ANALYSIS OF SERVICE TAX ON SUPPLY OF FOOD OR DRINK AND ACCOMMODATION AND THE KERALA HIGH COURT DECISION

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Introduction

Article 265 states that no tax shall be levied or collected without the authority of law. Further article 246 governs the subject matter of the laws made by the parliament and by the legislature of states. The matters are listed in the seventh schedule to the Constitution. The seventh schedule is classified into three lists:

a. List I: This list sets out the matters in which the parliament has an exclusive right to make laws
b. List II: This list enumerates the matters in respect of which the legislature of any state has an exclusive right to make laws.
c. List III: This list enumerates the matters in respect of both the parliament and subject to list I, legislature of any state, have powers to make laws.

Accordingly there were ensuing questions on the applicability of aspect theory ie whether the Union could levy taxes on subject matter of State list and vice versa. Further whether aspect theory can be valid where concurrent list exists. This question arises particularly in the items of negative list for software and IPR.

We examine in this article, the levy of State and Central levies on supply of food or drink and accommodation in light of the Kerala High Court Division Bench decision.

What is a composite transaction?

A composite transaction is a transaction which involves both supply of goods and services and such transaction cannot be vivisected for charging different types of taxes. Taxability of a composite transaction depends on the intention of the parties involved, that is whether parties has contracted for goods or services. The test for deciding whether a contract falls into one category or other is to decide as to what is the substance of the contract. It can be called as the dominant nature test.

The dominant nature test can be summed up as follows-

- If the dominant nature of such a transaction is sale of goods or immovable property then such transaction would be treated as such.
- If the dominant nature of such a transaction is provision of a service then such transaction would be treated as a service and taxed as such even if the transaction involves an element of sale of goods.

However this test has certain exceptions. The exceptions are those entries which were brought into definition of deemed sale vide article 366(29A) in the Constitution. Accordingly after the 46th amendment, it has become possible for the states to levy sales tax on the value of goods involved in the following-

a. a tax on the transfer of property in goods (whether as goods or in some other form) invoked in the execution of a works contract;
b. _____.;
c. _____;
d. _____;
e. 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;

Consequently, even the composite contract embodied in a single document would be deemed to be divisible for the purpose of levying sales tax. However for the other entries this question maybe open.

At the same time, the Finance Act 2011, had introduced a new service tax levy on Restaurants & Accommodation provided in hotels, lodges, inns etc. This levy would be applicable with effect from 01.05.2011.

Service Tax on restaurant and accommodation services

From 1.5.2011, the service tax is levied on Restaurant Service. The service tax is levied on services provided to any person, by a restaurant, 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;

Under negative list based taxation, the declared services has an entry 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 part of the activity.

Prior to 1.4.2013, levy was attracted when there was both air conditioner and license to serve alcoholic beverages. From 1.4.2013, the requirement of license to serve alcohol as a condition to attract service tax on restaurant services is done away with. It is sufficient that the restaurant, eating joint or mess has AC facility or central air heating to attract the levy. This has attracted the service tax levy on most hotels which were hitherto exempted /excluded from service tax levy.

Short term accommodation services are brought to tax net wef 1.5.2011. The service tax levy was attracted under this category on the services provided to any person, by a hotel, inn, guest house, club or campsite, by whatever name called, in relation to providing of accommodation for a continuous period of less than three months.

Under negative list based taxation, it levied service tax on services by way of renting of a hotel, inn, guest house, club, campsite or other places meant for residential or lodging purposes, having declared tariff of a unit of accommodation of equal to or more than rupees one thousand per day or equivalent;

Whether service tax and VAT can be levied on supply of food or drink?

If the entire amount is offered to VAT as a supply of food, levy of the service tax on the same amount would be amounting to a double taxation. The supreme court more than a decade back in K. Damodarasamy Naidu v. State of Tamil Nadu [2000 (117) STC 1 (SC)] has held that the tax is on the supply of food or drink and it is not of relevance that the supply is by way of a service or as part of a service. In our view, therefore, the price that the customer pays for the supply of food in a restaurant cannot be split up. The price provided for food could not be split up between charges for food and charges for services for the purpose of taxation. Applying same analogy, the question of taxing under service tax could be doubtful especially if on the full amount VAT has been paid appropriately.

The levy under service tax would also be against the basic principle that service tax and VAT are mutually exclusive. Once VAT is rightly levied on a transaction service tax cannot be levied on same. This has been held in a number of decisions, important of which is decision in Imagic Creative case 2008 (9) S.T.R. 337 (S.C.) which was a Supreme Court decision.

Further as per the explicit provision in Article 366(29A) it levied sales tax as a deemed sale 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. Further there was no deduction for the service portion of supply of goods[food/any article for human consumption]. In other words, the entire transaction was leviable to sales tax. In opinion of paper writers the levying of service tax is doubtful if on the full amount VAT has been paid as required under law.

Discussion on Kerala High Court Division Bench decision.

In a recent development while dismissing revenue appeal, division Bench of Kerala High Court (2014-TIOL-1913-HC-KERALA-ST**)** holds States alone have power to impose tax on sale of food and on accommodation. The High Court held:

After the Constitution (Forty Sixth Amendment) Act, the activity is deemed as a sale of goods. After the Constitution (Forty Sixth Amendment) Act, it cannot be said that it is an activity of service.

When the said activity is deemed to be a sale of the food and other articles of human consumption, by a constitutional definition, tax on the said activity can be imposed only by the States in view of Entry 54 in List II of the Seventh Schedule.

In other words, in view of the aforesaid constitutional amendment, it cannot be said that there is any service involved in the supply of food and other articles of human consumption in a restaurant. The States alone have the legislative competence to enact any law imposing tax on the said matter.

Coming to sub-clause (zzzzw) of Clause 105 of Section 65 of the Finance Act, 1994, as amended by Finance Act, 2011, as found by the learned single Judge, the Constitution Bench of the Apex Court in Godfrey Philips India Ltd v. State of U.P. - 2005-TIOL-10-SC-LT-CB, held that the word "luxuries" in Entry 62 of List II means the activity of enjoyment of or indulgence in that which is costly or which is generally recognized as being beyond the necessary requirements of an average member of society.

The matter covered by sub-clause (zzzzw) of Clause 105 of Section 65 of the Finance Act, 1994, as amended by Finance Act, 2011, namely short term accommodation service, is a matter enumerated in Entry 62 of List II of Seventh Schedule and the States alone have the legislative competence to enact any law imposing tax on the said matter.

Way forward

This decision was by application of the principle that the Constitution is above the law. The Constitution permitted sale of goods during service as taxable as a deemed sale. Necessarily service formed part of deemed sale of goods. Therefore, State Government alone has the competence to enact a law imposing tax on service elements forming part of sale of goods. This could be an indication how the issue of taxability of supply of food and drink may move forward.

At same time as the matter has not yet been confirmed at the highest level of judiciary. In the opinion of the paper writers, restaurants/ hotels could safely rely on this decision. They may as a measure of caution write under an acknowledgement seeking confirmation of their view that there is no liability. However those who do not wish to have any disputes with the government could err on side of caution and pay the ST wherever the customers are willing to pay.