L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

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GST

Supply of pipes and measurement equipment (SKID equipment), charged as 'gas connection charges', liable to service tax under 'Supply of Tangible Goods for Use'

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exceeding expectations
SINCE 1985

ISSUE

Whether service tax was leviable under Section 65(105) (zzzzj) of the Finance Act, 1994 (**"Act"**) on supply of SKID equipment?

FACTS

Assessee was in the business of distributing Compressed Natural Gas and Piped Natural Gas (**"PNG"**) to industrial, commercial, and domestic consumers.

To facilitate the distribution of gas, the assessee installed an equipment described as SKID at their customer's sites. The SKID equipment consisted of isolation valves, filters, regulators and electronic meters. The equipment regulated the supply of PNG and recorded the quantity consumed by the customer, which was then used for billing purposes. The assessee entered into a Gas Sales Agreement (**"GSA"**) with the consumers to whom PNG was supplied. The clauses of the GSA specified that the ownership of the equipment was retained by the assessee and that the customer had no control or any legal rights over the equipment.

Show Cause Notices were issued alleging that the supply of SKID equipment were covered under the category of 'Supply of Tangible Goods for Use services' and leviable to service tax as per Section 65(105)(zzzzj). The period involved was from May 16, 2008 to March 31, 2009. CESTAT Ahmedabad, on analysing the GSA, observed that the equipment was installed for measuring the amount of gas supplied to the customer for the purpose of billing, hence 'the use' of the equipment was by the assessee and not by the customer.

RELEVANT ARGUMENTS ON BEHALF OF THE REVENUE

- The SKID equipment was installed, maintained and repaired by the assessee at the cost of the customer. Neither ownership nor possession of the equipment was transferred to the customer. Therefore, conditions under Section 65(105) (zzzzj) were satisfied.

- The customer was as much concerned about the accuracy of the billing as the supplier of gas. The equipment benefited the customer by enabling them to verify the correctness of the charges levied. Thus, the equipment was installed for the 'use' by the customer too.

- The CBEC Circular No. 334/1/2008-TRU, dated February 29, 2008 had clarified that transactions that enabled usage of goods without transferring the right of possession and effective control, were in the nature of a service under Section 65(105)(zzzzj) and not sale under Article 366(29-A)(d) of the Constitution of India. Since the assessee had not paid Value Added Tax (**"VAT"**) for the charges collected on supply of pipelines and the equipment, this transaction must be treated as a service.

- Though the gas connection charges which were initially recovered were claimed to be refundable, the quantum of refunds varied from customer to customer. Data produced by the assessee indicated that in several cases full refunds were not made.

RELEVANT ARGUMENTS ON BEHALF OF THE ASSESSEE

- Contractual rights to the customer, including the right to verify and dispute the bill, must be kept distinct from the use of the SKID equipment.

- The SKID equipment was a technical device and the customer had no right or ability to use the equipment.

- Amounts collected under the head of 'gas connection charges' were in the nature of interest-free security deposits, which were required to be refunded in part, or in full, depending on the duration of the contract which determined depreciation. They were not collected as a consideration for providing a service.

- Section 65(105)(zzzzj) was introduced with the intention of capturing services which were technically not 'sale' and were escaping the net of VAT. In the present case, there was no transfer of the right to use the equipment nor was there any element of service in the supply of the equipment. The equipment was installed by the assessee as a seller of gas and was not used by the customer.

FINDINGS OF THE SUPREME COURT

Whether there was transfer of possession and effective control

- It is necessary to distinguish between Article 366(29-A)(d) of the Constitution of India and Section 65(105)(zzzzj) of the Act. The introduction of Section 65(105)(zzzzj) was with the intention of taxing such activities that enabled the customer's use of the service provider's goods without transfer of the right of possession and effective control. This provision created an element of taxation over a service, as opposed to a 'deemed sale' under Article 366(29-A)(d).

- Admittedly, there was no transfer of ownership or possession of SKID equipment by the assessee to its customers. Thus, the ingredient of not transferring the ownership, possession or effective control of the goods under Section 65(105)(zzzzj) was satisfied.

Whether the supply of the equipment was for the 'use' of the customers

- The expression 'use' does not have a fixed meaning. The content of the expression must be based on the context in which the expression is adopted.

- The expression 'use' in the present context signified the application of the goods for the purpose for which they were supplied under the terms of the contract.

- The SKID equipment ensured benefit to both seller and customer. The seller was concerned with the precise quantification of the gas supplied while the customer had an interest in ensuring the safety of its facilities and that the billing was based on the correct quantity.

- Section 65(105)(zzzzj) did not require exclusivity of use.

- The SKID equipment sub serves the contractual rights of both the seller and the purchaser of gas. Without the SKID equipment there would be no GSA.

'Gas connection charges' not a refundable security deposit

- The extent of the refund of gas connection charges collected from the consumers depended on their usage. The percentage of refund varied from customer to customer, while the remaining amount was retained by the assessee.

- As regards the domestic customers, no deposit receipts were provided.

- The argument that the charges constituted a refundable security deposit was hence rejected.

RATIO

- Supply of SKID equipment by the assessee, fulfils the taxable entry under Section 65(105)(zzzzj) of the Act and the 'gas connection charges' received by the assessee were leviable to service tax.

IMPLICATIONS AND COMMENTS

- This decision would have an impact in cases where any equipment of a nature similar to that of SKID equipment is supplied.
- As for the negative list regime (post July 01, 2012) and Goods and Services Tax regime (from July 01, 2017), this decision may not have a big impact since the transaction may be covered within the ambit of 'service' and 'supply', respectively.

[*Commissioner of Service Tax, Ahmedabad* v. *Adani Gas Ltd.* – Judgment dated August 28, 2020 in Civil Appeal No. 2633 of 2020, Supreme Court]

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