the Service Tax Valuation Rules, Service tax along with SB Cess and KKC needs to be applied on taxable value. Accordingly, effective rate of Service tax would be as under:
 - ✓ In case of AC Restaurant services: 6% (15%*40%); and
 - ✓ In case of Outdoor catering services: 9% (15%*60%)

Rebate of KKC paid on input services used for provision of export of services - Notification No. 29/ 2016-ST dated May 26, 2016:

The Central Government vide Notification No. 29/2016-ST dated May 26, 2016, has amended Notification No. 39/2012-ST dated June 20, 2012 (Rebate of the duty paid on excisable inputs or Service tax and cess paid on all input services used in providing service exported) to insert KKC under the definition of “service tax and cess”, to enable the provider of services to claim rebate of KKC paid on all the input services used in providing services exported in terms of Rule 6A of the Service Tax Rules, 1994.

Refund of KKC paid on specified services used in Special Economic Zone (“SEZ”) - Notification No. 30/2016-ST dated May 26, 2016:

The Central Government vide Notification No. 30/2016-ST dated May 26, 2016 has amended Notification No. 12/2013-ST dated July 1, 2013 (Exemption on services received by units located in a SEZ or Developer of SEZ and used for their authorised operation) to enable the

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SEZ Unit or the Developer for refund of the KKC paid on the specified services on which ab-initio exemption is admissible but not claimed.

Further, the refund of amount will be determined as under:

Service tax distributed to SEZ Unit/ Developer as per Rule 7 of the Credit Rules*(0.5+0.5)

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Amendment in the Service Tax Rules, 1994 for providing alternate rate for KKC– Notification No. 31/2016-ST dated May 26, 2016:

As per sub-rules 7, 7A, 7B and 7C to Rule 6 of the Service Tax Rules, 1994 (“**the Service Tax Rules**”), there is an alternative rate of Service tax for services, namely, air travel agents, insurance premium, purchase & sale of foreign currency and lottery distributor.

The Central Government vide Notification No. 31/2016-ST dated May 26, 2016 has amended the Service Tax Rules to insert sub-rule (7E) after sub-rule (7D), which prescribes that if Service tax is payable at an alternative rate, KKC would also be computed in proportion to such alternative rate, in similar manner as it was prescribed at the time of introduction of SB Cess:

Total Service tax liability calculated under Rule 6(7)(7A), (7B) or (7C) * 0.5

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For example, in case of air travel agent services, air travel agent opting alternative rate of Service tax is liable to pay Service tax at the rate of 0.7% of the basic fare in case of domestic bookings and at the rate of 1.4% of the basic fare in the case of international bookings. Therefore, KKC would be payable at the following rates:

Domestic bookings: $0.7\% * 0.5\% = 0.025\%$

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International bookings: $1.4\% * 0.5\% = 0.05\%$

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Further, in sub-rule (7D), for the figures "0.5" the words "*effective rate of Swachh Bharat Cess*" and for the words, figures and brackets "*14 (fourteen)*", the words and figures "*rate of service tax specified in section 66B of the Finance Act, 1994*" shall be substituted.

B. Cenvat credit of KKC to service providers only:

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Amendment in Rule 3 of the Credit Rules to allow Cenvat credit of KKC to a service provider: Notification No. 28/2016 - CE (N.T.) dated May 28, 2016

The Central Government vide Notification No. 28/2016-CE (N.T.) dated May 28, 2016, has amended Rule 3 of the Credit Rules to provide that:

- A provider of output service shall be allowed to take Cenvat credit of the KKC on taxable services leviable under Section 161 of the Finance Act, 2016 (28 of 2016);
- Cenvat credit of any duty specified in Rule 3(1) of the Credit Rules shall not be utilised for payment of KKC;
- Cenvat credit in respect of KKC shall be utilised only towards payment of KKC.

Thus, unlike SB Cess, which is not Cenvatable neither in the hands of service providers nor manufacturers, Cenvat credit of KKC paid on input services shall be allowed to be used for payment of the KKC on taxable services provided by a service provider. Further, Cenvat credit of Service tax or Excise duty can neither be utilized for payment of KKC nor vice versa.

Manifestly, the manufacturers paying KKC on procurement of their input services would not be in a position to avail Cenvat credit of the same and thus would form part of their cost, leading to increase in prices to that extent. Thus, imposition of KKC is likely to hamper "Make in India" and "Start-up India" campaign of the Modi Government.

Treatment of KKC on on-going services/ transactions already rendered prior to June 1, 2016– Still warranting clarification

Though, the Central Government has tried to address the concerns of the assessee/industry at large to certain extent well in advance which were dragged till February, 2016 for SB Cess levied last year w.e.f. November 15, 2015. But, at the same time, the Notifications fails to amend/ clarify certain open issues on applicability of KKC on on-going transactions/ services already rendered prior to June 1, 2016, which has raised daunting concerns amongst the Trade.

With the Service tax rate (including SB Cess and KKC) of 15% becoming effective from June 1, 2016, a turmoil is being faced by the service provider in respect of on-going transactions for which completion of services have taken place before June 1, 2016 with or without raising of corresponding invoices, but payment for the same is not received till June 1, 2016.

Point of Taxation for New Levy of KKC:

It is pertinent here to note that Explanation 1 & 2 to Rule 5 of Point of Taxation Rules, 2011 ("the POTR") have been inserted w.e.f. March 1, 2016. Explanation 1 provides that point of

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taxation in case of new levy on services shall be governed by Rule 5 of the POTR and as per Explanation 2, new levy or tax shall be payable on all cases other than specified in Rule 5.

Rule 5 of the POTR covers two specific situations where new levy shall **NOT** be payable:

1. Invoice issued and payment received against such invoice before such service becomes taxable;
2. Payment received before the service becomes taxable and invoice has been issued within 14 days of the date when the service is taxed for the first time

Effective June 1, 2016 KKC @ 0.5% on the value of all taxable service is proposed to be levied. Point of taxation in case of new levy on services shall be governed by Rule 5 of POTR. As per the Rule 5 read with explanations, only in two situations (mentioned above), the KKC shall not be payable and in all others, KKC is to be paid.

An illustrative table to above explanations is given as under:

S. No.	Date of applicability of KKC	Date of Invoice	Date of Payment Received	Applicability of KKC
1.	1 st June, 2016	14 th June, 2016	30 th May, 2016	No
2.	1 st June, 2016	18 th June, 2016	30 th May, 2016	Yes
3.	1 st June, 2016	30 th May, 2016	30 th May, 2016	No
4.	1 st June, 2016	3 rd June, 2016	3 rd June, 2016	Yes
5.	1 st June, 2016	30 th May, 2016	3 rd June, 2016	Yes

Vide this explanation, the Government is seeking to impose KKC in cases, where the invoice and provision of service has taken place prior to June 1, 2016, however payment is not received till June 1, 2016. This would imply that on all debtors as on May 31, 2016, assesses will be liable to pay KKC.

Applicability of KKC when liability to pay Service tax is on Service Receiver under reverse charge

POT in case of reverse charge is governed by Rule 7 of the POTR, which starts with non-obstante clause: "Notwithstanding anything contained in rules 3, 4, or 8". In terms of Rule 7

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of the POTR, point of taxation under reverse charge (except associated enterprises located outside India), shall be as under:

- Payment made within 3 months – Date of payment;
- Payment not made within 3 months - Date immediately following the end of 3 months

In case of associated enterprises, where the person providing the service is located outside India, POT shall be earlier of the following:

- Date of debit in the books of account of service receiver;
- Date of Payment

It would not be out of place here to mention that a proviso has been inserted in Rule 7 of the POTR vide *Notification No. 21/2016-ST dated March 30, 2016*, to provide that where there is change in the liability or extent of liability of Service tax to be paid under Reverse Charge:

- Service has been provided and the invoice issued before the date of such change, but payment has not been made as on such date, the POT shall be → the date of issuance of invoice.

Analyses of Erstwhile Rule 7 Vs. Amended Rule 7:

	Date of service	Date of invoice (DOI)	Date of payment (DOP)	Applicability of KKC
As per erstwhile Rule 7	20.05.2016	25.05.2016	<u>04.06.2016</u>	POT shall be DOP: KKC applicable
As per amended Rule 7	20.05.2016	<u>25.05.2016</u>	04.06.2016	POT shall be DOI: KKC not applicable

Service Provider Vs. Service Receiver: Anomaly

	Date of service	Date of invoice (DOI)	Date of payment (DOP)	Applicable Rule	Applicability of KKC
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Liability of SP under forward charge	20.05.2016	25.05.2016	<u>04.06.2016</u>	Rule 5(a) of the POTR	KKC applicable
Liability of SR under reverse charge	20.05.2016	<u>25.05.2016</u>	04.06.2016	Rule 7 of the POTR	POT shall be DOI: KKC not applicable

Thus, under similar situation, on one hand KKC would be payable in case liability to pay Service tax is on service provider but KKC would not be payable when liability to pay Service tax is on the service recipient under reverse charge.

Our Comments:

Under the Finance Act, Section 66B of the Finance Act is the charging Section for levy of Service tax on taxable services. We are reproducing herewith Section 66B of the Finance Act for the ease of convenience:

“66B. Charge of service tax on and after Finance Act, 2012.

*There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen per cent. **on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory** by one person to another and collected in such manner as may be prescribed.”*

The literal interpretation of the charging Section 66B of the Finance Act means that the levy of Service tax is on the value of all taxable services ‘provided or agreed to be provided’. However, the collection of Service tax may be shifted to any point/ stage/event, in any manner, as prescribed by the Rules made in this behalf.

The Hon’ble Supreme Court in the case of ***All India Federation of Tax Practitioners Vs. Union of India [2007-TIOL-149-SC-ST]*** held that “a tax on a thing or goods can only be with reference to a taxable event” and the same contention was upheld again in the case of ***Association of Leasing & Financial Service Companies Vs. Union of India [2010 (20) STR 417 (SC)]***, wherein the Hon’ble Supreme Court observed that the **taxable event under the Service tax law is the rendition of service.**

In view of the above discussed provisions, the matter is subjected to debate as to whether KKC would be leviable on a service rendered prior to June 1, 2016 when KKC was not applicable at the time of its rendition, merely because its payment is received on or after the date of levy or the invoice is not issued within 14 days of the date of levy.

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Here, it would not be out of place to mention that the POTR were framed by the Central Government in exercise of the powers conferred under Section 94 of the Finance Act and such delegated legislation cannot be extended to go beyond the vires of the Finance Act.

As KKC awaits its introduction, in few days to come, still an immediate detailed clarification on the stated issue would surely be welcomed by the industry at large.

Tax Planning for KKC in terms of Rule 5 of the POTR

The explanations added to Rule 5 of the POTR raise a fundamental question as to whether a service which has already been provided prior to introduction of levy could be taxed on raising of invoice or receiving payment subsequently. However, the chargeable event being rendering of services will always be the prime factor for determining leviability of any tax or cesses. Nonetheless, the following is advised to our esteemed readers to plan their tax liability under KKC:

- Service Provider:
 - ✓ Any payment/advance received against services provided or to be provided before June 1, 2016 → Raise Invoice within 14 days from the date of service is taxed first time i.e. June 1, 2016;
 - ✓ Services rendered & Invoice raised before June 1, 2016 → Collect Payment towards the invoice raised
- Service Receiver:
 - ✓ Services rendered and No payment made before June 1, 2016 → Ask for Invoice to be raised before June 1, 2016.

To understand applicability of KKC in detail with multiple practical example(s) as to what will be the scenario when new levy 'KKC' becomes applicable from June 1, 2016 @ 0.5% on value of all taxable service, please watch video presentation at:

https://www.youtube.com/watch?v=NU5_2iAMy3g

To view all the Notifications/Circular, please click on the link below:

<http://www.a2ztaxcorp.com/wp-content/uploads/2016/05/KKC.pdf>

Hope the information will assist you in your Professional endeavours. In case of any query/information, please do not hesitate to write back to us.

Thanks & Best Regards

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