Supply of Food - Whether Goods or Services

CA Abhay Desai

The supply of food may take many forms. Supply may be undertaken in restaurants or as a takeaway or as home delivery. Supply may be undertaken from the premises not belonging to the supplier or in various means of transportation such as trains. Supply may be undertaken over the counter. Now the determination of whether the supply in question is a supply of goods or a supply of services is critical. This is so because several provisions of the GST law including the determination of the applicable rate of tax hinges on the characterization of the supply in question. In the present article, we attempt to answer the question of the determination of the nature of supply when food is involved. We shall briefly examine the evolution of the law on the subject in the pre-GST era as that will be relevant in examining the provisions under the GST law. We shall then discuss the two possible approaches for interpretation of the relevant GST provisions and also examine the issues related to the applicable rate of tax including the controversial circular issued on the subject.

Pre-GST era – A history and the approach considered

Much litigation in the context of Sales Tax (including VAT) as well as Service tax has happened in respect of the supplies involving food. The key findings from the examination of the history are as follows:

i. Entry 54 of the State List in the 7th Schedule to the Constitution of India granted the power to the States to levy a tax on the sale or purchase of goods. Hon'ble Supreme Court consistently held in several cases[1] that the expression 'sale of goods' as used in the legislative entries in the Constitution bears the same meaning as it has in the Sale of Goods Act, 1930 in absence of any definition of the said term in the Constitution. The definition under the Sale of Goods Act, 1930 emphasizes that the sale entails the passing of the property in goods. Therefore transactions lacking the intent of passing the property in goods were held to be

1. *State of Madras vs. Gannon Dunkerley & Co. Ltd. (1959) SCR 379; New Indian Sugar Mills vs. Commissioner of Sales Tax AIR 1963 SC 1207; Bhopal Sugar Industries vs. STO AIR 1964 SC 1037*

outside the ambit of the power of the States to levy any Sales Tax.

ii. Accordingly Hon'ble Supreme Court in one of the first case[2] related to the topic took the view that supply of food to residents of a hotel who pay a composite charge for residence, use of public rooms and other amenities and food cannot partake the character of sale since intention on the part of the parties to sell and purchase foodstuff supplied during meal times cannot be realistically spelt out. The transaction essentially is one of service. Therefore it was held that the same cannot be assessed to sales tax by splitting the bill and assessing tax on the element representing the supply of food. Subsequently, the Hon'ble Supreme Court took the view[3] based on the principles laid down in the first case supra that even service of meals to visitors in the restaurant is essentially a contract of service and hence the same shall not be liable to Sales Tax. The Court emphasized the fact that the guests have no right to carry away the unconsumed food as well as the fact that other amenities and services present were of considerable materiality. Later while refusing to review the discussed decision[4], the Court however clarified 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 therefore it will be for the taxing authority to ascertain the facts and to determine upon those facts whether a sale of the food supplied is intended or not. Thereafter Courts started taking views[5] as to whether the transaction in question can be exigible to the Sales Tax or not based on the facts of each case. In a nutshell, the emphasis of the Courts in deciding the cases was on two broad factors viz. (a) right to take away the food and (b) dominant object of the transaction as gathered from the facts of the case. Basis the consideration of the two factors, the decisions were rendered.

iii. The aforesaid situation certainly resulted in the loss to the State since pre-dominant service transactions came outside the purview of the Sales Tax. The Parliament, therefore, enacted the Constitution (46th Amendment) Act, 1982 to introduce the legal fiction of 'deemed sale' under clause (f) of Article 366(29A) to say that there would be a deemed sale of food or any other article for human consumption or any drink if supplied, by way of or as part of any service or in any other manner whatsoever, for cash,

2. *State of Punjab vs. Associated Hotels of India Ltd. AIR 1972 SC 1131*
3. *Northern India Caterers (India) Ltd. vs. Lt. Governor Of Delhi (1978 AIR 1591)*
4. (1980 AIR 674)
5. *State of Tamil Nadu vs. Dalhousie Ice Cream Parlour (1997) 106 STC 422 (Mad.)* wherein it was held that serving ice cream by an ice cream parlor in glass cups that remained with the parlor was not a sale; *Durga Bhavan vs. Deputy Commercial Tax Officer (1981) 47 STC 104 (AP)* wherein it was held that supply of food by a restaurant to the persons to take it away and consume it elsewhere will be a sale.

deferred payment or other valuable consideration. Hence once it is satisfied that there is a supply of food by way of or as part of any service or in any other manner whatsoever, then the said supply shall be considered as a 'sale' permitting the States to impose the tax. Supreme Court thereafter held[6] that once the transaction comes under deemed sale, it was permissible to levy Sales Tax on the entire amount of consideration. However, in the context of the composite 'per day' charge by the residential hotels that was inclusive of boarding and lodging, the Court directed the State of Maharashtra to frame Rules to lay down a formula to identify the price that will be exigible to Sales Tax. The aforesaid Constitutional amendment still kept the issue open as to when can it be considered that the supply of food is 'by way of or as part of any service or in any other manner whatsoever'. However, predominant service transactions came to be liable to the Sales Tax.

iv. When the aforesaid developments took place, the entire focus was on ensuring that Sales Tax was leviable on the portion of the supply of food and drinks even where it was a part of the composite contract and the focus was not on capturing any portion of that composite contract for purpose of levy of Service Tax since the 46th Constitutional Amendment was brought in 1982 and Service Tax was not thought of till decade later. Later, the Courts upheld[7] the levy of service tax on composite contracts involving the supply of food. Recently Madras High Court took the view[8] that service attributes come into existence only from the point where the food and drinks are collected for service and hence held that service tax cannot be levied on food and drinks supplied in parcels by restaurants or sold from its take-away counters in absence of any service attributes.

The aforesaid journey indicates that the issues related to the determination of the nature of the transaction in question (sale or service or both) started owing to the restricted meaning assigned to the word 'sale' for the levy of the Sales Tax. That led to the evolution of the dominant intention test (given the presence of several elements in a transaction involving the supply of food). It further lead to loss of Revenue (where transactions were predominantly service) and necessitated the Constitutional amendment to introduce a legal fiction to enable the levy of the Sales Tax on transactions that were not 'sale' prior to the said amendment. However, the Courts still made a distinction between a sale (that may involve activities in nature of service but undertaken as part of the sale) and other transactions having distinct elements of service and applied the deeming fiction only to the latter since the former was entirely exigible to the Sales tax (VAT) within the original meaning of the term 'sale'. However, the identification of 'sale' vis-à-vis other transactions still posed a challenge and it

6. *K Damodarasamy Naidu & Bros vs. State of Tamil Nadu AIR 1999 SC 3909*
7. *Federation of Hotels & Restaurants Association of India vs. Union of India 2016 (44) STR 3 (Del.)*
8. *Anjappar Chettinad A/C Restaurant vs. Jt. Commr. 2021 (51) G.S.T.L. 125 (Mad.)*

was still based on a subjective analysis of the specific facts of each case (viz. the elements that may indicate the presence of service). We shall again refer to the aforesaid history when we analyze the GST provisions as under.

GST – old wine in a new bottle or a new approach

Now it is useful to first refer to the relevant provisions of the GST law before we proceed to analyze the same.

Article 246A as introduced vide the Constitution (One Hundred and First Amendment) Act, 2016 permits the Parliament as well as State Legislature to make laws with respect to goods and services tax imposed by the Union or by such State. The term "goods and services tax" has been defined vide Article 366(12A) to mean any tax on the supply of goods, or services or both except taxes on the supply of alcoholic liquor for human consumption. Further, the term "Services" has been defined vide Article 366(26A) to mean anything other than goods.

Now Sec. 9 of the CGST Act, 2017 provides for the levy of tax on the supply of goods or services or both. Sec. 7 of the said Act deals with the scope of supply. Sec. 7(1) *inter alia* provides that the term 'supply' includes all forms of supply of goods or services or both such as sale, etc. made for consideration in the course or furtherance of business whereas Sec. 7(1A) of the said Act interalia provides that where certain activities or transactions constitute a supply u/s 7(1), they shall be treated either as the supply of goods or supply of services as referred to in Schedule II. Clause 6(b) of the said Schedule II reads as under:

"6. Composite supply

The following composite supplies shall be treated as a supply of services, namely:—

(b) 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 (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration."

Now the core issue to address is whether the aforesaid legal provisions take us to the same approach as was the situation in the pre-GST era albeit with a difference that except for the transaction considered as 'sale' all the other transactions involving the supply of food shall be treated as a supply of service. In other words, sale, as understood in the pre-GST era, shall continue to be treated as supply of goods and other transactions owing to clause 6(b) *supra* to be treated as supply of service or whether a new approach is required. Let us consider both options.

Old wine in a new bottle

As discussed earlier, the Courts in the pre-GST era continue to hold that the 'sale' of foodstuffs even from a restaurant shall be exigible only to VAT and not service tax in absence of the presence of any distinct service elements in the transactions in question. Also as discussed the identification of the service elements was a subjective test wherein Courts took the view that the presence of service elements (can be cooking, packing, delivery) contractually associated with the transfer of property in goods will not take the transaction out of the ambit of 'sale' and hence shall be exigible only to Sales Tax/VAT and not service tax. If the said view is adopted in GST one may make the following arguments in its support:

a. The scope of supply u/s 7(1)(a) of the CGST Act, 2017 expressly mentions 'sale' as a form of supply.

b. In absence of a definition of 'sale' in the GST laws, one has to take recourse to the Sale of Goods Act, 1930 wherein the term 'sale' has been defined to mean the transfer of property in goods. Further, the said Act provides that the property in goods shall transfer on delivery (in absence of a contract to the contrary) and hence elements till the delivery shall form part of a single transaction and if the supplier in question does not undertake any activities post-delivery, then the transaction is a 'sale'.

c. Sec. 7(1A) of the CGST Act, 2017 read with clause no. 1(a) of Schedule II to the said Act provides that any transfer of the title in goods is a supply of goods. Therefore once the transaction is considered a 'sale', it is in nature of the transfer of the title in goods and hence the supply of goods.

d. Sec. 15(2)(c) of the CGST Act, 2017 provides that the value of supply shall include all incidental expenses including packing incurred at the time of, or before delivery of goods and hence the transaction considered as 'sale' shall be a supply of goods.

e. Clause 6(b) of Schedule II applies only if the supplies in question are 'Composite supply'. Hence once it is determined that the transaction in question satisfies the test of 'sale' as understood under the Sale of Goods Act, 1930, it cannot be a composite supply in absence of presence of two or more supplies and hence the said clause cannot apply to a 'sale' transaction.

If the above propositions are accepted then one may say that not much has changed under GST. The transactions considered 'sale' in the pre-GST era continue to attract GST as the supply of goods. Only the transactions not considered as 'sale' (i.e. having elements of service as understood in the pre-GST era) shall be covered under Clause 6(b) of Schedule II and hence liable to GST as the supply of service. Therefore take ways or home deliveries shall be considered as supply of goods and accordingly shall be liable to tax at the prescribed rates for the commodities in question.

A new approach

Alternate to the aforesaid approach, one may also consider a new approach to examine the transactions involving the supply of food. The new approach is based on the aspect that one cannot look at the transactions under GST with the old lenses. As discussed earlier, the old lenses of looking at the issue evolved due to the restricted meaning assigned to the word 'sale' for interpreting the provisions under the Sales Tax law. To enable the levy of Sales Tax on the transactions possessing the service elements, the concept of 'deemed sale' was evolved. However, still, the 'sale' as understood originally continued to be taxed exclusively under the Sales Tax/VAT and service tax came to be levied only on transactions possessing service elements beyond the 'sale'.

Now GST fundamentally is a 'supply' based levy. Hence we submit that a new approach considering 'supply' and not 'sale' as the initial point of the analysis is required. If this view is adopted one may make the following arguments in its support:

a. Sec. 9(1) of the CGST Act, 2017 provides for the levy of tax on the supply of goods or services or 'both'. Further Sec. 7(1) provides for an

inclusive definition of 'supply' to cover even the activities or transactions coming within the normal meaning of the said term. Further Sec. 7(1)(a) only provides an illustrative list of the possible forms of supply of goods or services or 'both' but does not categorically identify whether the concerned supply is of goods or services. It is therefore Sec. 7(1A) that provides that 'where' the transaction is considered as a 'supply' u/s 7(1), that the said supply shall be treated as supply of goods or that of services based on Schedule II. Said view also finds support from the fact that Sec. 7(1)(a) includes the expression 'both' so as to refrain from the specific categorization of the supply in question and leaves that job to Sec. 7(1A) that expressly does not use the word 'both' as it seeks to classify the supply into one of the two categories (i.e. goods or services).

b. Clause 6 of Schedule II seeks to cover the transactions in the nature of 'Composite supply'. The said term has been defined u/s 2(30) of the CGST Act, 2017 to mean a supply consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply. An important aspect to observe is the use of the indefinite article 'a'. Composite supply is 'a' supply consisting of two or more taxable supplies or any combination thereof. Hence what is envisaged is that the composite supply is a supply consisting of several elements (also referred to as supply in view of a very broad meaning assigned to the said term) wherein the same are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which element is a principal supply. Even the illustration given to the said definition states that where goods are packed and transported with insurance, the supply of goods, packing materials, transport and insurance is a composite supply and the supply of goods is a principal supply. Hence the elements of packing, transport and insurance are considered as supplies but when combined with the element of supply of goods, it becomes 'a' composite supply and that of goods since the said element of goods is predominant. We may also add that the broad definition of the term 'services' u/s 2(102) of the CGST Act, 2017 can also lend support to the view that elements possessing the characteristics of activities undertaken at the behest of the specific customer in a transaction can be termed as 'services'.

c. Even examination of the language of Sec. 7(1A) reveals that it uses the expression 'certain activities or transactions' (plural) in the context of 'a' supply. Hence the term 'supply' requires to be interpreted in the broadest possible sense to connote that various elements to a transaction (also considered as supplies) when combined naturally and when supplied in conjunction with each other in the ordinary course of business assume the character of a composite supply. In such a situation Sec. 8 provides for the determination of liability based on the predominant element. However, Sec. 7(1A) read with Schedule II creates an exception.

d. Clause 6 of Schedule II seeks to cover the transactions in the nature of 'Composite supply'. As discussed, the term 'Composite supply' is required to be seen vis-à-vis the elements involved in the transaction without bringing the notion of 'sale' as was the case in the pre-GST era where the levy was on 'sale' and not 'supply'. In that situation, in the context of activities or transactions involving food, it can be said that activities performed at the behest of the specific recipient as opposed to activities performed unilaterally for making the goods available for sale can be said to be the elements of service. Hence activities such as preparing the food (as per the specific instructions of the customer), packing the same for being conducive for consumption away from the premises and delivery of the food can be said to be elements of service. Once said so, by virtue of fiction created by Clause 6(b) of Schedule II presence of even a single element of service with the element of goods (i.e. food) will characterize the transaction as a 'Composite supply'. Once done so, then it shall be treated as a supply of services.

e. The expression 'supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food' also adds support to the present view. This is because the expression 'in any other manner' denotes activities or transactions involving the supply of food that are in nature of composite supply (but falling short of being considered as 'by way of or as part of any service'). Hence it covers essentially the transaction of 'sale' if it has other elements (capable of identification as supply) undertaken at the behest of the customer.

f. Based on the aforesaid approach one may say that clause 1(a) of Schedule II, therefore, covers transactions having only an element of transfer of the title in goods. In other words, transactions having other elements will be governed either by specific clauses of Schedule II (such as clause 6(b)) or by Sec. 8 (principal element test) in absence of application of Schedule II.

g. Explanatory Notes (though non-binding but having a persuasive value) clarify that the HSN 996331 in the context of services provided by various eating facilities includes takeaway services as well as door delivery of food.

h. The purpose behind Sec. 7(1A) read with Schedule II is to avoid the issues of classification that marred the sector such as the one under discussion in the pre-GST era. In such a situation, an interpretation favouring the purpose deserves to be adopted. The broad usage of the phrase 'supply', 'composite supply' and the expression 'in any other manner whatsoever' under clause 6(b) entails that the intent is to classify the transaction as the supply of services if the elements of goods are intertwined with the elements of service even though contractually it may be considered as 'sale'.

We, therefore, submit that under the new approach the broad meaning of the term 'supply' akin to activities undertaken for the customer is required to be the starting point for the analysis and not the 'sale' as was the case in the pre-GST era. If seen from the said lenses, then even the transactions such as

take ways or home deliveries can fall under clause 6(b) if it has elements beyond the pure transfer of title in goods. Therefore elements such as (a) nature of premises (b) process of manufacture of foodstuffs (c) process of serving (d) process of packing (e) process of delivery shall all be relevant and any or all of such activities undertaken at the behest of the specific customer will bring the additional service element combined with the goods element and hence take us to the clause 6(b).

We may also add here that the new approach advocated by us has been in vogue in foreign jurisdictions where the levy is supply based. As an illustration ECJ in a recent decision[9] relied on its earlier judgment and held that supply of prepared food and drink ready for immediate consumption is the result of a series of services ranging from the cooking of those dishes to their physical delivery in a receptacle and that the supply is accompanied by the provision to the customer of an infrastructure comprising both a catering room with support facilities, such as a cloakroom and furniture and crockery. Therefore ECJ appreciated that the term 'supply' consists of several elements (also considered as 'supply') and relied on the predominant element to characterize the transaction. This is so because the law in question (The VAT Directive read with the Polish VAT) did not have the fiction similar to clause 6(b) as is the case in our context. However, the ratio is equally applicable that in a supply based levy the elements involved are to be considered first and basis thereon if one finds a combination of several elements (goods and services), then the fiction provided in law to classify such a combination is required to be adopted or predominant test is otherwise required to be adopted.

A brief view on the tax rates

One may consider that even if one finds that the transaction in question is a supply of services by virtue of clause 6(b), even then one cannot apply a uniform rate of 5% (without ITC). This is so because the definition of 'restaurant service' under clause (xxxii) of Notification No. 11/2017 – CT (Rate) dated 28.06.2017 has been defined to mean supply, by way of or as part of any service, of goods, being food or any other article for human consumption or any drink, provided by a restaurant, eating joint including mess, canteen, whether for consumption on or away from the premises where such food or any other article for human consumption or drink is supplied. Hence conspicuously the words 'in any other manner whatsoever' as used in clause 6(b) are missing.

The expression 'by way of or as part of any service' denotes that the predominant element is of service. The missing expression 'in any other manner whatsoever' as discussed earlier denotes that the predominant element is goods and services are incidental (e.g. home deliveries). Therefore the absence of the given expression in the definition of 'restaurant service' can lead to a view that the rate of 5% cannot apply to the transactions where goods are pre-dominant. Unless the anomaly is resolved preferably by amending the rate notification, the given issue will continue. If kept unresolved, one may have to convince the Court to borrow the missing expression even in the definition of 'restaurant service' by undertaking a contextual interpretation as the said definition even seeks to cover situations where food is consumed away from the premises.

9. *J.K. vs. Dyrektor Izby Administracji Skarbowej w Katowicach Case C 703/19*

Controversial Circular

Circular No. 164/20/2021-GST dated 6-10-2021 has created certain confusion in the sector. In the case of supplies made by cloud kitchen or central Kitchen, it clarifies based on the explanatory notes and based on the aspect that such supplier provides the services of cooking and supply of food, that it is a supply of restaurant service attracting the rate of 5% (without ITC). On the other hand in the context of supplies provided in an ice cream outlet it clarifies that since the said outlets sell already manufactured ice-cream and they do not have a character of a restaurant and are not involved in cooking/preparing during the course of providing service, it is a supply of goods even if certain ingredients of service are present. Hence it clarifies that the ice cream sold by a parlor or any similar outlet would attract GST at the rate of 18%.

The aforesaid Circular, therefore, seeks to consider only two factors viz. (a) element of cooking and (b) nature of premises to characterize the transaction and identify the applicable tax rate. In the context of the supplies made by cloud kitchen or central Kitchen, it relies on the element of cooking whereas in the context of supplies provided in an ice cream outlet it relies on both the elements i.e. absence of cooking and the nature of premises (i.e. not restaurant). We submit that in the context of cloud kitchen or central Kitchen one ought to also see the facts of each case. It is possible that element of cooking cannot be considered as 'service' if such cooking is a continuous process not based on any specific customer orders (refer to ECJ ruling[10]). One may however also have to look at other elements to determine the presence of two or more supplies so as to take the transaction to clause 6(b). Also one has to consider whether the cloud kitchen or central Kitchen in question can be covered within the term 'restaurant, eating joint including mess, canteen' as used in the definition of 'restaurant service'. Similarly in the context of supplies provided in an ice cream outlet, one may say that the said outlet will not form part of the specified premises and hence the tax rate of 5% cannot apply, however, whether the supplies in question fall under clause 6(b) or not is required to be ascertained to determine the correct tax rate.

Conclusion

We believe that the interpretation of clause 6(b) is required to be undertaken using the lenses of 'supply' based law. The same cannot be interpreted using the lenses of the 'sale' based law as was the initial point of the controversy in the pre-GST regime. If done so, the position already taken by the concerned suppliers is required to be revisited in light of the aforementioned approach as well as the facts of each case.

10. Bog and Others C 497/09

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