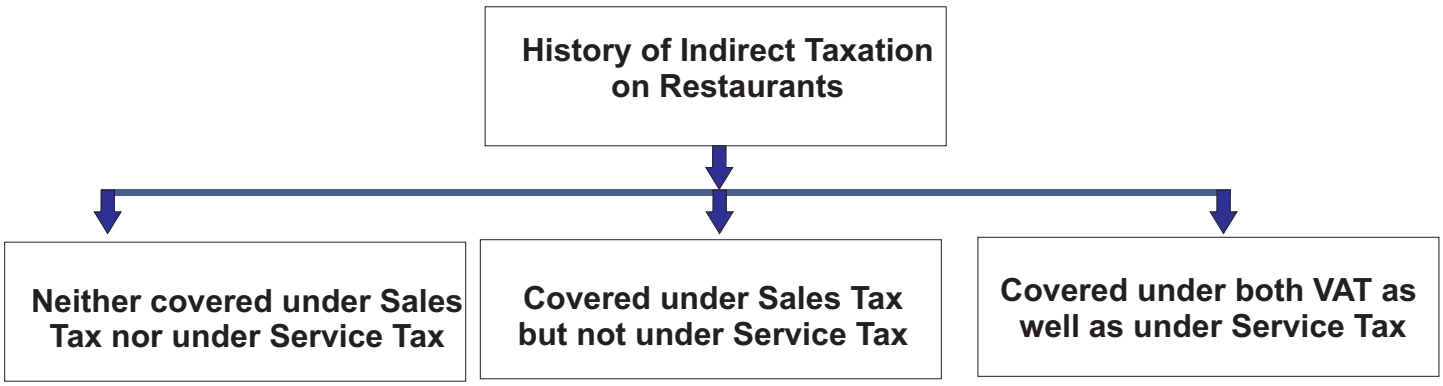
Service Tax on Restaurants – Legislative History & Recent Controversies

CA. SUMIT BANSAL
sumibans@gmail.com

Indirect tax levy on restaurants including eating joints or mess etc. has seen major flip flops in India's taxation laws history. Courts had held them to be not in the nature of sale of goods as there is no transfer of property in food but merely consumption of it. The Govt. then brought a deeming fiction in the Constitution itself to tax the same under sales tax. The Govt. is now seeking to tax the same under Service Tax as well thus resulting in denial of the basic principle of taxation of "No double taxation". The article seeks to study the entire history of indirect taxation on restaurants and the enraging controversy of the validity of levy of Service Tax on the same.



Phase 1: Neither covered under Sales Tax nor under Service Tax
Refer two landmark judgments of Supreme Court viz.
1. Associated Hotels of India case [1972] 29 STC 474 (SC):
Supreme Court held that there is no sale involved in the supply of food or drink by a hotelier to a person lodged in the hotel.

2. Northern India Caterers (India) Limited case [1978] 42 STC 386 (SC)
States have been proceeding on the basis that the 'Associated Hotels of India" case was applicable only to supply of food or drink by a hotelier to a person lodged in the hotel and that tax was leviable on the sale of foodstuffs by a restaurant. But over-ruling the decision of the Delhi High Court, the Supreme Court held in the above case that service of meals whether in a hotel or restaurant does not constitute a sale of food for the purpose of levy of sales tax but must be regarded as the rendering of a service in the satisfaction of a human need or ministering to the bodily want of human beings. It would not make any difference whether the visitor to the restaurant is charged for the

meal as a whole or according to each dish separately.
One of the explanation/logic behind the above two decisions was that unless one has eaten, property is not transferred and once eaten nothing remains in which property can be transferred. Therefore in situations where the person does not have the right to take away the food but the same is eaten within the restaurant, there is in effect no transfer of property in goods and hence no sale. Therefore the above two judgments clearly set forth that there cannot be levy of sales tax on sale/supply of food by restaurants, eating joints, mess etc. Since there was no Service Tax levy during that time in India, restaurant activity enjoyed no indirect tax levy.

Phase 2: Covered under Sales Tax but not under Service Tax
The Government felt that owing to above two Supreme Court judgments the States are missing on revenue from sale of food by restaurants etc. and therefore brought an amendment in the Constitution as follows:
46th Constitution Amendment Act, 1983 inserted Article 366 (29A), clause 5 as per which sales have been deemed to include the following: “Supply of any 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 service.”
And therefore started the era of charging VAT on restaurants including eating joints or mess etc. Since there was no service tax levy even at this point in time in India, there was no question of levying any Service Tax here.

Phase 3: Covered under both Value Added Tax as well as under Service Tax
Sec 66E of the Finance Act 1994, specifically includes the following as a declared service chargeable to service tax: “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.”
Though brining some relief to small dhabas, hotels etc. Mega Exemption Notification No. 25/2012 Dt. 20.06.2012 exempts “Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year.”
The emphasis is to levy tax on services provided by only such restaurants where the service portion in the total supply is substantial and discernible. Therefore Service Tax is applicable on service portion on sale of food stuff in air-conditioned restaurants whether or not it is part of any hotel or other establishment. Even the eating joints in air-conditioned malls and eateries like Pizza Hut, Mc Donald s, Coffee Cafe Day, Subway etc are also liable to Service Tax on supply of food and beverages in their premises as all of these are air-conditioned. As per the intention of the legislation, we can infer that a restaurant just like a halwai shop (even if air-conditioned) that provides food to be packed and taken away or merely a table where food can be kept is not covered under service tax as there is hardly any service portion. However restaurants would find it practically not feasible to segregate take away sales & in-dining sales because usually the restaurants charge the same rate in both the cases.

Valuation of Service Portion
In order to separate service portion from the gross amount charged, the law provides for valuation rules as follows: -
1. Rule 2C vide notification no, 24/2012 effective from 01.07.2012: Determination of Value of Service Portion in supply of food or any other article of human consumption or any drink:-
a. In a restaurant – service portion shall be 40% of the gross amount charged.
b. As part of outdoor catering - it shall be 60%of the gross amount charged.
Gross amount charged shall not include VAT paid/payable on transfer of property in goods. It means the sum total of the gross amount charged by the restaurant and the FMV of all goods & services supplied in or in relation to it by the customer, whether or not supplied under the same contract or any other contract, after deducting the amount charged for such goods & services, if any & VAT, if any levied thereon.
Any good meant for human consumption classifiable under chapters 1-22 of CET are not inputs for provision of

such service. Cenvat credit is therefore not available on these items. Availability of Cenvat credit on other inputs, input services and capital goods is however available subject to provisions of Cenvat Credit Rules, 2004.

2. Notification 26/2012 dated 20.06.2012: Bundled services by way of supply of food or any other article of human consumption or any drink, in a premise (including hotel, club, pandal, or any other place specially arranged for organizing a function) together with renting of such premises – abatement of 30% of gross amount charged.

Thus in case of supply of food etc by a caterer when the same is supplied in a premises and gross amount charged is including arrangement of premises, notification 26/2012 shall apply and taxable value shall be 70% (this is because service portion here is high, example marriage venues providing food, premises, decoration & entertainment services as a package).

Registration

Another pertinent question is that when does a restaurant need to register and what is the basic exemption limit for charging service tax. As per Notification 33/2012 Central Government exempts taxable services of aggregate value not exceeding 10,00,000 rupees in any financial year from the whole of the service tax leviable thereon. Any provider of taxable services whose aggregate value of taxable services in a FY exceeds Rs 900,000 is required to get registration within a period of 30 days of exceeding the aggregate value of taxable services of nine lakh rupees. However since Sec 66E seeks to tax only the service portion in the restaurant activity; the effective threshold limit for seeking registration shall be 9/40% = Rs 22.5 lacs and basic exemption limit shall be 10 / 40% = Rs 25 lacs of gross billing.

Recent clarifications / Notifications

1. Prior to 01st April 2013, only restaurants including eating joints or mess etc. serving food / beverages having AC / central heating facility and also having a license to serve alcoholic beverages were taxable. The Govt. widened the tax net with effect from 01st April 2013 wherein all air-conditioned / centrally heated restaurants etc. came under the service tax net irrespective whether they serve alcoholic beverages or not. It must be noted that even when only a part of restaurant is air conditioned or even when a restaurant is air-conditioned for part of year, the same shall fall under Service Tax net. Further air-conditioning may be Central, window or split; however heating facility must necessarily only be central, to attract Service tax levy.

2. The Central Government vides Notification No. 14/2013-ST dated October 22, 2013 has provided that, services provided in relation to serving of food or beverages by a canteen having the facility of air-conditioning or central air-heating at any time during the year maintained in a factory covered under the Factories Act, 1948 will be exempt from levy of service tax. However since the above shall be effective from 22nd Oct, 2013, the said exemption shall not be available for period starting from 1st April, 2013 to 21st October, 2013.

3. Restaurant Service – clarification provided by CBEC

The CBEC has provided clarifications vide Circular No. 173/8/2013-ST., Dated: October 7, 2013 on various doubts and questions raised pertaining to Restaurant Services, which is reproduced here in below:

	Doubts	Clarifications
1	**In a complex where air conditioned as well as non-air conditioned**	**Services provided in relation to serving of food or beverages by a restaurant, eating joint or mess, having the facility of air conditioning or central air heating in any part of the establishment, at any time during the year**

	restaurants are operational but food is sourced from the common kitchen, will service tax arise in the non-air conditioned restaurant	**(hereinafter referred as 'specified restaurant') attracts service tax. In a complex, if there is more than one restaurant, which are clearly demarcated and separately named but food is sourced from a common kitchen, only the service provided in the specified restaurant is liable to service tax and service provided in a non -air-conditioned or non-centrally air- heated restaurant will not be liable to service tax. In such cases, service provided in the non-air-conditioned / non-centrally air-heated restaurant will be treated as exempted service and credit entitlement will be as per the Cenvat Credit Rules.**
2	In a hotel, if services are provided by a specified restaurant in other areas e.g. swimming pool or an open area attached to the restaurant, will service tax arise	Yes. Services provided by specified restaurant in other areas of the hotel are liable to service tax.
3	Whether service tax is leviable on goods sold on MRP basis across the counter as part of the Bill/invoice.	If goods are sold on MRP basis (fixed under the Legal Metrology Act) they have to be excluded from total amount for the determination of value of service portion

However till date there has been no clarification on whether an AC Restaurants charging service tax on Self-service or Pick up or home delivery would also be required to charge service tax Though Department has shown intention of not levying Service Tax on home delivery vide its opinion in Letter No. DOF 334/3/2011-TRU, dated 28.02.2011 acknowledging that food sold by way of pick-up or home delivery do not have element of services such as use of space, crockery, furniture, air-conditioning, ambience etc. However the charging section 66E provides “food supplied in any manner”. Thus there shall remain ambiguity till department provides formal clarification.

Controversy on Double Taxation & recent Kerala High Court Judgment

Supply of foods or drink is also a deemed sale in our Constitution on which sales tax or value added tax (VAT) is payable. But the Government levied Service Tax as well on such activities claiming that it is only taxing the service component of the overall transaction involving supply of food or drinks. Kerala High Court has on 3rd July, 2013 in a batch of Writ Petitions filed by KERALA CLASSIFIED HOTELS AND RESORTS ASSOCIATION and OTHS. VERSUS UNION OF INDIA and OTHS. 2013 (7) TMI 431 - struck down the said levy as unconstitutional and hence invalid holding it to be beyond the legislative competence of Parliament. The petitioners argued that levy of Service Tax on food supply by the centre transgresses upon the subject matter falling under the State list i.e., entry 54 and entry 62 respectively of the list II of the Seventh Schedule of the Constitution and therefore, beyond the legislative competence of the Parliament. The court observed that the very purpose of incorporating the definition of tax on sale or purchase of goods in India’s Constitution was to empower the State Governments to impose tax on the supply, whether it was by way of or as part of any service or sale of goods either being food or any other article for human consumption or any drink. The Constitution permits sale of goods during service as taxable and if there is any service, it forms part of sale of goods. As such, the State Governments alone have the legislative competence to enact a law imposing a tax on service component in sale of food or drinks. Not only this, the court said that the service providers were entitled to seek refund of the amount of Service Tax already paid as it was collected without any authority of law.

Further case laws supporting Kerala HC judgment:
Imagic Creative Pvt. Ltd. Vs. Commissioner of Commercial Taxes [2008 (9) STR 337 (S.C.)] = 2008-TIOL-04-SC-VATwherein it was held that payments of service tax and VAT were mutually exclusive. Therefore, they should be held to be applicable having regard to the respective parameters of service tax and the sales tax as envisaged in a composite contract as contradistinguished from an indivisible contract. It is, therefore, difficult to hold that in a case of restaurant activity, sales tax would be payable on the value of the entire contract; irrespective of the element of service provided.Logically therefore States should levy VAT on that portion of gross amount charged that represents consideration for sale of food and rest proportion reflecting service component should be subject to Service Tax levy.
However since Article 366 (29A) legalizes a deeming fiction whereby the entire activity of supply of goods being food or any article for human consumption shall be deemed to be a sale. And by virtue of that once the sale tax has already been discharged on the whole amount, one cannot be asked to pay service tax on the service portion as it amounts to double taxation of that service portion.
Lodging / accommodation Services
Such services were also brought into tax net w.e.f. May, 2011. However, services by way of renting of a hotel, inn, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a room below rupees one thousand per day or equivalent are exempt from levy of Service Tax. The Kerala High Court also struck down the levy of Service Tax on accommodation services provided by hotels in the same judgmentdated 3rd July, 2013, listed above. While the Government may go into appeal to apex court, hotels and restaurants would certainly cheer and look forward with optimism.

Conclusion

From a layman point of view, undoubtedly when one eats at a restaurant – there are two transaction – one sale of food articles and second service availed of the hospitality, of the ambience and of the hygiene and entertainment. Though the proportion of sale to service shall vary between a road side dhaba to a five star restaurant. However what does comes out seeing the history of taxation on restaurant activity is that the only motive of the Government is maximization of tax revenues by creating deeming fictions suiting the purpose of revenue. One hopes that eventually the Kerala HC judgment shall be challenged in SC and there would be some settlement on the issue. Till then uncertainty will remain.

Clarification on Applicability of the Companies Act, 2013 to Auditor's Report to FY 2014-15 and Onwards.

CLARIFICATION

Applicability of the Companies Act, 2013 to Auditor’s Report to FY 2014-15 and Onwards1

The Ministry of Corporate Affairs, on 26th March 2014 notified a majority of the remaining sections of the Companies Act, 2013, including sections 139 to 148, relating to audits and auditors. The Act was stated to be effective from 1st April, 2014. Accordingly, queries are being raised by a number of members as to whether any auditor’s report of a company being signed on or after 01st April, 2014 would be in accordance with the requirements of section 143 of the Companies Act, 2013.

In this context, it may be noted that the Ministry of Corporate Affairs (MCA) has, on 04th April 2014, vide its General Circular No. 08/2014, clarified that the financial statements (and documents required to be attached thereto), auditor’s report and Board’s report in respect of financial years that commenced earlier than 01st April, 2014 shall be governed by the relevant provisions/Schedules/rules of the Companies Act 1956. This MCA Circular can be seen at URL http://www.mca.gov.in/Ministry/pdf/General_Circular_8_2014.pdf.

Therefore, it is clear from MCA’s aforesaid General Circular that the auditor’s report of a company pertaining to any financial year commencing on or before 31st march 2014, would be in accordance with the requirements of the Companies Act, 1956 even if that financial year ends after 01st April 2014. For example, where the financial year of a company is 01st January 2014 to 31st December 2014, the statutory auditor’s report signed therefor would be in accordance with the requirements of the Companies Act, 1956.

As a corollary to MCA’s General Circular, it appears that the provisions of the 2013 Act would apply only to the financial years commencing on or after 01st April 2014. Thus, for example, the statutory auditor’s report signed in respect of the financial year of the company ended 31st March 2015would need to be issued in accordance with the provisions of the Companies Act, 2013.

Issued by Auditing & Assurance Standards Board.