LB decision in Aggarwal Color case on Notification No. 12/2003– an analysis – Dec 21, 2011

THE recent decision of the Larger Bench in the Aggarwal Colour Advance Photo System case, reported in *2011-TIOL-1208-CESTAT-DEL-LB* would seem to have raised a lot of questions, on the levy of service tax on the 'sale' portion and more importantly, on the very applicability of Notification No. 12/2003 in respect of deemed sale transactions.Despite my obvious shortcomings in terms of my understanding of indirect taxes, I am undertaking this brave attempt at writing this piece.

First, let's look at the gist of the two issues that were before the Hon'ble Tribunal, as reported by **TIOL** (I've extracted the relevant portions of the decision as reported in **TIOL**):

Issue No.1 : Whether for the purpose of Section 67 of the Finance Act, 1994 the value of service provided in relation to photography would be the "gross amount charged" including the cost of material, goods used/consumed minus the cost of unexposed film?

Issue No.2 : Whether the term 'sale' appearing in exemption Notification No.12 /03-S.T., dated 20-6-03, is to be given the same meaning as given by Section 2(h) of the Central Excise Act, 1944, read with Section 65(121) of the Finance Act, 1994 or this term would also include the deemed "sale" as defined by Article 366 (29A)(b) of the Constitution?

The observations of the LB can be summarized, very briefly, as under:

On Issue No.1 :

Service tax is levied on the gross value of taxable service. That is measure of levy. Therefore, determination thereof is crucial. Power is vested with Central Government to notify in public interest to grant exemptions from service tax in exercise of power conferred u/s 93 of the Finance Act, 1994. Depending on the facts and circumstances of each taxable service provided, certain elements of cost make value of such services and such elements which are integral, relevant, indispensable and inevitable to provide taxable service and bring that service to the stage of performance, contribute to the value of such service. Service tax being destination based consumption tax, till the taxable service reaches its destination, all elements of cost making the service reachable to such destination contribute to the value addition and form part of value thereof. Agreement or understanding of the parties to deal with the consideration for the service rendered and received does not affect incidence of tax. In whatever manner the recipient and provider of taxable service mutually arrange their affairs for their benefit to deal with consideration that is of no significance to law. Service Tax (Determination of Value) Rules 2006 which came into force from 19.4.2006 is a step towards ascertainment of value of taxable service.

The nature and character of service tax has been explained by Apex Court in para 22 of the judgment Association of Leasing & Financial Service Companies vs. Union of India and others reported in *2010-TIOL-87-SC-ST-LB* . It is an economic concept based on the principle of equivalence in a sense that consumption of goods and consumption of service are similar as they both satisfy human needs. Today with the technological advancement there is a very thin line which divides a "sale" from "service". Applying the principle of equivalence, there is no difference between production or manufacture of saleable goods and production of marketable/saleable services in the form of an activity undertaken by the service provider for consideration, which correspondingly stands consumed by the service receiver. Such principle of equivalence is inbuilt into the concept of service tax under the Finance Act, 1994. It is thus a tax on an activity and it is a value added tax. The value addition is on account of the activity, which provides value addition.

On Issue No.2 :

Notification No.12 /2003-ST dated 20/6/2003 was issued by Central Government in exercise of powers conferred by section 93 of the Finance Act, 1994 exempting so much of value of all the taxable services as is equal to the value of goods and material sold by the service provider to the recipient of service.

The term "sold" as appearing in the Notification can only be read with reference to definition of 'sale' as appearing in the Central Excise Act, made applicable for the purpose of levy of service tax under the Finance

Act, 1994, It therefore follows that the Notification intends to exempt the value of goods and materials sold by the service provider while providing service. To claim a part of the value charged as exempt in terms of the Notification, an Assessee has to discharge burden of proof adducing evidence showing value of goods and material actually sold and satisfy the conditions of Notification. The expression 'sold' cannot in our considered view include 'deemed sale' of goods and material consumed by the service provider while generating and providing service.

The decision of the LB on the above referred two issues raised as follows -

(i) For the purpose of Section 67 of the Finance Act, 1994, the value of service in relation to photography would be the gross amount charged including cost of goods and material used and consumed in the course of rendering such service. The cost of unexposed film etc. would stand excluded in terms of Explanation to section 67 if sold to the client.

(ii) The value of other goods and material, if sold separately would be excluded under exemption Notification No.12 /2003 and the term 'sold' appearing there-under has to be interpreted using the definition of 'sale' in the Central Excise Act, 1944 and not as per the meaning of deemed sale under Article 366 (29A) (b) of the Constitution.

The Larger Bench added that it can be said that determination of value of taxable service of photography depends on the facts and circumstances of each case as the Finance Act, 1994 does not intend taxation of goods and materials sold in the course of providing all the taxable services.

One popular and perhaps, totally erroneous conclusion which would seem to flow from this decision is that, Notification No. 12/2003 cannot cover 'deemed sales' transactions involving works contracts. To me, this conclusion, which could be advanced by the Revenue, would seem to be totally incorrect and against the law laid down by the Apex Court, in several cases. More importantly, such a conclusion would go against the legislative intent behind the 46 th Amendment to the Constitution. Let's try and see how.

We must bear in mind that, civil works contractors are very much involved in the 'sale of goods' within the meaning of the applicable sales tax laws. As we are aware, in terms of the the 46 th Amendment to the Constitution, a new Clause 29A was introduced in Article 366. This insertion, has defined the expression "tax on sale or purchase of goods" employed in various Articles, including the Seventh Schedule to the Constitution to bring within its ambit, six specific types of transactions which prior to 1982, were not considered as sale transactions. Due to this Constitutional amendment, these six types of transactions have now come to attract the levy of sales tax / VAT by the States. The States do not make any distinction between these transactions and other transactions, for purposes of levy of tax, except for the fact that, the transactions which have come into the tax net by virtue of the Constitutional amendment, as stated above, are considered for an appropriate deduction of the labour and like charges under the VAT/sales tax laws. After the 46 th Amendment, referred to above, by a deeming fiction, these six types of transactions are deemed to be sale transactions, for purpose of levy of sales tax/VAT. There is no reason to hold that, there is a difference between these six types of transactions and the other transactions, from the point of levy of sales tax/VAT.

All the sales tax/VAT laws have included works contracts, in the definition of 'sale', as we know. For instance, as per the definition of 'sale' under Section 2(29) of the Karnataka Value Added Tax Act, 2003, a transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract, is covered within the ambit of 'sale'. Hence, there is no reason to believe that, the six types of transactions which include works contracts are to be treated in a manner which is different from the sales transactions. Consequently, any benefit that is available under the service tax law for sale transactions, is very much available to these six types of transactions.

The intention behind issuing Notification No. 12/2003, should also be borne in mind, which is to ensure the legal view that, a transaction or a part of a transaction which has suffered sales tax/VAT, cannot again be subjected to the levy of service tax, which would result in a double levy, in respect of the same transaction or part of the transaction. This view has also been repeatedly stated by the CBEC in its Circulars and notably in the Master Circular No dated 23-8-2007 in Para 036.03/23.08.07, wherein, a very bold statement that "Service tax is not leviable on a transaction treated as sale of goods and subjected to levy of sales tax/VAT. Whether a given transaction between the service station and the customer is a sale or not, is to be determined taking into account the real nature and material facts of the transaction. Payment of VAT/sales tax on a transaction indicates that the said transaction is treated as sale of goods" is made.

TheHon'ble Supreme Court has, while dealing with the constitutional validity of the levy of service tax, dealt with the concept of sale. For instance, in the case of Tamil Nadu KalyanaMandapam Association v. Union of India **2004-TIOL-36-SC-ST** in Para Nos 42, 43 and 44, the Apex Court has referred to the concept of sale of goods under the Sale of Goods Act, 1930 and sale under the law of contracts and has observed as follows:

Quote:

"it is well settled that for the tax to amount to a tax on sale of goods, it must amount to a sale according to the established concept of a sale in the law of contract or more precisely the Sale of Goods Act, 1930".

Unquote:

It is very surprising to see that this very important decision of the Apex Court was not considered by the LB.It is very clear from the above decision that, when sales tax/VAT is levied on the 'sale component' in a composite contract of sale and service by the state Governments under the sales tax/VAT laws, the Central Government can levy service tax only on the service component, which in effect, would be the balance value of the transaction. Denial of the benefit of Notification No. 12/2003 to works contracts, on the basis that, these are 'deemed sale' transactions, would, in effect mean, the service tax is levied even on the sale component of the composite value, which is clearly not permissible, in terms of the law laid down by the Apex Court. The decision of the Hon'ble Delhi High Court in Indian Railways Catering and Tourism Corporation Limited v. Government of NCT and Otrs***2010-TIOL-517-HC-DEL-ST*** which has been rendered on a similar set of facts, is also relevant here.

It must be reiterated that,works contractors are involved in 'sale of goods' within the meaning of the State VAT/sales tax laws in terms of the following decisions:

- *State of Tamil Nadu v. Thiru Murugan Brothers AIR 1988 SC 336*
- *Coffee Board, Karnataka v. Commissioner of Commercial Taxes, Karnataka AIR 1988 SC 1487*
- *Steel Authority of India Ltd, Bangalore v. Asst Commissioner of Commercial Taxes, (Int.V), South Zone, Bangalore 1996 (41) Kar.L.J. 322 (HC)*
- *Hindustan Shipyard Limited v. State of Andhra Pradesh* ***(2002-TIOL-619-SC-CT)***

Further, in *State of Madras v. Gannon Dunkerly and Company (Madras) Limited* ***(2002-TIOL-493-SC-CT-LB)***, it has been held that, even before the 46 th Amendment to the Constitution referred to above, the 'sale' portion of the works contract could be taxed under the sales tax laws of the States. The substantive law that flows out of this decision is that, the Central Government cannot, under any circumstances, levy service tax on the 'sale' portion of the works contracts. Hence, to deny the benefit of Notification No. 12/2003 to works contractors, on the basis that, these are not 'sale transactions' within the meaning of the Central Excise Act, would be go against the decisions and the law laid down by the Apex Court.

Further, in terms of Rule 2A of the Service Tax (Determination of Value) Rules, 2006, in the case of a works contractor, the value of the taxable service has to be determined on the basis of the value of the services as is equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the said works contract. By no stretch of imagination can it be held that, 'goods' are not transferred by the works contractor, while executing the works contracts. This important principle, it seems, has also not been considered by the Hon'ble LB.

Further, the full import of the decision of theApex Court has, in IMagic Creative Pvt Ltd v. Commissioner of Commercial Taxes, Karnataka **2008-TIOL-04-SC-VAT** and Bharat Sanchar Nigam Limited v. Union of India **2006-TIOL-15-SC-LB** would not seem to have been fully appreciated by the Hon'ble LB, while delivering

the decision, in as much as, it has been clearly held in these decisions that VAT and service tax are mutually exclusive and operate in their respective spheres. The Apex Court has further held that in these decisions, that the transactions in their entirety could not be charged to both taxes and that, this would lead to double taxation of a single transaction, comprising of both sales and services, which is impermissible in law. It seems clear thatthe denial of the benefit of Notification No. 12/2003 would lead to double taxation of the same transaction/value, in terms of levy of both VAT/sales tax and service tax, which goes against the law laid down by the Apex Court.

With specific reference to the availability of the benefit of Notification No. 12/2003 to works contractors, the final order of the Bangalore Bench of the Hon'ble CESTAT, in the case of Sobha Developers Ltd has not been considered by the LB, very surprisingly. The Revenue's appeal against this decision which had allowed the benefit of Notification No. 12/2003 to works contractors, is already before the Apex Court. The Bangalore CESTAT had taken similar stands in FIREPRO SYSTEMS PRIVATE LTD. Versus COMMR. OF SERVICE TAX, BANGALORE **2008-TIOL-1377-CESTAT-BANG**., BLUE STAR LTD. Versus COMMISSIONER OF C. EX., HYDERABAD-II **2008-TIOL-342-CESTAT-BANG** wherein, it has been held thatthe benefit of Notification No. 12/2003 is available to a works contractor.

Moreover, from the facts governing this decision, it seems clear that, the decision would have applicability only in respect of cases like photography services, wherein, a distinction has been made, very rightly, between materials consumed and materials transferred. It is nobody's argument that, materials consumed should be allowed the benefit of Notification No. 12/2003. But, to seek to levy service tax even on the value of goods transferred by the works contractor would amount to going against the legislative provisions and the decisions of the Apex Court, in my humble view.

Before concluding…….

I must congratulate my dear learned Advocate friends from Bangalore, Anand and AnirudhNayakfor recently writing an excellent article on the same subject, in a leading fortnightly, which has inspired me to write this piece.

If a view is taken that the benefit of Notification No. 12/2003, (which I consider to be the most important and perhaps, forming the very basis of the levy of service tax) is to be extended only to transactions treated as 'sales' within the meaning of the central excise law, one would wonder, what purpose will this Notification serve, if at all.

Talking of the precedential value of this decision, I would wonder if this would apply to cases other than photography or related services. Certainly, there is no case for this to be applied to works contracts or for that matter, to transactions other than photography services. Going by the law of precedents, this case, if at all, has to be applied strictly only on facts.

Talking of the levy of service tax and the famous (or now infamous) Notification No. 12/2003, it would seem that the Notification, or for that matter, the service tax law, has really no power to exempt the value of goods which are not used for providing the service. In a typical case of a works contract, the value of goods sold/transferred by the works contractor, cannot, by any stretch of imagination, be treated as having been used by the works contractor to render the service. In fact, in terms of the law of levy of sales tax on works contracts, it is the other way round. It is the case of the works contractor, effecting a sale involving transfer of property in goods, being exempted from the levy of sales tax/VAT on the component involving services like labour and like charges, as per the VAT laws. Where is the question of exempting the value of goods, when the goods are not used by the works contractor for rendering the service?

That service tax cannot be levied on sale of goods, is a law that would survive, even without Notification No. 12/2003. This Notification only provides that, subject to production of documentary evidence, which is procedural law, the value representing the sale of goods is exempt from the levy of service tax. The substantive law, of course, is that, the sale /deemed sale of goods which has already suffered the levy of VAT/sales tax, cannot be subjected to the levy of service tax. The whole discussion is *qua*levy of VAT and

not *qua* , levy of central excise duty, in my view. One might wonder as to the relevance of the central excise duty, while interpreting Notification No.12/2003.

Will this decision affect transactions involving transfer of right to use goods, which is covered under the definition of 'sale' under the VAT law, eg. sale of software licenses, copyrights, etc.? A strong No, in my view.