1

Service Tax Implication on Hotel and Software Industry – Mulund CA CPE Study Circle

CA Ashit Shah
Shah & Savla
Chartered Accountants

2

Matters to be covered

- Service Tax on Hotels & Restaurants
- Service Tax on Software – Information Technology Software

Shah & Savla

3

History – Tax on Hotels & Restaurant

- Transaction for supply of food and beverages in a restaurant or hotel is a contract of sale of goods or a composite contract for sale and service.
- Hon'ble Supreme Court in Northern India Caterers (1978) 42 STC 386 held that service of meals, whether in a hotel or restaurant does not constitute a sale of good for the purpose of levy of Sales Tax.

Shah & Savla

4

History – Tax on Hotels & Restaurant

- It was further held that such supply of food should be regarded as service in the satisfaction of a human need. If would not make any difference whether the visitor to the hotel is charged for the meal as a whole or according to each dish separately.
- This lead to amendment in Article 366(29A) of the Constitution.

Shah & Savla

5

History – Tax on Hotels & Restaurant

- 46th Amendment had included within its scope "the supply, by way of or as a part of any service, of food or any drink for cash, deferred payment or other valuable consideration", as deemed sales.
- Subsequent to the Constitutional amendment, VAT (Sales Tax) is being paid on the sale of food in hotels.

Shah & Savla

6

History – Tax on Hotels & Restaurant

- Five member Bench of SC in the matter of K. Damodarswamy Naidu & Sons Ltd. (2000) 117 STC 1, it was held that entire value should be deemed to be the consideration towards the sale.
- East India Hotels Ltd. (2001) 121 STC 46 (SC), it was held that when all movable properties, materials, articles or commodities are goods, food in restaurant is necessarily to be regarded as goods. The moment, dish is supplied and sale price is paid, it would amount to sale.

Shah & Savla

7

Taxability prior to 1st July 2012

- Finance Act, 2011 had introduced sub clause (zzzzv) in Section 65(105) from 1st May 2011. Taxable Services means –

Any services provided or to be provided to any person, by a restaurant, by whatever name called, having the facility of air-conditioning in any part of the establishment, at any time during the financial year, which has licence to serve alcoholic beverages, in relation to serving of food or beverage, including alcoholic beverages or both, in its premises;

Shah & Savla

8

Taxability prior to 1st July 2012

- Meaning of Restaurant as per Dictionary –

" a commercial place or establishment where meals are prepared and served to customers".

- Levy is directed at services provided by high-end restaurants that are having facility of air-conditioned and have license to serve liquor.

Shah & Savla

9

Taxability prior to 1st July 2012

- Such restaurants provide conditions and ambience in a manner that service provided may assume predominance over the food in many situations.
- It should not be confused with mere sale of food at any eating house, where such services are materially absent or so minimal that it will be difficult to establish that any service in any meaningful way is being provided.

Shah & Savla

10

Taxability prior to 1st July 2012

- The levy is intended to be confined to the value of services contained in the composite contract and shall not cover either the meal portion in the composite contract or mere sale of food by way of pick-up or home delivery, as also goods sold at MRP.

Shah & Savla

11

Clarification – C. No. 139/8/2011 dated 10-05-2011

1. More than one restaurant of same entity in one complex, of which one restaurant do not have air condition facility. Other restaurant liable?

Tax would be applicable only if both the conditions are fulfilled. If both the restaurants are clearly demarcated and separately named, the one which satisfies both criteria, is only liable to service tax.

Shah & Savla

12

Clarification – C. No. 139/8/2011 dated 10-05-2011

2. Services are provided from restaurant to other parts of the restaurant i.e. swimming pool or an open area attached to restaurant.

Taxable Services provided by a restaurant in other parts of the hotel eg. Swimming pool are also liable to service tax as these areas are become extensions of the restaurant.

Shah & Savla

13

Clarification – C. No. 139/8/2011 dated 10-05-2011

3. Room Service or Parcel Services attract Service Tax?

When the food is served in the room, service tax cannot be charged under the restaurant service as the service is not provided in the premises of the air-conditioned restaurant with a licence to serve liquor.

Shah & Savla

14

Clarification – C. No. 139/8/2011 dated 10-05-2011

4. VAT imposed by States required to be included for the purpose of Service tax?

For the purpose of service tax, State Value Added Tax (VAT) has to be excluded from the taxable value.

Shah & Savla

15

Clarification – C. No. 334/3/2011 dated 25-04-2011

- Value of taxable service would include any service charge separately charged by the Restaurant.
- However the amount paid by the customer ex-gratia e.g. as tip to any member of the staff doesn't constitute consideration paid to the restaurant and shall remain outside this levy.

Shah & Savla

16

Valuation of Taxable Services

- Restaurant's have option to avail the benefit of abatement of 70% from the value of taxable services is provided under N. No. 1/2006 dated 01-03-2006.
- Effective rate of tax after abatement would be 3.09% till 31-03-2012.
- After 01-04-2012 to 30-06-2012 effective rate would be 3.708% (being rate of tax enhanced from 10% to 12%)

Shah & Savla

17

Taxability after 1st July 2012

- Finance Act, 2012 had introduced concept of Negative list based taxation from 1st July 2012 and includes in "declared services" sub clause (i), which levy tax on "service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner, as a part of the activity.

Shah & Savla

18

Splitting of Services & Goods

- Composite Contract of supply food & beverages can be split artificially and levy Service tax on service portion ?
- Delhi Tribunal in matter of Sayaji Hotels (2011) 24 STR 177 held that in case of composite contract, hotel can not artificially divide the contract and levy service tax on identified service portion. Only option available is to pay tax on abated value as provided in N. No. 1/2006.

Shah & Savla

19

Exemption to certain class of Restaurants

- Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having (i) the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year, and (ii) a licence to serve alcoholic beverages.
- S. No. 19 of N. No. 25/2012 dated 20-06-2012

Shah & Savla

20

Exemption to certain class of Restaurants

- However, from 1st March 2013 condition of license to serve alcoholic beverages had been removed.
- Those restaurants, eating joint or a mess not having facility of air conditioning or central air-heating in any part of the establishment, at any time during the year are exempted from 1st March 2013.

Shah & Savla

21

Exemption to certain class of Restaurants

- Restaurants, Eating Joints or Mess locate in State of Uttrakhand are exempt from the taxable services provided from 17-09-2003 to 31-03-2014.
- This exemption had been granted to support and ensure sustenance for the local population by revival of Hospitality Industry due to floods and landslides.

[Ad-hoc Exemption Order No. 1/1/2013]

Shah & Savla

22

Dictionary Meaning

- Restaurant is defined as "place where people pay to sit and eat meals that are cooked and served on the premises"
- Eating Joint is defined as "informal an establishment of a specified kind, especially one where people meet for eating, drinking, or entertainment".

Shah & Savla

23

Dictionary Meaning

- Mess defined as –

a. A group of people, usually soldiers or sailors, who regularly eat meals together.

b. Food or a meal served to such a group: took mess with the enlistees.

c. A mess hall.

Shah & Savla

24

Dictionary Meaning

- "Food" is any substance or material eaten to provide nutritional support, fuel for the body. Food is usually of plant or animal origin, and contains essential nutrients, such as carbohydrates, fats, proteins, vitamins, or minerals.
- Beverage is always a food, though a food is not necessarily a beverage. A beverage can be generally described as any liquid specifically consumed by drinking, whether as food or solely for purposes of hydration.

Shah & Savla

25

Valuation of Taxable Services

- Rule 2C of Service Tax (Determination of Value) Rules, 2006 provides that value of service portion in an activity wherein goods, being food or any other article of human consumption or any drink is supplied, in any manner, as a part of activity, at a Restaurant would be 40% of total amount charged.
- Effective rate of tax 4.944%

Shah & Savla

26

Valuation of Taxable Services

- "total amount" means the sum total of the gross amount charged and the FMV of all goods and services supplied in or in relation to the supply of food or any other article of human consumption or any drink (whether or not intoxicating), whether or not supplied under the same contract or any other contract, after deducting-
  (i) the amount charged for such goods or services, if any; and
  (ii) the value added tax or sales tax, if any, levied thereon:
- FMV of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Shah & Savla

27

Valuation of Taxable Services

- From 1st July 2012 onwards, Restaurant's have to determine the value of service in relation to supply of food and Beverages as per the Rule 2C of SDVR, 2006, as N. No. 12/2003 was rescinded from 01-07-2012.
- No Option for claiming deduction of goods, as provided under Rule 2A for "Works Contract Service".

Shah & Savla

28

Cenvat Credit

- Restaurants are eligible to avail the Cenvat Credit on Capital Goods and Input Services provided such goods and services are covered within the definition of CG and IS.
- Inputs such as "Raw and prepared animals", "Vegetable products", "Fats, Oils and their cleavage products", "prepared food stuffs", "Beverages" and "Vinegar" are not eligible for Credit.

Shah & Savla

29

Canteen facility provided by Employer

- Serving of food or beverages by a canteen maintained in a factory (as defined under Factories Act, 1948) having the facility of air-conditioning or centrally air heating at anytime during the year.

  [N. N. 14/2013 – dated 22-10-2013]
- Under Factories Act, 1948, every factory wherein more than 250 workers are employed ordinarily employed, must provide canteen and maintained by the occupier for the use of workers.

Shah & Savla

30

Supply of food in Train / Air Plane

- Indian Railways supplies food and beverages to passengers while on board. Service Tax can not be attracted on following arguments.
  - Supply contract brought under fiction of 'deemed sale' and splitting of service and supply in respect of such contract, constitutionally permissible;
  - passengers having no choice of articles served as the same supplied as per menu fixed by Railway Board;
  - Passenger having no choice as to time and place of service of food

Shah & Savla

31

Supply of food in Train / Air Plane

- No refund allowed if food provided not accepted;
- Service element in providing food in present case incidental and bare minimum required for selling food;
- Impugned transaction one of pure sale of goods ;
- Sale of goods taking place when goods loaded on board trains in Delhi and not at place when food is served;
- Petitioner at liberty to challenge Service tax levy

  Indian Railways – (2010) 20 STR 437 (Delhi)

  Sky Gourment P. Lt. – (2009) 14 STR 777 (Tri-Bang)

  Saj Flight Services – (2006) 4 STR 432 (Ker) – ST Applicable

32

Constitutional Validity

- Kerala Classified Hotels & Resorts Association 2013(31) STR 257 filed writ petition challenging Constitutional validity.
- Hon'ble High Court held as under:
  - It was beyond legislative competence of Parliament as transaction were covered by Entry 54 of List II of 7th Schedule of Constitution of India, and within exclusive competence of State Legislature.

Shah & Savla

33

Constitutional Validity – Hon'ble HC

- Under deeming provision of Article 366(29-A)(f) of Constitution of India, incidence of tax was on supply of any goods by way of or as part of any service,
- When food or alcoholic beverages were supplied as part of any service, such transfer was deemed to be sale.
- As transfer was during course of service, deeming provision permitted State Government to impose tax on such transfer.

Shah & Savla

34

Constitutional Validity – Hon'ble HC

- Accordingly, it was held that levy is unconstitutional and beyond the legislative competence of Parliament.
- It was further directed that if petitioner had made any payment of taxes, they are entitled for refund.
- However, HC fails to throw light on dual taxation by Centre as well as State thereby burden of tax is enhanced on customer. Centre charges tax on 40% whereas State charge on full 100%.

Shah & Savla

35

Key Features

Particulars	From 01-05-11 to 31-03-12	From 01-04-12 to 30-06-12	From 01-07-12 to 31-03-13	From 01-04-2013
Scope	Restaurants having AC & license to serve liquor	Restaurants having AC & license to serve liquor	Restaurants having AC & license to serve liquor	Restaurants having AC
Abatement	70%	70%	60%	60%
Effective Rate	3.09%	3.708%	4.944%	4.944%
Free Supplies	Included	Included	Included – FMV	Included - FMV
Cenvat Credit	Not eligible for CG, Inputs & IS	Not eligible for CG, Inputs & IS	Not eligible for Inputs under chapter 1 t0 22	Not eligible for Inputs under chapter 1 t0 22

Shah & Savla

36

Tax on Software – Prior to July 12

- Finance Act, 2008 had introduce new sub clause (zzzze) in section 65(105) and "information technology service" was brought in to existence from 16-05-2008.
- Taxable service means any service provided or to be provided to any person, by any other person in relation to information technology software for use in the course, or furtherance, of business or commerce, including

Shah & Savla

37

ITS includes .... – Prior to July 12

(i) development of information technology software,
(ii) study, analysis, design and programming of information technology software,
(iii) adaptation, upgradation, enhancement, implementation and other similar services related to information technology software,
(iv) providing advice, consultancy and assistance on matters related to information technology software, including conducting feasibility studies on implementation of a system, specifications for a database design, guidance and assistance during the start up phase of a new system, specifications to secure a database, advice on proprietary information technology software,

Shah & Savla

38

ITS includes .... – Prior to July 12

(v) acquiring the right to use information technology software for commercial exploitation including right to reproduce, distribute and sell information technology software and right to use software components for the creation of and inclusion in other information technology software products,
(vi) acquiring the right to use information technology software supplied electronically;

The phrase 'acquiring the right to use' has been replaced with 'providing the right to use' vide Ministry's Circular Letter D.O.F. No. 334/13/2009-TRU dated 6.7.2009.

Shah & Savla

39

Types of Software's

1. Packaged Software or Canned Software:
   Such software's are marketed as a standard product, to meet the particular requirement of the large number of user. Although such programs may be tailored to a user's taste by setting various preferences.

2. Customized Software:
   Such software's are is meant to meet the particular requirement of the user or individual.

Shah & Savla

40

Tax on Software – After July 12

- Finance Act, 2012 had introduced concept of Negative list based taxation from 1st July 2012 and includes in "declared services", Section 66E, sub clause (d), which levy tax on services relating to information technology services.

- Section 66E (d) covers development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software;

Shah & Savla

41

Tax on Software – After July 12

- Almost all the services relating to ITS, whether used for any commercial or non-commercial purpose, will be consider as taxable services.

Shah & Savla

42

Meaning of ITS – After July 12

- Section 65B (28) defines meaning of ITS as –

  "information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment;

Shah & Savla

43

Meaning of ITS – After July 12

- Software is also an intellectual property.
- The licensing of software is also a taxable service under clause (c) of Section 66E. Amount paid by the person for licensing of software is nothing but amount paid for use or enjoyment of software and hence service tax is payable.

Shah & Savla

44

Sale of Packaged Software

- Apex Court in the matter of Tata Consultancy Services – 2004 (178) ELT 22 held that pre-package or canned software are put on some medium i.e. pen drive or CD, before its sale and hence is in the nature of "goods" and not covered by sub clause (d) of "declared services".
- Such activity would only be transfer of right to title in goods and hence out of the purview of definition of Service as provided in S. 65B(44).

Shah & Savla

45

Sale of Packaged Software

- Prior to July 2012, CBEC through the Notification No 53/2010 ST dated 21.12.2010 has exempted service tax on retail sale of packaged computer software classifying the packaged software as goods and not service, subject to certain conditions.
  - (i) Appropriate Excise Duty is paid by manufacturer, duplicator or person holding the copy right;
  - (ii) Appropriate Custom Duty is paid by the importer;
  - (iii) No excess amount in excess of retail sales price is recovered from customer.

Shah & Savla

46

Sale of Packaged Software

- Post July 2012, CBEC through Education Guide at para 5.4.1 provided that Sale of pre-package or canned software is in the nature of sale of goods and is not covered by entry (d) of "declared goods".

Shah & Savla

47

Sale of Customized Software

- Hon'ble SC on Tata Consultancy Services matter did not decide as to whether unbranded software is considered as goods or not, as the same was not an issued before Court.
- SC in BSNL 2006 (2) STR 161 upheld that software whether customized or non-customized would become goods provided it satisfies the attributes of goods, viz (a) its utility; (b) capability of being sold & bought; (c) capability of being transmitted, transferred, delivered, stored or possessed.

Shah & Savla

48

Sale of Customized Software

- Madras High Court in the matter of Infosys Technologies Ltd. 2009 (233) ELT 56 relying on the judgment of TCS held that unbranded / customized software developed and sold to customer, with or without obligation for system upgradation, repair and maintenance or employee training, satisfies the rule as "goods", it will also be "goods" for the purpose of Sales Tax.

Shah & Savla

49

Sale of Customized Software

- When software sold electronically it would tantamount to "sale" only if source code and entire property in software is transferred to buyer. But in the common parlance there is no sale of software as such as entire property in software is never passed on to buyer. In such cases only right to use a software for a particular period is transferred and renewal fee is charged from the buyer. Accordingly, Service tax would attract.

Shah & Savla

50

Software downloaded electronically

- Software is downloaded through medium of internet, it can not be considered as "goods" as per rationale of the SC in Tata Consultancy Services matter.
- Central Excise duty is not levied as goods are not physically removed from the factory gate, which is requirement of levy of Excise Duty, hence can not be termed as manufacturing.

Shah & Savla

51

Software downloaded electronically

- Digital Equipment (India) Ltd. (2001) 135 ELT 962, Tribunal held that when there is transfer of information or idea or knowledge on email, such transfer would not be covered within the ambit of "goods" under Customs Act. Since, this are not goods, its "Service".
- Pantex Geebee Fluid Power Ltd. (2003) 160 ELT 514, Tribunal held that transfer of intellectual property by intangible means, like email, would not be liable for custom duty.

Shah & Savla

52

Software downloaded electronically

- Microsoft Corporation (India) P. Ltd. – AAR / ST / 04 /2013 dated 02-09-2013, Authority of Advance Ruling ruled that when software is downloaded electronically, it would attract Service tax.
- Hence, downloaded software's will attract Service tax.

Shah & Savla

53

License to use pre-package software

- Education Guide at para 6.4.4. provides pre- packaged software is "goods" as per SC in Tata Consultancy Services matter.
- To determine whether providing license to use a software is a service or sale of goods it would need to be seen whether the license to use packaged software tantamount to 'transfer of right to use goods'. Effective control & possession of property.

Shah & Savla

54

License to use pre-package software

- Transfer of right to use goods' is deemed to be a sale under Article 366(29A) of the Constitution of India and transfer of goods by way of hiring, leasing, licensing or any such manner without transfer of right to use such goods is a declared service.
- Such license to use is in paper form or in electronic form makes no material difference to the transaction.

Shah & Savla

55

On Site Development & Content online

- On site development of software is covered under the category of development of information technology software. Accordingly, such charges would attract service tax under "declared services". [Para 6.4.2 of Education Guide]
- Delivery of content online would not amount to a transaction in goods as the content has not been put on a media before sale. Hence it is provision of service.

Shah & Savla

56

Advise, Consultancy on matters of ITS

- Advise, consultancy and assistance on matters relating to information technology software will not be covered under "declared services". However, such activities carried out by person for another for consideration would fall within the definition of service and hence chargeable to service tax if other requirements of taxability are satisfied.

Shah & Savla

57

Shah & Savla

58

Happy Sunday from

Shah & Savla
Chartered Accountants

Visit us at
www.shahnsavla.com

Talk to us at
+91 22 2501 0700
+91 22 2501 0701
+91 22 2501 0702

Shah & Savla