

Supply of right to use equipment, even with operator, qualifies as sale under VAT – Service tax not payable: Allahabad CESTAT

21 January 2022



Summary

The Customs, Excise, Service Tax Appellate Tribunal (CESTAT) Allahabad has held that the supply of diesel generator sets to customers would not amount to Supply of Tangible goods for Use (STGU) service¹ or a declared service² merely because the operator is also provided along with the equipment. The CESTAT observed that the operators provided by the Appellant were working entirely under the direction and control of the customer and the Appellant had no control over them. Thus, so long as the effective control over the diesel generator sets remained with the customers, providing of operators to customers would not mean that the transaction was not that of sale. Hence, the transaction between the Appellant and the customers would qualify as a transfer of right to use goods with the control and possession over the diesel generator sets.

The CESTAT further observed that once the control and possession of the diesel generator sets was transferred to the customers, mere repair and maintenance work will also not change the nature of transaction. The transportation and installation of diesel generator sets at the site of the customers as per the requirement of agreement cannot lead to a conclusion that the Appellant was rendering STGU service.

Facts of the case

- The appellant³ supplies diesel generators to customers on hire basis. In the present case, it had entered contracts of arranging specified equipment for specified duration on hire. The appellant received a fixed amount on monthly basis along with overtime charges in case the equipment was operated beyond the maximum working hours per month.
- The appellant submitted that during the period of hire, it does not have any control over the equipment. Rather the effective control vests with the customer. The operator provided by appellant acts as per directions provided by customer. Further, the working hours of equipment is entirely at the discretion of customer. The fuel and lubricant required to run the diesel set is provided by the customer.
- The appellant contended that supply of diesel generator sets to customer does not amount to STGU service as the legal right to use the sets was only with customer. Therefore, service tax could not be levied on the transaction.

Allahabad CESTAT observations and ruling⁴:

- **Provision regarding nature of transaction:** The provision⁵ of the Finance Act provides for three conditions to be satisfied in order to recognise a transaction as a taxable service. The appellant satisfies the first two conditions, i.e., transfer/supply of goods and such transfer must be by way of hire or lease or licence for using goods. The third condition regarding the right of possession and effective control is of main dispute.
- **Transaction qualifies as transfer of right to use:** As per the terms of the contract, the operator is provided by the appellant to the customer along with the equipment. The customer drew plans and issued instructions to the operator for operating diesel sets. The duration of use of equipment was entirely at the discretion of customer. Also, the equipment did not leave/enter the premises of customer without a pass issued by customer. Thus, the transaction would qualify as a right to use with control and possession over equipment passing on to customer.

¹ from 01.04.2011 to 30.06.2012

² from 01.07.2012 to 2014-15.

³ Express Engineers & Spares Private Limited

⁴ Service Tax Appeal No. 70537 of 2018 and Service Tax Appeal No. 70592 of 2018 and Final Order No. 70004-70005/2022 dated 11 Jan 2022

⁵ Section 66E(f) of the Finance Act, 1994

- **Transaction treated as sale of goods:** The operators were working entirely under the direction and control of the customers. The Appellant had no control over them. The effective control over the diesel generator sets remained with the customer and the operators were also under the direction and control of the customer, it would mean that the transaction was of sale. This view finds support from the judgments of the Gauhati High Court⁶ and of the Andhra Pradesh High Court⁷. Once the control and possession of the diesel generator sets was transferred to the customer, mere repair and maintenance work will also not change the nature of transaction. This is clear from the decisions of the Gauhati High Court and of the Tribunal⁸.
- **Payment of VAT indicates transaction is a sale of goods:** Payment of VAT on supply of goods is also a factor to determine whether the transaction is that of sale. The circular⁹ clarifies that payment of VAT/Sales Tax on a transaction indicates that the transaction is treated as sales of goods. Further, the circular¹⁰ clarifies that transfer of right to use any goods is leviable to VAT as deemed sales of goods and such transfer involves both possession and control of goods. Therefore, service tax cannot be levied on transaction treated as sale of goods.

Our comments

The Apex Court in its landmark decision in case of Rashtriya Ispat Nigam Ltd.¹¹ has held that in case limited rights has been given to the customers, it cannot be said as a transfer of the right to use any goods as long as the possession and effective control over the goods lies with the owner. Thus, such transactions are not liable to state VAT.

It is a settled law that where right of possession of the goods together with effective control over such goods is transferred, it would be tantamount to a deemed sale which would be beyond the purview of service tax.

In the present case, the CESTAT Allahabad has held that since the effective control over the diesel generator sets along with the operators remained with the customers, the transaction would qualify as a transfer of right to use goods with the control and possession over the diesel generator sets and hence, not liable to service tax.

The present ruling shall provide required relief to businesses and will set precedence in similar matters.

⁶ in Dipak Nath

⁷ in G.S. Lamba

⁸ in Petronet LNG Ltd.

⁹ Circular dated 23.08.2007

¹⁰ D.O. F. No.334/1/2008-TRU dated 29.02.2008

¹¹ Civil Appeal No. 31 of 1991 dated 6 March 2002

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