New Service related to supply of tangible goods to open a Pandora's box – Mar 3, 2008

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MR Chidambaram has managed to come out with a new taxable service, which is bound to crease a lot of controversies. Section 65(105)(zzzj) is proposed to read as follows:

"Services provided in relation to supply of tangible goods, without transferring right of possession and effective control of said tangible goods".

This is what the clarificatory circular dated February 29, 2008 issued by the Board states…

4.4 SUPPLY OF TANGIBLE GOODS FOR USE

4.4.1 Transfer of the right to use any goods is leviable to sales tax / VAT as deemed sale of goods [Article 366(29A)(d) of the Constitution of India].

Transfer of right to use involves transfer of both possession and control of the goods to the user of the goods.

4.4.2 Excavators, wheel loaders, dump trucks, crawler carriers, compaction equipment, cranes, etc., offshore construction vessels & barges, geo-technical vessels, tug and barge flotillas, rigs and high value machineries are supplied for use, with no legal right of possession and effective control. Transaction of allowing another person to use the goods, without giving legal right of possession and effective control, not being treated as sale of goods, is treated as service.

4.4.3 Proposal is to levy service tax on such services provided in relation to supply of tangible goods, including machinery, equipment and appliances, for use, with no legal right of possession or effective control. Supply of tangible goods for use and leviable to VAT / sales tax as deemed sale of goods, is not covered under the scope of the proposed service. Whether a transaction involves transfer of possession and control is a question of facts and is to be decided based on the terms of the contract and other material facts. This could be ascertainable from the fact whether or not VAT is payable or paid.

It seems that the Government wants to levy service tax, on the rentals related to the leasing / renting out of movable property being goods, which are not otherwise subject to VAT/sales tax.

There is no connection, in my opinion, between transfer of possession of goods and control of goods and the levy of sales tax/VAT, vis-à-vis the lease rentals. In other words, levy of lease tax on lease rentals is for the 'transfer of right to use goods' and falls under the deemed sale category and has to be distinguished from the 'transfer of goods' which is a sale simplicitor transaction. The whole premise then, for the levy of service tax on this new services, seems quite shaky.

The Board seems to be confusing between transfer of right to goods which is a sale and transfer of right to use goods which is a deemed sale. Of course, under the VAT law, the concept of deemed sales has lost much of its signature and has got subsumed under the legality of a sale of goods. In the earlier regime of the sales tax law, there used to be a separate provision for the levying of sales tax on deemed sales involving transfer of right to use goods, which no longer exists under the VAT dispensation. The Board does not seem to be in the aware of these changes as it still going by the concept of deemed sales governing the levy of VAT on transfer of right to use goods.

Further, while the TRU Circular talks about transfer of right to use goods, the main definition in Section 65(105)(zzzzh) talks about transfer of goods which is a sale, pointing out to a drafting error. I would strongly

submit that the definition of the new taxable service does not reflect the clarifications issued by the TRU Circular.

Further, the Board seems to believe that leasing out of excavotors and other movables, which are supplied for use with no legal right of possession and effective control is not covered by VAT. The Board is wrong again, here. As stated above, possession and effective control have no bearing on the levy of VAT on the rentals arising out of the right to use these goods/movables, in my strong opinion. What is sought to be subjected to VAT is the transfer of right to use goods and this factor determining the taxability has no other strings attached to it, under the VAT law of most States.

The intent to levy service tax on leasing transactions involving movables, which are not otherwise taxable to VAT/sales tax, represents, to me, a dangerous mindset. There could be umpteen instances of leasing out of movables not being to subject to VAT/sales tax and all of these now, will have to come under service tax. We need to understand that the basic difference between service tax and VAT is that, VAT is attracted on money related transactions while service tax gets attracted even in the case of non-money related transactions. Thus, for example, if a company has leased out movable assets to its sister company in exchange of a reverse lease from the sister company to itself, it would still pay no VAT, as no consideration being money gets transferred. But, as per the Budget provisions, this transaction would, in its entirety, be liable for service tax, as under the service tax law, consideration or gross amount received includes non-monetary consideration including book entries, thanks to the amendment introduced by the 2008-09 Budget.

Take another example involving an inter-state leasing of movable heavy vehicles, which is a common feature in the construction industry. While the lease rentals arising out of an inter-state lease might get subjected to the VAT levy depending on the state where the agreement is signed, the state in which the movable goods are actually used, etc. In some cases, there would be no liability to VAT in respect of inter-state leasing of movables in any of the States. In all of these cases, service tax would indeed get attracted, thanks to the Budget. In my strong opinion, the fact that no VAT gets levied on a leasing transaction involving movables, does not still take away its character of still being not a service, liable for service tax.

Added to the confusion is the fact that in some cases, lease rentals are subject to VAT @ 4% while service tax would be applicable @ 12.36%. A lessor would find it better to pay VAT on all of his leasing transactions, rather than to pay service tax, in a worst scenario.

The Government clearly is trying to extend its taxing reach to the domain reserved for the States and the latest move in my opinion, is violative of Article Article 366(29A)(d) of the Constitution. I am shocked at the attitude displayed here in trying to levy tax on a leasing transaction involving movables, somehow. The clear intention seems to be that the lessor has to pay taxes, whether in the form of VAT or in the form of Service Tax. The concept of ‘either pay him or else pay me’ will hopefully not stand the judicial scrutiny.

Undoubtedly, this new service is bound to open a Pandora’s box.