

Supply of Tangible Goods for Use

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Finance Act 2008 has introduced among many, a new category of service which would be subjected to levy of service tax and that is supply of tangible goods for use. This category has been introduced with effect from 16.05.08 and is another instance where a transaction of supply of goods is sought to be subjected to service tax levy. The intention here seems to be to tax such supply of goods where no VAT/sales tax is levied/leviable. This has been clarified by the departmental letter F.No. 334/1/2008 TRU dated 29.02.08 which goes to the extent of saying that transaction of allowing another person to use the goods without giving legal right of possession and effective control which is not treated as a sale of goods is treated as a service, thereby deeming such transaction as one amounting to service. This seems to be a fallout of the decision of the Karnataka High Court in Lakshmi Audio Visual Vs ACCT (2001 (124) STC 426 (Kar) case as well as similar decision in other states wherein it was held – “there is no deemed sale under KST in providing audio visual services for any program or event without delivering any equipment to the customer.” One would have to analyze each case (agreements, invoices, conduct of parties etc.) to find out whether there is transfer of possession and effective control as it would determine whether the transaction is to be taxed as one of sale, or one of service.

Definition

As per Section 65(105)(zzzzj) of Chapter V of Finance Act as amended, taxable service means any service provided or to be provided to any person, by any other person in relation to supply of tangible goods including machinery, equipment and appliances for use, without transferring right of possession and effective control of such machinery, equipment and appliances. Thus if one purely goes by the definition, it may also be possible to argue that what is liable is service in relation to supply of tangible goods without transferring right of possession and effective control of such machinery and not the supply itself though the intention of revenue as evidenced by the departmental letter, is different.

Concept of tangible goods

Before we proceed further with our discussion, it would be important to go through the definitions of some of the important terms relevant in this regard. The term “tangible goods” has not been defined under the Finance Act and one would have to refer other sources for the same. “Goods” has been defined under the Sale of Goods Act to mean every kind of movable property other than actionable claims and money; and including stock and shares, growing

crops, grass and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale. Goods should thus be movable property capable of being bought and sold and capable of being transmitted, transferred, delivered, stored and possessed. Immovable property is not being taxed under this category and would have to be examined under the category Renting of Immovable Property service under service tax.

The term “tangible” would have to be seen in light of the meaning assigned by English Dictionary. As per Random House Webster’s Unabridged Dictionary, tangible means capable of being touched or discernible by the touch. The goods being supplied should be tangible goods i.e. having physical existence and form, in order to attract liability under this category. In other words intangibles would not be covered under this category at all and the taxability of the same would have to be seen under the old category of Intellectual Property Services since this service category specifically deals with tangible goods.

Concept of supply, control etc

The term “supply” means to furnish or provide (a person, establishment or place etc) with what is lacking or requisite. The word supply need not necessarily indicate transfer of the right of possession or effective control over the goods/materials in question.

The term “transfer” means “to make over the possession or control of” or “to convey or remove from one place, person to another”.

The term “possession” has been defined as “actual holding or occupancy, either with or without rights of ownership”.

The term “control” has been defined as “to exercise restraint or direction over; dominate, regulate, or command.”

If one recalls the definition, in order to make a transaction of supply of tangible goods not liable under this category, there should be a transfer of both possession as well as effective control over the said goods, to the user. The presumption here seems to be that VAT/sales tax is levied in cases where both right of possession as well as effective control over the goods is transferred to the user. The risk and reward of ownership would lie with the person who enjoys the possession.

Concept of deemed sale

In this regard, it would be interesting to go through Article 366(29A) of the Constitution of India as well as the decision of the Supreme Court in Bharat Sanchar Nigam Ltd and Another Vs

Union of India and Others (2006-TIOL-15-SC-CT-LB) wherein the concept of sale, deemed sale and the powers of the states to levy sales tax on deemed sales had been discussed in detail in light of the 46th amendment to our Constitution. Article 366(29A) after the said amendment, goes thus – “tax on the sale or purchase of goods” includes –

- (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
- (b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;
- (c) a tax on the delivery of goods on hire-purchase or any system of payment by installments;
- (d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;
- (e) a tax on the supply of goods by any unincorporated association or body of person to a member thereof for cash, deferred payment or other valuable consideration;
- (f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration;

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made.

The Supreme Court in the aforesaid case (BSNL Vs UOI) had reiterated that the sale element in those contracts not falling under the aforesaid six clauses would be taxed depending on the substance of the contract (i.e. applying dominant nature test). Here, the intention of the parties entering into the particular transaction of sale would be important. However, in cases where the contract falls under any of the six categories specified above under Article 366(29A) of the Constitution of India, the dominant nature test need not apply and the sale element of those contracts can be subjected to sales tax by the concerned state even if one or more of the ingredients for sale as specified by Section 4 of Sale of Goods Act 1930 are absent. Thus one would have to examine the nature of transactions that one intends to bring under this category of service as the same would also have to be seen from the sales tax/VAT angle to know the overall liability for the assessee.

The departmental letter talks about certain cases where both, right as to possession and effective control may not be transferred to the user. These could cover the present practice of hiring of excavators, wheel loaders, dump trucks, crawler carriers, compaction equipment, cranes, offshore construction vessels and barges, geotechnical vessels, tug and barge flotillas, rigs, airplanes and high value machineries. There may however, be cases where hiring of equipment involves exercising of control over such equipment albeit temporarily, by the user without physically operating the same. In such a scenario, the transaction would be liable under service tax. Here, there is a danger of the transaction inviting scrutiny of the LVO as well if one were to note the decision of the Gauhati High Court in HLS Asia Ltd Vs State of Assam (2003-132-STC 217) where the importance of implied possession and the absolute authority of the user/customer over the usage of the equipment was brought out.

Assessee may here note that transfer of right to use goods for any purpose falls under clause (d) of Article 366(29A) of Constitution of India which can be subjected to sales tax by the concerned states as a deemed sale. Here, the right in question is legal right to use goods. As discussed in BSNL Vs UOI case, to constitute a transaction for the transfer of the right to use the goods the transaction must have the following attributes –

- (a) There must be goods available for delivery
- (b) There must be consensus *ad idem* as to the identity of the goods
- (c) The transferee should have a legal right to use the goods – consequently all legal consequences of such use including any permissions or licenses required therefore should be available to the transferee
- (d) For the period during which the transferee has such legal right, it has to be to the exclusion of the transferor
- (e) Having transferred the right to use the goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others

Where the aforesaid criteria are satisfied in a transaction, the same would fall under clause (d) of Article 366(29A) of Constitution of India and would attract sales tax. When the transaction is subject to sales tax, the same cannot be subject to service tax. Even where the transaction is one of hiring, the question of levying sales tax/VAT would arise where full possession and control is given to the hirer/user as per the decision rendered in Rashtriya Ispat Nigam Vs State of Andhra Pradesh (2002-TIOL-560-SC-CT).

Exemptions

The supply of goods carriage to a Goods Transport Agency for carriage of goods by road liable under GTA service, without transferring the right as to possession and effective control, has been exempted under notification 29/2008 ST dated 26.06.08. The usage of the vehicle should be by the said GTA.

Benefits – Cenvat Credits

The service provider is entitled to claim cenvat credits on the input services used for providing such taxable service, in the opinion of the authors. Input services could be in the nature of manpower recruitment and supply services, authorized service station services, security services etc. Credits would also be admissible in terms of the excise duty on the spares. The credit of excise duty on capital goods would also be admissible where the equipments are procured by the assessee/service provider from a manufacturer or a dealer registered under Central Excise and then supplied to the user. However where the goods in question should not fall under the category of motor vehicles as credit would not be available. The representation that the same should also be allowed has been made in the pre budget memorandum by trade and professional bodies. **Issues**

Where the transaction is one of supply and sales tax/VAT is chargeable, is service tax payable?

Where the transaction is one involving sale or transfer of right to use goods, the taxability would be under sales tax/VAT and not under service tax. This would be the case where the transaction is one of pure supply of tangible goods for use.

Where the supply is part of a composite contract which involves other services what should be the treatment to be given?

Where services are provided and tangible goods are also supplied for use, the nature of services provided would assume significance especially under service tax where the services provided are taxable services. For instance, if site formation services are provided along with supply of excavators, and such supply is part and parcel of the contract for service, then the charges for site formation related work would be taxed under the head site formation services under service tax. The assessee would have to then analyze whether the usage of excavator amounts to transfer of right to use goods to the client/customer. Where it does not, the charges for the same would have to be subjected to service tax. The classification of the service would be done using the basic principles of classification under service tax.

What is the additional criteria for Export of Service or for finding out whether the taxable service has been received in India from abroad?

The service has been put under recipient based criterion to decide whether the taxable service is exported or received in India from abroad. This is in addition to the basic conditions pertaining to export out of India or receipt of service in India from abroad. The place of usage of tangible goods would also play an important part. For regarding the service as having been exported, the usage should be outside India. Similarly, for regarding the service as having been received in India from abroad, the usage of the tangible goods by the service recipient should be in India.

It is expected that the agreements which are entered into for such transactions maybe clear as to the possession including the effective possession. As the state and centre tax ST and VAT, disputes can be expected in this area.