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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: July 22, 2016
Decision on: August 12,2016

\+ **W.P.(C) 6482 of 2011**

FEDERATION OF HOTELS AND RESTAURANTS ASSOCIATION OF INDIA AND ORS. ..... Petitioners

Through: Mr. N. Venkataraman, Senior Advocate with Mr. Sidharth Aggarwal, Advocate.

versus

UNION OF INDIA AND ORS. ..... Respondents

Through: Mr. Dev P. Bhardwaj, CGSC for UOI with Ms. Anubha Bhardwaj, Advocate.
Mr. Harpreet Singh, Senior Standing Counsel with Mr. Gajan Kumar Singhal, Advocate for R-2 & R-3.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE NAJMI WAZIRI

J U D G M E N T

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Dr. S. Muralidhar, J.:

1.1 The challenge in this petition under Article 226 of the Constitution of India is to the constitutional validity of Section 65 (105) (zzzzv) of the Finance Act 1994 (FA) whereby the provision to any person by a restaurant, by having the facility of air-conditioning in any part of its establishment serving food or beverage, including alcoholic beverages or both, in its premises has been made amenable to service tax. Also challenged is the

constitutional validity of Section 65 (105) (zzzzw) of the FA whereby the provision by a hotel, inn, guest house, club or camp-site by whatever name called to any provision, accommodation for a continuous period of less than three months has been made amenable to service tax.

1.2 The additional prayers in the writ petition are for a declaration that Section 66 E (i) of the FA to the extent it seeks to constitute a service portion in an activity of supply of food or other articles as 'declared service' to be bad in law. The Petitioners seek a declaration that Rule 2C of the Service Tax (Determination of Value) Rules, 2006 is invalid.

Profile of the Petitioners

2.1 Petitioner No.1 is the Federation of Hotels and Restaurants Association of India, a registered association whose members are a number of hotels spread all over the country. Petitioner No.2, the Leela Palace, Chanakya Puri, New Delhi is a unit of Hotel Leela Venture Limited which runs 5-star hotels all over the country. Petitioner No.3 is Rodeo, a restaurant which is part of the chain operating in the National Capital Territory of Delhi.

2.2 Several members of the Petitioner No.1 Association run hotels which provide both lodging and meals to the residents. They also operate air-conditioned restaurants where meals are served to non-residents and casual visitors. Many of the hotels have licence to serve liquors in such restaurants. Some of the members of the Petitioner No.1 Association operate only air-conditioned restaurants, serve meals to the visitors and also have licence to serve liquor.

Case of the Petitioners

3. The case of the Petitioners in short is that after Constitution (Forty-Sixth Amendment) Act, 1982 which inserted clause 29A (f) in Article 366 defining ‘tax on sale or purchase of goods’ to include 'a tax on the supply, by way of or as part of any service, of food or any drink for cash, deferred payment or other valuable consideration', all aspects of the transaction of sale of food and beverages by the members of Petitioner No.1 to their customers fell within the meaning of 'sale of goods' amenable to sales tax i.e. value added tax (‘VAT’) levied by taxing statutes of the States. It is submitted that the provision of food and beverages in a restaurant, even where it forms part of a hotel which provides lodging and meals is covered entirely by Entry 54 of List II read with Article 366 (29A) (f) and, therefore, it is only the State legislature that has the exclusive competence to legislate in respect of levy of tax on such sale or purchase of goods. It is contended that no part of the transaction of supply of food in a restaurant or hotel is now left out for being made amenable to service tax levied by a statute enacted by Parliament. Thus it is submitted that Section 65 (105) (zzzzv) of the FA is beyond the legislative competence of Parliament.

4. Further, it is pointed out that under Entry 62 of List II (State List) the States are empowered to impose tax on luxuries including taxes on entertainment, amusement, betting and gambling. In fact State Legislatures have enacted statutes in terms of which luxury tax is levied on hotel accommodation. It is submitted that the entire amount paid on provision of accommodation by hotels is also a matter falling exclusively in the State List. Therefore, the constitutional validity of Section 65 (105) (zzzzw) of the

FA the above provision whereby Parliament seeks to levy service tax on a transaction which is completely covered by Entry 54 of List II is challenged for lack of legislative competence.

Relevant provisions

5. First, the relevant constitutional and statutory provisions require to be referred to. Articles 245, 246 and 248 of the Constitution read thus:

> "245. (1) Subject to the provisions of this Constitution, Parliament may make laws for the whole or any part of the territory of India, and the Legislature of a State may make laws for the whole or any part of the State.
>
> (2) No law made by Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation.
>
> 246. (1) Notwithstanding anything in clauses (2) and (3), Parliament has exclusive power to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule (in this Constitution referred to as the "Union List").
>
> (2) Notwithstanding anything in clause (3), Parliament, and, subject to clause (1), the Legislature of any State also, have power to make laws with respect to any of the matters enumerated in List III in the Seventh Schedule (in this Constitution referred to as the "Concurrent List").
>
> (3) Subject to clauses (1) and (2), the Legislature of any State has exclusive power to make laws for such State or any part thereof with respect to any of the matters enumerated in List II in the Seventh Schedule (in this Constitution referred to as the "State List").
>
> (4) Parliament has power to make laws with respect to any matter for any part of the territory of India not included in a State notwithstanding that such matter is a matter enumerated in the State List.

248. Residuary powers of legislation.

(l) Parliament has exclusive power to make any law with respect to any matter not enumerated in the Concurrent List or State List.

(2) Such power shall include the power of making any law imposing a tax not mentioned in either of those Lists."

6. Entries 54 and 62 of List II of the Seventh Schedule to the Constitution read as under:

54. Taxes on the sale or purchase of goods other than newspapers, subject to the provisions of entry 92A of List I.

62. Taxes on luxuries, including taxes on entertainments, amusements, betting and gambling

7. By the Constitution (Forty-Sixth Amendment) Act, 1982, Article 366 (29A) was inserted and it reads as under:

"29A) "tax on the sale or purchase of goods" includes-

(a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;

(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract;

(c) a tax on the delivery of goods on hire-purchase or any system of payment by instalments;

(d) a tax on the transfer of the right to use any goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration;

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made."

8. Consistent with the above provisions, many state legislatures have enacted statutes bringing to tax sale of food and beverages. For e.g. the Section 2 (zc) of the Delhi Value Added Tax Act 2004 defines 'sale' thus:

"(zc) "sale" with its grammatical variations and cognate expression means any transfer of property in goods by one person to another for cash or for deferred payment or for other valuable consideration (not including a grant or subvention payment made by one government agency or department, whether of the central government or of any state government, to another) and includes-

(i) to (vi)....

(vii) supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service is for cash, deferred payment or other valuable consideration."

Impugned provisions of the Finance Act 1994

9. By the Finance Act 2011the following sub-clauses, (zzzzv) and (zzzzw) were inserted in sub-section 105 of Section 65 of the FA making the following transactions taxable as service, viz., the service provided:

> "(zzzzv)- to any person, by a restaurant, by whatever name called, having the facility of air-conditioning in any part of the establishment, at any time during the financial year, which has license to serve alcoholic beverages, in relation to serving food or beverage, including alcoholic beverages or both, in its premises.
>
> (zzzzw)- to any person by a hotel, inn, guest house, club or camp-site by whatever name called, for providing of accommodation for a continuous period of less than three months."

10. The Tax Research Unit (TRU) of the Department of Revenue, Government of India explained the background and the purport of the above changes by a communication dated 28th February 2011, the relevant portions which read as under:

> "2. New Services
>
> 2.1 The following two new services have been proposed:
>
> (i) Services by air-conditioned restaurants having license to serve liquor; and
>
> (ii) Short-term accommodation in hotels/inns/clubs/guest houses etc.
>
> 1.1 Restaurants provide a number of services normally in combination with the meal and/or beverage for a consolidated charge. These services relate to the use of restaurant space and furniture, air-conditioning, well-trained waiters, linen, cutlery and crockery, music live or otherwise, or a dance floor. The customer also has the benefit of personalized service by indicating his preference for certain ingredients e.g. salt, chilies, onion, garlic or oil. The extent and

quality of services available in restaurant is directly reflected in the margin charged over the direct costs. It is thus not uncommon to notice even packaged products being sold at prices far in excess of the MRP.

1.2 In certain restaurants the owners get into revenue-sharing arrangements with another person, who takes the responsibility of preparation of food, with his own materials and ingredients, while the owner takes responsibility for making space available, its decoration, furniture, cutlery, crockery and music etc. The total bill, which is composite, is shared between the two parties in terms of the contract. Here the consideration for services provided by the restaurants is more clearly demarcated.

1.3 Another arrangement is whereby the restaurant separates a portion of the bill as service charge. This amount is meant to be shared amongst the staff who attend the customers. Though this amount is exclusively for the services it does not represent the full value of all the services rendered by the restaurants.

1.4 The new levy is directed at services provided by high-end restaurants that are air-conditioned and have license to serve liquor. Such restaurants provide conditions and ambience in a manner that service provided may assume predominance over the food in many situations. It should not be confused with mere sale of food at any eating house, where such services are materially absent or so minimal that it will be difficult to establish that any service in any meaningful way is being provided.

1.5 It is not necessary that the facility of air-conditioning is available round the year. If the facility is available at any time during the financial year the conditions for the levy shall be met.

1.6 "The levy is intended to be confined to the value of services contained in the composite contract and shall not cover either the meal portion in the composite contract or mere sale of food by way of pick-up or home delivery, as also goods sold at MRP. Finance Minister has announced in his budget speech 70% abatement on this

service, which is, *inter alia*, meant to separate such portion of the bill as relates to the deemed sale of meals and beverages. The relevant notification will be issued when the levy is operationalised after the enactment of the Finance Bill."

11. Likewise on the aspect of short-term accommodation, it was clarified that the "actual levy will be restricted to accommodation with declared tariff of Rs. 1,000 per day or higher by an exemption notification." The tax would be levied even where the actual amount charged from a customer was less than Rs. 1,000 and would be charged on the "gross amount paid or payable for the value of the service." The Finance Minister had announced a 50% rebate from the value of the service which again was to be announced by a notification issued when the levy was operationalised.

12. The above amendments by which clauses (zzzzv) and (zzzzw) were introduced in Section 65 (105) of the FA have been challenged on the ground that they are beyond the legislative competence of Parliament.

13. Thereafter, Parliament enacted the Finance Act, 2012 amending the FA by inserting Sections 65B (22), 65 B (44), 66B and 66E. The relevant provisions of the Finance Act 2012 read as under:

> "143. In the Finance Act, 1994-
> ...
> (C) after section 65A, the following section shall be inserted with effect from such date as the Central Government may, by notification, appoint, namely:-
>
> Interpretations.
> 65B. In this Chapter, unless the context otherwise requires,-
> .....

(22) "declared service" means any activity carried out by a person for another person for consideration and declared as such under Section 66E;

(44) "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include-

(a) an activity which constitutes merely,-
.....
(ii) such transfer, delivery or supply of any goods which is deemed to be sale within the meaning of clause (29A) of article 366 of the Constitution; or
.....
(F) after Section 66A, the following sections shall be inserted with effect from such date as the Central Government may, by notification, appoint, namely:

Charge of service tax on and after Finance Act, 2012.

"66B. There shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.
.....

Declared services.

66E. The following shall constitute declared services, namely:-
.....
(i) 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."

14. By a Notification No. 12/2012-Service Tax dated 17th March 2012 the

Union of India exempted various taxable services from the whole of the service tax leviable under Section 66B of the Finance Act, 1994. The following two activities, which were taxable services were exempted by the said notification:

> "18. 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;
>
> 19. 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 and which has a licence to serve alcoholic beverages."

15. On 20th June 2012 by Notification No. 25/2012-ST, the aforementioned notification dated 17th March 2012 was superseded. The two activities which were exempted read as under:

> "18. 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 unit of accommodation below rupees one thousand per day or equivalent.
>
> 19. Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having (i) the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year and (ii) which has a licence to serve alcoholic beverages."

16. Notification No. 24/2012-ST dated 6th June 2012 was issued under Section 94 (2) (aa) of the FA whereby the Service Tax (Determination of Value) Second Amendment Rules, 2012 amending the Service Tax

(Determination of Value) Rules, 2006 was issued. Rule 2C that was inserted by the said amendment it reads as under:

> "2C. Determination of value of service portion involved in supply of food or any other article of human consumption or any drink in a restaurant or as outdoor catering.- Subject to the provisions of Section 67, the value of 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 at a restaurant or as outdoor catering, shall be the specified percentage of the total amount charged for such supply, in terms of the following Table, namely:-

Sl. No.	**Description**	**Percentage of the total amount**
(1)	(2)	(3)
1.	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, at a restaurant.	40
2.	Service portion in outdoor catering 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 such outdoor catering.	60

Explanation 1.- For the purposes of this rule, "total amount" means the sum total of the gross amount charged and the fair market value of all goods and services supplied in or in relation to the supply of food

or any other article of human consumption or any drink (whether or not intoxicating), whether or not supplied under the same contract or any other contract, after deducting-

(i) the amount charged for such goods or services, if any; and

(ii) the value added tax or sales tax, if any, levied thereon:

Provided that the fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Explanation 2.- For the removal of doubts, it is clarified that the provider of taxable service shall not take CENVAT credit of duties or cess paid on any goods classifiable under Chapters 1 to 22 of the Central Excise Tariff Act, 1985 (5 of 1986).”

17. These further changes by the Finance Act, 2012 have also been challenged in the present writ petition. The additional prayers in the amended writ petition are for a declaration that Section 66E of the FA to the extent it seeks to constitute a service portion in an activity of supply of food or other articles as ‘declared service’ to be bad in law. Further the Petitioners seek a declaration that Rule 2C of the 2006 Rules is also bad in law.

18. By Notification No.3/2013-Service Tax dated 1st March, 2013 issued under Section 93 (1) of the FA the Notification dated 10th June, 2012 was amended and Entry 19 was substituted as under:

"19. 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."

Submissions of learned Senior counsel for the Petitioners

19. Mr. N. Venkataraman, learned Senior counsel appearing for the Petitioners, first traced the history of the Constitution (Forty-Sixth Amendment) Act, 1982 and in particular the insertion of clause (f) in 29A of Article 366A of the Constitution. He sought to draw a distinction between the entries in Article 366 (29A)(a), (b), (c) and (d) each of which began by describing a tax on the sale and purchase of goods as a tax on the 'transfer of property' in goods or on the 'delivery of goods' or the transfer of the right to use any goods for any purpose". According to him, Clauses (e) and (f) on the other hand described a tax on the "supply of goods" and not merely on the transfer of a property in goods. This according to him makes a catering contract involving the provision of food and drinks in a hotel or restaurant different from a mere sale of goods or food and drinks.

20. Referring to the decisions in ***State of Himachal Pradesh v. Associated Hotels of India Ltd. (1972) 1 SCC 472*** and ***Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi (1978) 4 SCC 36*** Mr. Venkataraman submitted that in both the aforementioned decisions the supply of food and drinks in a hotel was viewed by the Supreme Court to be a composite transaction providing a service which was indivisible and therefore, not amenable to sales tax. It was with a view to overcoming those decisions, Parliament brought the entire transaction which otherwise would constitute a service, within the definition of 'sale'. Therefore no part of the transaction, which may have an aspect of supply of goods and another aspect of service

was left out of the ambit of clause (f) of Article 366 (29A).

21. Mr Venkataraman pointed out that the enactment by the Parliament by the Finance Act, 2011 by which two new transactions were brought within the net of service tax with effect from 1st May 2011 in the form of Sections 65 (105) (zzzzv) and (zzzzw) was beyond its legislative competence. He submitted that resort could not be had to the residue Entry 97 of List I (Union List) of the Seventh Schedule with respect to a matter fully covered by Entry 54 of List II (the State list). He pointed out that Entry 92C of List I which provides 'Taxes on Services' is yet to be notified and in any event could not make any difference to the legal position. According to him, it is not possible to extricate and assign separate value of the various aspects associated with the provisions of service.

22. Referring to Section 65(105) (zzzz) he pointed out that the renting of immovable property excludes building used solely for residential purposes and building used for the purposes of accommodation including hotels, hostels, boarding houses, holiday accommodation, tents, camping facilities from the ambit of service tax. With the above services having been exempted under Section 65(105) (zzzz), it cannot be brought back by introducing another entry in the form of Section 65(105) (zzzzw). He submitted that both VAT and luxury tax are collected by the State Governments. VAT is calculated on the sale of goods and luxury tax is payable by hotels, inn, guest houses, clubs and camp sites on provision of accommodation. Service tax on either of these aspects, therefore, cannot be levied as the two imposts were mutually exclusive. Referring to the decision

in ***Imagic Creative Pvt. Ltd. v. Commissioner of Commercial Taxes 2008 (9) STR 337 (SC)***, he submitted that the payment of service tax and VAT are mutually exclusive. It is submitted that the attempt at treating transactions of sale of food, beverages and liquor and also short term accommodation provided by the hotels for less than three months as taxable service was an attempt in double taxation inasmuch as the same transaction is liable for the payment of both service tax and sales tax in one case and service tax and luxury tax on the other.

23. Mr. Venkataraman placed considerable reliance on the decision of the Constitution Bench of the Supreme Court in ***K. Damodarasamy Naidu v. State of Tamil Nadu (2000) 1 SCC 521*** where the Supreme Court, according to him, clarified that while a customer in a fancy restaurant pays far more for the supply of the goods, the amount paid for such supply is amenable to sales tax notwithstanding that it may be part of rendering of service in the form of good furniture, furnishing and fixtures, linen, crockery, cutlery etc. He also relied on the decision of the Division Bench of the Kerala High Court dated 21st October 2014 in W.A. No. 1125 of 2013 (***Union of India v. Kerala Hotel Association***) whereby the Division Bench upheld the decision of a Single Judge striking down Section 65(105) (zzzzv) and (zzzzw) of the FA on the ground of lack of legislative competence of the Parliament.

24. Mr. Venkataraman sought to distinguish the decision in ***Tamil Nadu Kalyana Mandapam Association v. Union of India AIR 2004 SC 3757*** which according to him itself drew a distinction between the supply of food

and drink in restaurant and the provision of service in a Mandapam. He referred to the decision in ***International Tourist Corporation v. State of Haryana AIR 1981 SC 774*** which emphasised that before legislative competence can be claimed for Parliament by resort to the residuary power, the legislative incompetence of the State legislative must be clearly established. Emphasising the 'pith and substance' and the 'dominant nature' tests, he submitted that in the present case the transaction in pith and substance was entirely one of sale as defined under Article 366(29A) (f) and therefore the State alone was competent to levy sales tax to the exclusion of the Union. He also referred to the decision in ***Bharat Sanchar Nigam Ltd. v. Union of India (2006) 3 SCC 1,*** which according to him held that the Union did not have any power to tax a transaction the dominant nature of which was the sale of goods.

25. According to Mr Venkataraman Rule 2C of the 2006 Rules which deemed 40% of the total value of the transaction to be attributable to the value of services was arbitrary and without any basis and was liable to be quashed. Likewise, there was no basis for fixing the figure of Rs. 1,000 per day tariff for the exemption from service tax on accommodation in terms of the notifications dated 17th March and 6th June 2012.

26. Mr. Venkataraman sought to distinguish the judgment of the Bombay High Court in ***Indian Hotels and Restaurant Association v. Union of India 2014 (34) S.T.R 522 (Bom)***which negatived the challenge to the validity of Section 65 (105) (zzzzv) of the FA, the decision of the Karnataka High Court in ***Ballal Auto Agency v. Union of India 2015 (40) S.T.R. 51 (Kar)***

which negatived the challenge to the validity of Section 65 (105) (zzzzv) and (zzzzw) of the FA and the decision of the Chhattisgarh High Court in ***Hotel East Park v. Union of India 2014 (35) S.T.R. 433 (Chhattisgarh)*** which negatived the challenge to the validity of Section 66 E (i) of the FA.

Submissions of counsel for the Respondents

27. In reply to the above submissions, it was urged by Mr. Dev Bhardwaj, learned Standing counsel for the Central Government and Mr. Harpreet Singh learned Senior Standing counsel for the Service Tax Department as under:

(i) Service tax was collected on specific taxable services which would include catering contracts, which were composite contracts. The objective under the FA was to levy service tax only on the service component of a transaction, with abatement being allowed for the value of the goods supplied in the course of such contract.

(ii) A distinction is to be drawn between the 'selective approach' adopted when Sections 65 (105) (zzzzv) and (zzzzw) of the FA were introduced and the 'comprehensive' approach with the introduction of Section 65B (44) with a new charging provision, Section 66B of the FA. Under the new approach the service portion in an activity wherein goods or other article of consumption or any drink is supplied in any manner is a declared service under Section 66E(i) of the Act. In the case of short-term accommodation (hotel) service, the abatement method is followed to arrive at the value of the service portion. Prior to 2012, as far as the restaurant services were

concerned, the service portion was 30% with an abatement of 70% for the value for the goods portion. As far as the short-term accommodation service was concerned, the service portion was taken at 50%. These percentages after 2012 were changed to 40% in the restaurant service and after CENVAT credit was allowed the effective rate of service tax was 4.8%. As far as short-term accommodation service was concerned, the effective rate of service tax was 7.2% or less after CENVAT credit is allowed.

(iii) It is emphasised that the objects and reasons of the 46th amendment to the Constitution make it clear that the phrase 'service' used in Article 366 (29A) (f) emphasises the segregable nature of the composite contract. The entire contract was not deemed to be a sale of goods but only the supply of goods as part of the service including the service provided in a restaurant. The State can levy sales tax only on the goods portion in the case of restaurant service and the Union is constitutionally entitled to tax the service portion. The stand of the Respondents is that if the State took cognizance of the meaning of tax on supply of goods and services under Article 366(29A) (f) and limited their taxation in the case of restaurant service to the goods portion leaving the service portion for taxation by the Union then the issue of double taxation would not arise. Likewise, as far as short-term accommodation (hotel) service is concerned, the power of the State to impose tax on the aspect of luxuries would not preclude the Union to levy tax on the service. A reference is made to the decisions in ***Federation of Hotel & Restaurant Association of India v. Union of India 1988 AIR 1291*** and ***Association of Leasing Financial Service Companies v. Union of India (2011) 2 SCC 352***.

(iv) By the notification dated 17th March 2012, as modified by the Notification dated 6th June 2012, there has been an increase in the value of the service portion of the composite contract of supply of goods and services in a restaurant from 30 to 40%. Further a limited exemption has been granted from the service tax leviable on short-term accommodation (hotel) service when the declared tariff per day for a hotel room is less than Rs.1000. This has been done in the interests of the economically poor tourist. The exemption is also similar to the exemptions given by the States while levying luxury tax.

(v) Consistent with the best practices in the area of Goods and Service Tax ('GST'), from 2012 onwards the Government of India has allowed unrestricted CENVAT credit of service tax paid on input services and credit of duty paid on inputs (goods other than those falling under the Central Excise Tariff Chapter 22) or capital goods, used for providing restaurant service. Under the new approach the CENVAT credit has been liberalized to coincide with internationally followed GST principles and the value of the goods portion has been settled at the level of 60%. Likewise, in the case of short-term accommodation (hotel) service, CENVAT credit of input services has been allowed at the hands of the service provider. It is pointed out that therefore the additional burden of service tax arising out of rationalization of abatement percentages involving goods portion would be offset by the gains arising from the liberalization of CENVAT credit chain in the hands of the service provider. It is submitted that for the ultimate consumer, effect of the changes in abatement percentages involving goods portion would by and

large be neutral.

(vi) Legislative competence is to be determined with reference to the object of the levy and not with reference to its incidence or the machinery for collection of tax. Referring to the decision in ***Association of Leasing & Financial Services Companies v. Union of India*** (*supra*), it is emphasised that only the supply of goods as part of any service is amenable to tax/VAT under Article 366 (29A)(f) and that the service portion is excluded from the supply.

(vii) Under the Central Product Classification ('CPC') of United Nations Statistical Commission, the 'Food Serving Services' and 'Beverages Serving Services' for consumption on the premises are being categorized under Groups 632 and 633. The International Standard Industrial Clarification ('ISIC') of all economic activities also classifies 'food and beverages service activities' under Division 65 and more specifically under Class 5610 and 5630.

(viii) What is being taxed by the Union is the activity of providing short-term accommodation and not luxury provided in a hotel. Service tax is applied only on the taxable value arrived at after abatement. It is possible that the activity may be service for the purpose of one statute and sale for the purpose of another. The same activity could be treated as service in one situation and as sale in another.

(ix) Levy of service tax falls under Entry 97 of List I read with Article 248

of the Constitution of India as held in ***Tamil Nadu Kalyana Mandapam Association v. Union of India*** (*supra*) ***Gujarat Ambuja Cements Ltd. v. Union of India (2005) 4 SCC 214*** and ***All India Federation of Tax Practitioners v. Union of India (2007) 7 SCC 527***. In terms of ***Tamil Nadu Kalyana Mandapam Association*** (*supra*), if an aspect is not covered within List II Schedule VII of the Constitution of India, it would fall within the exclusive power of the Parliament in terms of Article 248 of the Constitution of India. Since in the present case it is clear that the power to tax the service element does not lie within the legislative competence of the States, the same falls within the domain of the Parliament under Entry 97, List I of Schedule VII of the Constitution of India.

Legislative History of the 46th Amendment

28. Before discussing the scope of expression 'tax on the sale of goods' occurring in Article 366 (29A) of the Constitution, which was inserted by the Constitution with introduction of 46th Amendment Act, the legal history behind the said amendment requires to be noticed.

29. In ***State of Madras v. Gannon Dunkerley AIR 1958 SC 560***, the Supreme Court was considering the question whether a works contract which was a composite one involving the supply of goods as well as supply of labour and services would be amenable to state sales tax. It was held that the sale of goods should have three ingredients: (i)an agreement to transfer title (ii) consideration and, (iii) an actual transfer of title in the goods. It was held that where there is a contract involving sale of material and provision of labour which could not be separated, it would not fall within the definition

of sale of goods since there was no supply of materials. It was held that the State Government would not have legislative competence to levy tax on such transaction.

30. The decision in ***Gannon Dunkerley*** (*supra*) recognized eight possible deductions from the value of the composite works contract. However, at that stage there was no machinery provision by which it was possible to bifurcate the expenses into the portion relating to supply of goods and the supply of labour and services, particularly if the contractor's accounts were not maintained in that manner.

31. The first instance of challenge to levy of sales tax on the supply of food and drinks in a hotel, another composite contract, was in ***State of Himachal Pradesh v. Associated Hotels of India Ltd.*** (*supra*). The Supreme Court was considering a situation where hotels were providing to their guests both accommodation and food which was served at fixed hours without there being no separate charge for the food. The Supreme Court held this to be a composite contract which could not be split up and taxed as one for sale of goods and another for service in the absence of any intention to separately sell the food. The transaction was, therefore, held to be outside the purview of the State sales tax.

32. The issue was re-visited by the Supreme Court in ***Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi*** (*supra*). The Supreme Court examined whether under the Bengal Finance Sales Tax Act, 1941 the supply of food in a restaurant was exigible to tax as a sale. The Supreme Court

followed the earlier decision in ***State of Himachal Pradesh v. Associated Hotels of India Ltd.*** (*supra*) and held that the true essence of the transaction was service and did not involve a transfer of the general property in the food supplied. The Court observed:

> "6. It has already been noticed that in regard to hotels this Court has in *M/s. Associated Hotels of India Limited* adopted the concept of the English law that there is no sale when food and drink are supplied to guests residing in the hotel. The court pointed out that the supply of meals was essentially in the nature of a service provided to them and could not be identified as a transaction of sale. The court declined to accept the proposition that the Revenue was entitled to split up the transaction into two parts, one of service and the other of sale of food-stuffs. If that be true in respect of hotels, a similar approach seems to be called for on principle in the case of restaurants. No reason has been shown to us for preferring any other. The classical legal view being that a number of services are concomitantly provided by way of hospitality, the supply of meals must be regarded as ministering to a bodily want or to the satisfaction of a human need. What has been said in Electa B. Merrill appears to be as much applicable to restaurants in India as it does elsewhere. It has not been proved that any different view should be taken, either at common law, in usage or under statute."

33. In the order in the review petition, ***Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi (1980) 2 SCC 167*** (hereafter ***Northern India Caterers Review Order***), the Supreme Court clarified that where food was supplied in an eating house or a restaurant and it is established upon the facts that the substance of the transaction, evidenced by its dominant object, was the sale of food and the rendering of services was merely incidental, the transactions would be exigible to sales tax. The Court further clarified as under:

> "It appears from the submissions now made that the respondent as

well as other States are apprehensive that the benefit of the judgment of this Court will be invoked by restaurant-owners in those cases also where there is a sale of food and title passes to the customers. It seems to us that having regard to the facts upon which our judgment rests undisputed as they have remained throughout the different stages of the litigation-and the considerations which they attract, no such apprehension can be reasonably entertained. Indeed, we have no hesitation in saying that where food is supplied in an eating-house or restaurant, and it is established upon the facts that the substance of the transaction, evidenced by its dominant object, is a sale of food and the rendering of services is merely incidental, the transaction would undoubtedly be exigible to sales-tax. In every case it will be for the tax authority to ascertain the facts on making an assessment under the relevant sales tax law and to determine upon those facts whether the sale of the food supplied is intended".

34. It is not in dispute that with a view to overcome the aforementioned decisions in ***State of Himachal Pradesh v. Associated Hotels of India*** (*supra*) and ***Northern India Caterers (India) Ltd. v. Lt. Governor*** (*supra*) and other decisions, Parliament inserted Article 366 (29 A) (a) to (f) by the 46th Amendment to the Constitution. This is apparent from the Statement of Objects and Reasons (SOR) for the 46th Amendment, the relevant portions of which read as under:

> "2. By a series of subsequent decisions, the Supreme Court has, on the basis of the decision in *Gannon Dunkerley* held various other transactions, which resemble, in substance, transactions by way of sales, to be not liable to sales tax. As a result of these decisions, a transaction, in order to be subject to the levy of sales tax under Entry 92-A of the Union List or Entry 54 of the State List, should have the

following ingredients, namely, parties competent to contract, mutual assent and transfer of property in goods from one of the parties to the contract to the other party thereto for a price.

3. This position has resulted in scope for avoidance of tax in various ways. An example of this is the practice of inter-State consignment transfers i.e. transfer of goods from head office or a principal in one State to a branch or agent in another State or vice versa or transfer of goods on consignment account, to avoid the payment of sales tax on inter-State sales under the Central Sales Tax Act. While in the case of a works contract, if the contract treats the sale of materials separately from the cost of the labour, the sale of materials would be taxable but in the case of an indivisible works contract, it is not possible to levy sales tax on the transfer of property in the goods involved in the execution of such contract as it has been held that there is no sale of the materials as such and the property in them does not pass as movables… In the *Associated Hotels of India* case (AIR 1972 SC 1131), the 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.
…
8. Besides the above mentioned matters, a new problem has arisen as a result of the decision of the Supreme Court in *Northern India Caterers (India) Ltd. v. Lt. Governor of Delhi* (AIR 1978 SC 1591). 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 has 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.

9. It is, therefore, proposed to suitably amend the Constitution to include in article 366 a definition of "tax on the sale or purchase of goods" by inserting a new clause (29A)… "

35. As noted in the concurring opinion of Dr. A. R. Lakshmanan, J. in ***Bharat Sanchar Nigam Ltd. v. Union of India*** *(supra)*:

> "Each one of the sub-clauses of Article 366(29-A) introduced by the Forty-sixth Amendment was a result of a ruling of this Court which was sought to be neutralised or modified. Sub-clause (a) is the outcome of *New India Sugar Mills Ltd. v. and Vishnu Agencies (P) Ltd. v. CTO 14 STC 316*. Sub-clause (b) is the result of *Gannon Dunkerley & Co. 1959 SCR 379*. Sub-clause (c) is the result of *K.L. Johar and Co. v. CTO 1965 (2) SCR 112*. Sub-clause (d) is consequent to *A.V. Meiyappan v. CIT 20 STC 115*. Sub-clause (e) is the result of *Jt. Commercial tax Officer v. YMIA (1970) 1 SCC 462*. Sub-clause (f) is the result of *Northern India Caterers (India) Ltd.v. Lt. Governor of Delhi* "

36. Importantly, in para 13 of the SOR for the 46th Amendment to the Constitution it was observed that the "proposed amendments would help in the augmentation of the State revenues to a considerable extent." The focus was on ensuring that State sales tax was leviable on the portion of supply of food and drinks even where it was as a part of a composite catering contract. The focus at that stage was not on capturing any portion of that composite contract for the purpose of levy of service tax. This was 1982 and service tax was not thought of till a decade later. Therefore, it is difficult to imagine that Parliament had in 1982 at the time of the 46th Amendment consciously decided that no portion of the composite contract of a catering contract would be amenable to levy of Union service tax.

Validity of Section 65 (105) (zzzzv) of the FA

37. With the above legislative history in the background, the challenge to Section 65 (105) (zzzzv) of the FA which provides for levy of service tax on provision of service by air-conditioned restaurants having license to serve liquor is now examined.

38. The broad parameters on which the challenge to constitutional validity of central taxing statutes on the ground of lack of legislative competence of the Parliament is to be approached has been encapsulated in the following passage in ***International Tourist Corporation v. State of Haryana*** (*supra*):

> "7. Before exclusive legislative competence can be claimed for Parliament by resort to the residuary power, the legislative incompetence of the State legislative must be clearly established. Entry 97 itself is specific that a matter can be brought under that entry only if it is not enumerated in List II or List III and in the case of a tax if it is not mentioned in either of those lists. In a Federal Constitution like ours where there is a division of legislative subjects but the residuary power is vested in Parliament, such residuary power cannot be so expansively interpreted as to whittle down the power of the State legislature. That might affect and jeopardise the very federal principle. The federal nature of the Constitution demands that an interpretation which would allow the exercise of legislative power by Parliament pursuant to the residuary powers vested in it to trench upon State legislation and which would thereby destroy or belittle State autonomy must be rejected."

39. In ***Gujarat Ambuja Cements Ltd. v. Union of India*** (*supra*) the Court explained:

> "This mutual exclusivity which has been reflected in Article 246(1) means that taxing entries must be construed so as to maintain exclusivity. Although generally speaking, a liberal interpretation must be given to taxing entries, this would not bring within its purview a tax on subject-matter which a fair reading of the entry does not cover. If in

substance, the statute is not referable to a field given to the State, the court will not by any principle of interpretation allow a statute not covered by it to intrude upon this field."

40. Specific to the challenge to the levy of service tax by Parliament on the service portion of a composite contract the following passage in ***Commissioner, Central Excise & Customs, Kerala v. Larsen & Toubro Ltd. (2016) 1 SCC 170*** is instructive:

> "15.At this stage, it is important to note the scheme of taxation under our Constitution. In the lists contained in the 7th Schedule to the Constitution, taxation entries are to be found only in lists I and II. This is for the reason that in our Constitutional scheme, taxation powers of the Centre and the States are mutually exclusive. There is no concurrent power of taxation. This being the case, the moment the levy contained in a taxing statute transgresses into a prohibited exclusive field, it is liable to be struck down. In the present case, the dichotomy is between sales tax leviable by the States and service tax leviable by the Centre. When it comes to composite indivisible works contracts, such contracts can be taxed by Parliament as well as State legislatures. Parliament can only tax the service element contained in these contracts, and the States can only tax the transfer of property in goods element contained in these contracts. Thus, it becomes very important to segregate the two elements completely for if some element of transfer of property in goods remains when a service tax is levied, the said levy would be found to be constitutionally infirm.

41. As regards the limitation on the legislative power of the States to levy sales tax on services the Court in ***Bharat Sanchar Nigam Limited v. Union of India*** (*supra*) observed:

> "80. … No one denies the legislative competence of the States to levy sales tax on sales provided that the necessary concomitants of a sale are present in the transaction and the sale is distinctly discernible in the transaction.

> 81. This does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods. Even in those composite contracts which are by legal fiction deemed to be divisible under Article 366(29-A), the value of the goods involved in the execution of the whole transaction cannot be assessed to sales tax."

42. Therefore what is essential in proceeding to examine the challenge in the present case is to determine whether the composite catering contract is capable of being segregated into the portion pertaining to supply of goods and the portion pertaining to the service provided.

43. To revert to Article 366 (29A), the focus as far as the present petition is concerned is on Clause (f) which seeks to define tax on sale purchase of goods. The constituent elements as it were, of the definition are:

(i) the supply of goods being food or any other article for human consumption or any drink (whether or not intoxicating);

(ii) the supply of goods could by way of or as part of any service or in any other manner whatsoever; and

(iii) such supply or service could be for cash, deferred payment or other valuable consideration.

44. If the above three elements are present then "such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods

by the person to whom such transfer, delivery or supply is made."

45. The subject matter of "transfer, delivery or supply" are the 'goods', which in this case would be food or any other article fit for consumption whether or not intoxicated. The key expression is not just 'supply' but 'supply of goods'. It is arguable that the expression 'supply of goods' connotes that the dominant nature of the transaction is the transfer, delivery or supply of goods and the provision of service is only incidental to such transfer, delivery or supply. The dominant nature test was emphasised in ***Bharat Sanchar Nigam Limited v. Union of India*** (*supra*) However, in ***Larsen and Toubro Limited v. State of Karnataka (2014) 1 SCC 708***, the Supreme Court held:

> "Whether the contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract."

46. By the same logic even if some part of the composite transaction involves the rendering of service, there should be no difficulty in recognising the power of the Union to bring to tax that portion. Section 66 E (i) of the FA which defines 'declared service' to be the "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."

47. The sheet anchor of the case of the Petitioners is the decision of the Constitution Bench in ***K Damodarasamy Naidu v. State of Tamil Nadu*** (*supra*) whereas the Respondents rely extensively on the decision in ***Tamil Nadu Kalyana Mandapam Association v. Union of India*** (*supra*). Both the said decisions therefore require to be examined in some detail.

48. In ***K Damodarasamy Naidu v. State of Tamil Nadu*** (*supra*) the Supreme Court was examining the validity of Second 3-D of the Tamil Nadu General Sales Tax Act 1959 which sought to levy sales tax on supply of food and drink in restaurants. The contention was that since the transaction was a composite one involving provision of service, the entire value of the transaction could not be subject to sales tax. This contention was repelled by the Supreme Court. It was observed:

> "9. The provisions of sub-clause (f) of clause (29-A) of Article 366 need to be analysed. Sub-clause (f) permits the States to impose a tax on the supply of food and drink. The supply can be by way of a service or as part of a service or it can be in any other manner whatsoever. The supply or service can be for cash or deferred payment or other valuable consideration. The words of sub-clause (f) have found place in the Sales Tax Acts of most States and, as we have seen, they have been used in the said Tamil Nadu Act. The tax, therefore, is on the supply of food or drink and it is not of relevance that the supply is by way of a service or as part of a service. In our view, therefore, the price that the customer pays for the supply of food in a restaurant cannot be split up as suggested by learned counsel. The supply of food by the restaurant-owner to the customer though it may be a part of the service that he renders by providing good furniture, furnishing and fixtures, linen, crockery and cutlery, music, a dance floor and a floor show, is what is the subject of the levy. The patron of a fancy restaurant who orders a plate of cheese sandwiches whose price is shown to be Rs.50 on the bill

> of fare knows very well that the innate cost of the bread, butter, mustard and cheese in the plate is very much less, but he orders it all the same. He pays Rs.50 for its supply and it is on Rs.50 that the restaurant-owner must be taxed".

49. The crucial sentence in the above passage is: "The tax, therefore, is on the supply of food or drink and it is not of relevance that the supply is by way of a service or as part of a service. In our view, therefore, the price that the customer pays for the supply of food in a restaurant cannot be split up as suggested by learned counsel." The Court was careful to emphasise that the subject of the levy was supply of food and drink. The reluctance to recognise the splitting of the transaction was with reference to the 'price' paid for the transaction, which is understandable if the break-up was not provided by the seller. This becomes even more evident when the following sentence is read carefully. The Court observed: "The supply of food by the restaurant-owner to the customer though it may be a part of the service that he renders by providing good furniture, furnishing and fixtures, linen, crockery and cutlery, music, a dance floor and a floor show, is what is the subject of the levy." Thus it reiterated that the subject of the levy is "the supply of food". The decision in ***K Damodarasamy Naidu*** *(supra)* did not engage with the question whether the service element involved in the supply of food and drink would be amenable to service tax. The only question was whether the entire transaction was exigible to sales tax even where the supply of food and drink was in the course of providing a service and that question that was answered in the affirmative. The Court is, therefore, of the considered view that the decision in ***K Damodarasamy Naidu*** *(supra)* is not an authority for proposition that in a catering contract, which is

admittedly a composite contract, the service portion thereof cannot be made exigible to service tax levied by a Union legislation.

50. In the context of a catering contract, there is no overlapping as such between Entry 54 of List II which relates to tax on sale and purchase of goods and has to be read with Article 366 Clause 29A(f) and Entry 97 of List I which covers a tax on the service portion of such contract. The discernment of the service portion of a composite catering contract, different from the portion pertaining to supply of goods, is theoretically possible to be explained when the 'aspect doctrine' is applied. In ***Federation of Hotel & Restaurant Assn. of India v. Union of India, (1989) 3 SCC 634*** a Constitution Bench of the Supreme Court observed:

> "31. Indeed, the law "with respect to" a subject might incidentally "affect" another subject in some way; but that is not the same thing as the law being on the latter subject. There might be overlapping; but the overlapping must be in law. The same transaction may involve two or more taxable events in its different aspects. But the fact that there is an overlapping does not detract from the distinctiveness of the aspects. Lord Simonds in *Governor General-in-Council* v. *Province of Madras AIR 1945 PC 98* in the context of concepts of Duties of Excise and Tax on Sale of Goods said:
>
> > "... The two taxes, the one levied on a manufacturer in respect of his goods, the other on a vendor in respect of, his sales, may, as is there pointed out, in one sense overlap. But in law there is no overlapping. The taxes are separated and distinct imposts. If in fact they overlap, that may be because the taxing authority, imposing a duty of excise, finds it convenient to impose that duty at the moment when the excisable article leaves the factory or workshop for the first time on the occasion of its sale...."
>
> 32. Referring to the "aspect" doctrine Laskin's *Canadian Constitutional Law* states:

> "The 'aspect' doctrine bears some resemblance to those just noted but, unlike them, deals not with what the 'matter' is but with what it 'comes within'.... (p. 115)
>
> ... it applies where some of the constitutive elements about whose combination the statute is concerned (that is, they are its 'matter'), are a kind most often met with in connection with one class of subjects and others are of a kind mostly dealt with in connection with another. As in the case of a pocket gadget compactly assembling knife blade, screwdriver, fishscaler, nailfile, etc., a description of it must mention everything but in characterising it the particular use proposed to be made of it determines what it is. (p. 116)
>
> "... I pause to comment on certain correlations of operative incompatibility and the 'aspect' doctrine. Both grapple with the issues arising from the composite nature of a statute, one as regards the preclusory impact of federal law on provincial measures bearing on constituents of federally regulated conduct, the other to identify what parts of the whole making up a 'matter' bring it within a class of subjects...." (p. 117)

51. The aspect doctrine was highlighted by the Supreme Court in the context of levy of service tax on the service portion of leasing and financing transactions in ***Association of Leasing Financial Service Companies v. Union of India*** (*supra*) as under:

> "30. .....The object behind enactment of Article 366(29A) is to tax the composite price so that the full value of the hire-purchase price is taxed and to avoid the judgment in K.L. Johar's case whose implication was to narrow the tax base resulting in seepage of sales tax revenue. It is in that sense "splitting" of the contract needs to be understood. Thus, it cannot be said that Parliament divested itself of the power to levy service tax vide enactment of the Constitution (Forty-sixth Amendment) Act. Even in the Report of the Law Commission, it has been observed that "if a hire-purchase transaction

> results in a sale, sales-tax is undoubtedly leviable by the States. No doubt, it is difficult to determine the "sale price" for the purpose of the sales tax law but this has no bearing on the question of legislative competence"

52. Turning now to the main plank of the Respondents' case, it is noticed that the service component of an outdoor catering contract was again emphasised in ***Tamil Nadu Kalyana Mandapam Association v. Union of India*** (*supra*) in the following passage:

> "43. In regard to the submission made on Article 366(29A) (f), we are of the view that it does not provide to the contrary. It only permits the State to impose a tax on the supply of food and drink by whatever mode it may be made. It does not conceptually or otherwise includes the supply to services within the definition of sale and purchase of goods. This is particularly apparent from the following phrase contained in the said sub-article "such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods." In other words, the operative words of the said sub-article is supply of goods and it is only supply of food and drinks and other articles for human consumption that is deemed to be a sale or purchase of goods.
>
> 44. The concept of catering admittedly includes the concept of rendering service. The fact that tax on the sale of the goods involved in the said service can be levied does not mean that a service tax cannot be levied on the service aspect of catering."

53. Mr. Venkataraman, tried to distinguish the above decision in ***Tamil Nadu Kalyana Mandapam Association*** by pointing out that the question there arose in a different context. He relied on the following passage in the decision to urge that there was a difference between the provision of outdoor catering service in a Mandapam and the supply of food and drinks in a restaurant:

> "55. … A customer goes to a mandap-keeper, say a star hotel, not merely for the food that they will provide but for the entire variety of services provided therein which result in providing the function to be solemnized with the required effect and ambience. Similarly the services rendered by outdoor caterers is clearly distinguishable from the service rendered in a restaurant or hotel inasmuch as, in the case of outdoor catering service the food/eatables/drinks are the choice of the person who partakes the services. He is free to choose the kind, quantum and manner in which the food is to be served. But in the case of restaurant, the customer's choice of foods is limited to the menu card. Again in the case of outdoor catering, customer is at liberty to choose the time and place where the food is to be served. In the case of an outdoor caterer, the customer negotiates each element of the catering service, including the price to be paid to the caterer. Outdoor catering has an element of personalized service provided to the customer. Clearly the service element is more weighty, visible and predominant in the case of outdoor catering. It cannot be considered as a case of sale of food and drink as in restaurant. Though the Service Tax is leviable on the gross amount charged by the mandap-keeper for services in relation to the use of a mandap and also on the charges for catering, the Government has decided to charge the same only on 60% of the gross amount charged by the mandap-keeper to the customer."

54. The Court is unable to agree with the above submission of Mr. Venkataraman. While the Court in the above passage seeks to distinguish the services rendered by outdoor restaurant from the services rendered in a restaurant and points out that in outdoor catering there is an element of personalized service, it in no way suggests that there is no service element involved in the supply of food and drinks in a restaurant. In fact as the Court reads the decision two specific issues were addressed as evident from the following passage:

"39. In the present case, service tax levied on services rendered by mandap-keeper as defined in the said Act under Sections 65, 66 and 67 of the Finance Act has been challenged by the appellants on the following two grounds:

(a) that it amounts to a tax on land and, therefore, by reason of Entry 49 of List 2 in of the Seventh Schedule of the Constitution, only the State Government is competent to levy such tax; and

(b) insofar as it levies a tax on catering services, it amounts to a tax on sale and purchase of goods and, therefore, is beyond the competence of Parliament, particularly in view of the definition of tax on sale and purchase of goods contained in Article 366(29-A)(f) of the Constitution."

55. Therefore, the question whether in the context of Article 366 (29A) (f) of the Constitution the service portion of a composite catering contract can be made exigible to service tax was squarely in issue. This becomes clear when one refers to para 57 of the said judgment which reads as under:

"A tax on services rendered by mandap-keepers and outdoor caterers is in pith and substance, a tax on services and not a tax on sale of goods or on hire purchase activities. Section 65 clause 41 sub clause (p) of the Finance Act, 1994, defines the taxable service (which is the subject matter of levy of service tax) as any service provided to a customer by a mandap-keeper in relation to use of a mandap in any manner including the facilities provided to a customer in relation to such use also the services, if any, rendered as a caterer. The nature and character of this service tax is evident from the fact that the transaction between a mandap-keeper and his customer is definitely not in the nature of a sale of hire purchase of goods. It is essentially that of providing a service. In fact, as pointed out earlier, the manner of service provided assumes predominance over the providing of food in such situations which is a definite indicator of the supremacy of the service aspect. The legislature in its wisdom noticed the said supremacy and identified the same as a potential region to collect indirect taxes. Moreover, it has been a well established judicial principle that so long as the legislation

> is in substance, on a matter assigned to a legislature enacting that statute, it must be held valid in its entirety even though it may trench upon matters beyond its competence. Incidental encroachment does not invalidate such a statute on the grounds that it is beyond the competence of the legislature (*Prafulla Kumar vs. Bank of Commerce*). Article 246(1) of the Constitution specifies that the Parliament has exclusive powers to make laws with respect to any of the matters enumerated in List I in the Seventh Schedule to the Constitution. As per Article 246(3), the State Government has exclusive powers to make laws with respect to matters enumerated in List II (State List). In respect of matters enumerated in List III (Concurrent List) both Parliament and State Government have powers to make laws. The service tax is made by Parliament under the above residuary powers."

56. The Supreme Court applied pith and substance doctrine and concluded that "the manner of service provided assumes predominance over the providing of food in such situations which is a definite indicator of the supremacy of the service aspect." For good measure the Supreme Court held: "The concept of catering admittedly includes the concept of rendering service. The fact that tax on the sale of the goods involved in the said service can be levied does not mean that a service tax cannot be levied on the service aspect of catering." What the decision therefore does is to highlight the possibility of splitting up of the composite transaction into the provision of service element and the supply of food. The Respondents are justified in contending that as far as the interpretation of Article 366 (29A) (f) of the Constitution is concerned, the decision in ***Tamil Nadu Kalyana Mandapam Association v. Union of India*** (supra) fully supports their stand.

57. It may be noticed at this stage that even though the issue in point was not centrally in issue in ***Bharat Sanchar Nigam Limited v. Union of India***

(*supra*) the Supreme Court analysed the various clauses of Article 366 (29-A) and observed *inter alia*, that "

> " ....Clause (f) pertains to contracts which had been held not to amount to sale in *State of Punjab vs. M/s. Associated Hotels of India Ltd*. (supra). That decision has by this clause been effectively legislatively invalidated. All the clauses of Article 366 (29A) serve to bring transactions where one or more of the essential ingredients of a sale as defined in the Sale of Goods Act 1930 are absent, within the ambit of purchase and sales for the purposes of levy of sales tax. To this extent only is the principle enunciated in *Gannon Dunkerly* limited. **The amendment especially allows specific composite contracts viz. works contracts (Clause (b)), hire purchase contracts (Clause (c)), catering contracts (Clause (e)) by legal fiction to be divisible contracts where the sale element could be isolated and be subjected to sales tax**.
>
> *Gannon Dunkerley* survived the 46th Constitutional Amendment in two respects. First with regard to the definition of 'sale' for the purposes of the Constitution in general and for the purposes of Entry 54 of List II in particular except to the extent that the clauses in Art. 366(29A)operate. By introducing separate categories of 'deemed sales', the meaning of the word 'goods' was not altered. Thus the definitions of the composite elements of a sale such as intention of the parties, goods, delivery etc. would continue to be defined according to known legal connotations. This does not mean that the content of the concepts remains static. Courts must move with the times. But the 46th Amendment does not give a licence for example to assume that a transaction is a sale and then to look around for what could be the goods. The word "goods" has not been altered by the 46th Amendment. That ingredient of a sale continues to have the same definition. The second respect in which *Gannon Dunkerley* has survived is with reference to the dominant nature test to be applied to a composite transaction not covered by Article 366(29A).Transactions which are mutant sales are limited to the clauses of Article 366(29A). All other transactions would have to qualify as sales within the meaning of Sales of Goods Act 1930 for the purpose of levy of

> sales tax. **Of all the different kinds of composite transactions the drafters of the 46th Amendment chose three specific situations, a works contract, a hire purchase contract and a catering contract to bring within the fiction of a deemed sale. Of these three, the first and third involve a kind of service and sale at the same time**. Apart from these two cases where splitting of the service and supply has been Constitutionally permitted in clauses (b) and (g) of Clause 29A of Art. 366, there is no other service which has been permitted to be so split." (emphasis supplied)

58. The Parliament has further made the legal position explicit by inserting Section 66 E (i) of the FA read as it were with Section 65 (22) and 65 (44) of the FA. It states that the "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" is a 'declared' service. The legislative carving out of the service portion of the composite contract of supply of food and drinks has sound constitutional basis as explained in the aforementioned decisions of the Supreme Court. Even if this is viewed as Parliament deploying a legal fiction, it is legally permissible. In ***State of U.P. v. Hari Ram (2013) 4 SCC 280*** it was held:

> "18. The legislature is competent to create a legal fiction, for the purpose of assuming existence of a fact which does not really exist. … In interpreting the provision creating a legal fiction, the court is to ascertain for what purpose the fiction is created and after ascertaining this, the court is to assume all those facts and consequences which are incidental or inevitable corollaries to the giving effect to the fiction."

59. Thus it is not possible to accept the contention of the Petitioners that Parliament lacks the legislative competence to enact Section 65 (105) (zzzzv) of the FA with a view to bringing the service component of the composite contract of supply of food and drinks by an air-conditioned

restaurant within the service tax net.

60. Next the challenge to Rule 2-C of the 2006 Rules requires to be examined. The case of the Petitioners is that the said rule is bad in law as it arbitrarily attributes 40% of the value of the composite contract of supply of food and drinks to the service component. The legal basis for this challenge is to be found in the following passage in ***Govind Saran Ganga Saran v. CST 1985 Supp SCC 205:***

> "6. The components which enter into the concept of a tax are well known. The first is the character of the imposition known by its nature which prescribes the taxable event attracting the levy, the second is a clear indication of the person on whom the levy is imposed and who is obliged to pay the tax, the third is the rate at which the tax is imposed, and the fourth is the measure or value to which the rate will be applied for computing the tax liability. If those components are not clearly and definitely ascertainable, it is difficult to say that the levy exists in point of law. Any certainty or vagueness in the legislative scheme defining any of those components of the levy will be fatal to its validity."

61. What Rule 2C does is to enable the assessing authority to put a definite value to the service portion of the composite contract of supply of goods and services in an air-conditioned restaurant. Correspondingly there is an abatement for that portion which pertains to the supply of goods in the form of food and drink which would be amenable to sales tax or value added tax. As rightly pointed out by learned counsel for the Respondent that such grant of abatement has the approval by the Supreme Court in ***Association of Leasing & Financial Service Companies v. Union of India*** (*supra*) wherein the abatement was 90% and the standard rate of service tax was applied on

@ 10% of the cost of the leasing transaction which approximately represented the service element. It also requires to be kept in mind that the ready reckoner formula is useful where an assessee does not maintain accounts in a manner that will enable the assessing authority to clearly discern the value of the service portion of the composite contract. It hardly needs emphasis that when during the course of assessment proceedings an assessee is able to demonstrate, on the basis of the accounts and records maintained by it for that purpose, that the value of the service component is different from that obtained by applying Rule 2C the assessing authority would be obliged to consider such submission and give a decision thereon. With the machinery provision for the levy and determination of service tax on the service portion clearly being spelt out in the Rules themselves, the legal requisites highlighted in ***Govind Saran Ganga Saran v. CST*** (*supra*) stand satisfied.

62. Indeed a perusal of one of the bills produced by the Petitioners themselves reveals that of the total sale of food for Rs. 2300, food tax (i.e. VAT) is levied @ 12.5% and works out to Rs. 287.50, service tax is @ 4.94% which works out to Rs. 113.71. An abatement has been provided in the rate of service tax. Where the service tax should be @ 12.36% it is, after abatement, 4.94%. Therefore it is not right that the measure of tax is the same. This is notwithstanding the settled legal position that value of taxable service is not determinative of the character of the levy. In ***Association of Leasing & Financial Service Companies v. Union of India*** (*supra*) the Supreme Court observed:

"45 (i) The measure of taxation does not affect the nature of taxation

and, therefore, the manner of quantification of the levy of service tax has no bearing on the factum of legislative competence."

63. For all the aforementioned reasons, the Court upholds the constitutional validity of Section 65 (105) (zzzzv) and Section 66 E (i) of the FA read with Section 65 (22) and 65 (44) thereof and Rule 2 C of the 2006 Rules 2006.

Challenge to the validity of Section 65 (105) (zzzzw) of the FA

64. Turning now to the challenge to Section 65 (105) (zzzzw) of the FA by which the service tax is sought to be levied on short-term accommodation provided in a hotel, it must be noticed at the outset that main contention of the Petitioners is that levy of tax on luxuries as contemplated under Article 246 read with Entry 62 of List II (State List) of the Constitution entirely covers the field and therefore, Parliament lacks the legislative competence to levy such service tax.

65. To test the above submission it requires to be examined if indeed the Petitioners may be right in their contentions when the definition of 'luxury' is examined. Since the Petitioners are based in Delhi, the Court proposes to examine the relevant legislation applicable in the National Capital territory of Delhi.

66. Under Section 2 (i) of the Delhi Tax Luxuries Act, 1996 ('DTL Act'), the expression "luxury provided in a hotel" is defined to mean "accommodation and other services provided in a hotel, the rate or charges for which including the charges for air-conditioning, telephone, radio, music, extra beds and the like, is five hundred rupees per room per day or more; but does not include the supply of food, drinks or other services which is separately

charged for." Section 3 (1) of the DTL Act is the charging section which states: "Subject to the provisions of this Act and the rules made thereunder there shall be levied a tax on the turnover of receipts of a hotelier." The expression "turnover of receipts" has been defined in Section 2 (r) of the DTL Act to mean" the aggregate amounts of valuable consideration received or receivable by a hotelier or by his agent in respect of the luxuries provided in a hotel in a given period." The expression "hotel" has been defined in Section 2 (g) of the DTL Act to include "a residential accommodation, a lodging house, an inn, a club, a resort, a farm house, a public house or a building or a part of a building where a residential accommodation is provided by way of a business."

67. Turning to Section 65 (105) (zzzzw) of the FA it contemplates a service provided "to any person by a hotel, inn, guest house, club or camp-site by whatever name called, for providing of accommodation for a continuous period of less than three months." When the above definition is placed alongside the above extracted provisions of the DTL Act, it is difficult to discern any real difference in the subject matter of the two levies. In other words, what is defined under the DTL Act of 1996 is an identical service of providing accommodation in a hotel. The only additional pre-fix in the FA is the hyphenated word "short-term" in Section 65 (105) (zzzzw) followed by the expression "for a period of less than three months". However, such provision of short-term accommodation of less than three months is by no means exempt from luxury tax under the DTL Act. The very same taxable event of providing service by way of accommodation in a hotel etc. is the

subject matter of both levies viz., luxury tax under the DTL Act and service tax under the FA.

68. Consequently Section 65 (105) (zzzzw) of the FA fails the foremost test of constitutionality of a Union tax as highlighted in ***International Tourist Corporation v. State of Haryana*** (*supra*) that "[b]efore exclusive legislative competence can be claimed for Parliament by resort to the residuary power, the legislative incompetence of the State legislative must be clearly established." Here the DTL Act which provides for levy of luxury tax on provision of the service of accommodation in a hotel etc. is traceable to Entry 62 of List II and the State is therefore competent to levy and collect luxury tax on such taxable event.

69. In ***Godfrey Phillips India Ltd. v. State of U.P., (2005) 2 SCC 515,*** the Constitution Bench of the Supreme Court considered at length the meaning of term 'luxuries' in Entry 62 of List II of the Seventh Schedule to the Constitution. The exercise was undertaken in the context of the challenge laid to State legislations seeking to levy tax on luxury goods or articles. Holding that the levies were invalid as they could not, with respect to that entry, be on luxury 'articles' the Court observed as under:

> "68. … The juxtaposition of the different taxes within Entry 62 itself is in our view of particular significance. The entry speaks of "taxes on luxuries *including* taxes on entertainments, amusements, betting and gambling". The word "including" must be given some meaning. In ordinary parlance it indicates that what follows the word "including" comprises or is contained in or is a part of the whole of the word preceding. The nature of the included items would not only partake of the character of the whole, but may be construed as clarificatory of the whole.

> 69. It has also been held that the word "includes" may in certain contexts be a word of limitation [*South Gujarat Roofing Tiles Manufacturers Assn.* v. *State of Gujarat (1976*) *4 SCC 601*]. In the context of Entry 62 of List II this would not mean that the word "luxuries" would be restricted to entertainments, amusements, betting and gambling but would only emphasise the attribute which is common to the group. If luxuries is understood as meaning something which is purely for enjoyment and beyond the necessities of life, there can be no doubt that entertainments, amusements, betting and gambling would come within such understanding. Additionally, entertainments, amusements, betting and gambling are all activities. "Luxuries" is also capable of meaning an activity and has primarily and traditionally been defined as such. It is only derivatively and recently used to connote an article of luxury. One can assume that the coupling of these taxes under one entry was not fortuitous but because of these common characteristics.
>
> …
>
> 77. Hence on an application of general principles of interpretation, we would hold that the word "luxuries" in Entry 62 of List II means the activity of enjoyment of or indulgence in that which is costly or which is generally recognised as being beyond the necessary requirements of an average member of society and not articles of luxury."

70. The above decision is significant for recognising the term 'luxury' to not mean luxury articles or goods but the 'activity of enjoyment'. In this context the following observations of the Supreme Court in ***Assn. of Leasing & Financial Service Companies v. Union of India, (2011) 2 SCC 352*** are relevant:

> "38. In *All-India Federation of Tax Practitioners case (2007) 7 SCC 527* this Court explained the concept of service tax and held that service tax is a value added tax ("VAT", for short) which in turn is a destination based consumption tax in the sense that it is levied on commercial activities and it is not a charge on the business but on the consumer. That, service tax is an economic concept based on the principle of equivalence in a sense that consumption of goods and

> consumption of services 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". That, 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. It is this principle of equivalence which is inbuilt into the concept of service tax under the Finance Act, 1994. That service tax is, therefore, a tax on an activity. That, service tax is a value added tax."

71. In the counter affidavit filed by the Respondent, it is simply asserted that service tax is a levy that is distinct from luxury tax levied by the States. But the basis for this assertion is not set out. On the other hand, while seeking to explain the exemption granted to rooms with a tariff of less than Rs. 1000 per day, reference is made to the threshold limits fixed in the luxuries tax legislation of the States like for e.g., Maharashtra and Delhi. It is, therefore, plain that there is not merely an overlap of luxury tax and service tax as far as accommodation provided in hotels is concerned. It is in fact the same levy but by different statutes: one enacted by the State and the other by the Union. This is indeed an instance of encroachment by the Union into a field that is completely covered by a State legislation.

72. The following observations of the Supreme Court in ***Imagic Creative Ltd. v. Commissioner of Commercial Taxes*** (*supra*) in the context of VAT and service tax would equally apply to a situation where luxury tax and service tax are sought to be levied on the same taxable event:

> "32. Payments of service tax as also VAT are 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."

73. The levy of service tax on short-term accommodation fails on other respects too. Significantly, the 2006 Rules do not provide the machinery for levy and collection of tax on accommodation. Even the rebate provided on the basis of the room tariff is not engrafted into the 2006 Rules. While Rule 2C provides the basis for determining the value of services for the purposes of Section 65 (105) (zzzzv), there is no corresponding provision for determining the value of the service in the case of Section 65 (105) (zzzzw) of the FA. In other words there is no machinery for the computation of the taxable value of the service of providing accommodation. In ***Commissioner of Income Tax v. B. C. Srinivasa Setty AIR 1981 SC 972*** in the context of the absence of a machinery provision for computation of tax on goodwill, in the context of Section 45 of the Income Tax Act 1961, for the it was observed:

> "The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise one would be driven to conclude that while a certain income seems to fall within the charging section there is no scheme of computation for quantifying it."

74. The exemption from service tax on the provision of accommodation for a room having a declared tariff of less than Rs. 1,000 per day or equivalent is by Notification No. 12/2012 dated 17th March 2012. This is not provided in the Act or the Rules. In ***Commissioner of Central Excise and Customs, Kerala v. Larsen and Toubro Ltd. (2016) 1 SCC 170***, the Supreme Court

affirmed the decision of the Orissa High Court in ***Larsen and Toubro Ltd. v. State of Orissa (2008) 12 VST 31*** to the effect that the machinery provisions for levy of the tax could not be provided by instructions and circulars. It was held by the Orissa High Court that "It is a well-settled principle that in matters of taxation either the statute or the Rules framed under the statute must cover the entire field. Taxation by way of administrative instructions which are not backed by any authority of law is unreasonable and is contrary to article 265 of the Constitution of India."

75. Consequently, the Court is satisfied that the provision of short-term accommodation in hotels etc. envisaged in Section 65 (105) (zzzzw) of the FA read with Section 65 (44) of the FA is a taxable event that is entirely covered by the term 'luxuries' in Entry 62 of List II of the Seventh Schedule to the Constitution and therefore outside the legislative competence of Parliament.

76. Before concluding the Court would like to observe that it has refrained from discussing the decisions of the other High Courts which have taken a view on the issues involved herein since at least three of those decisions i.e., the decisions of the Division Benches of the Kerala High Court in ***Union of India v. Kerala Hotel Association*** (*supra*), the Bombay High Court in ***Indian Hotels and Restaurant Association v. Union of India*** (*supra*) and the Karnataka High Court in ***Ballal Auto Agency v. Union of India*** (*supra*) are subject matter of pending appeals in the Supreme Court.

Conclusions

77. The Court accordingly:

(i) upholds the constitutional validity of Section 65 (105)(zzzzv) read with Section 66E (i), Section 65 (22) of the Finance Act 1994 as well

as Rule 2C of the Service Tax (Determination of Value) Rules, 2006;

(ii) strikes down Section 65 (105) (zzzzw) of the Finance Act 1994 pertaining to levy of service tax on the provision of short-term accommodation and the corresponding instructions/circulars seeking to operationalise the levy as unconstitutional and invalid.

78. The writ petition is disposed of in the above terms but, in the facts and circumstances, with no orders as to costs.

S. MURALIDHAR, J

NAJMI WAZIRI, J

AUGUST 12, 2016
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