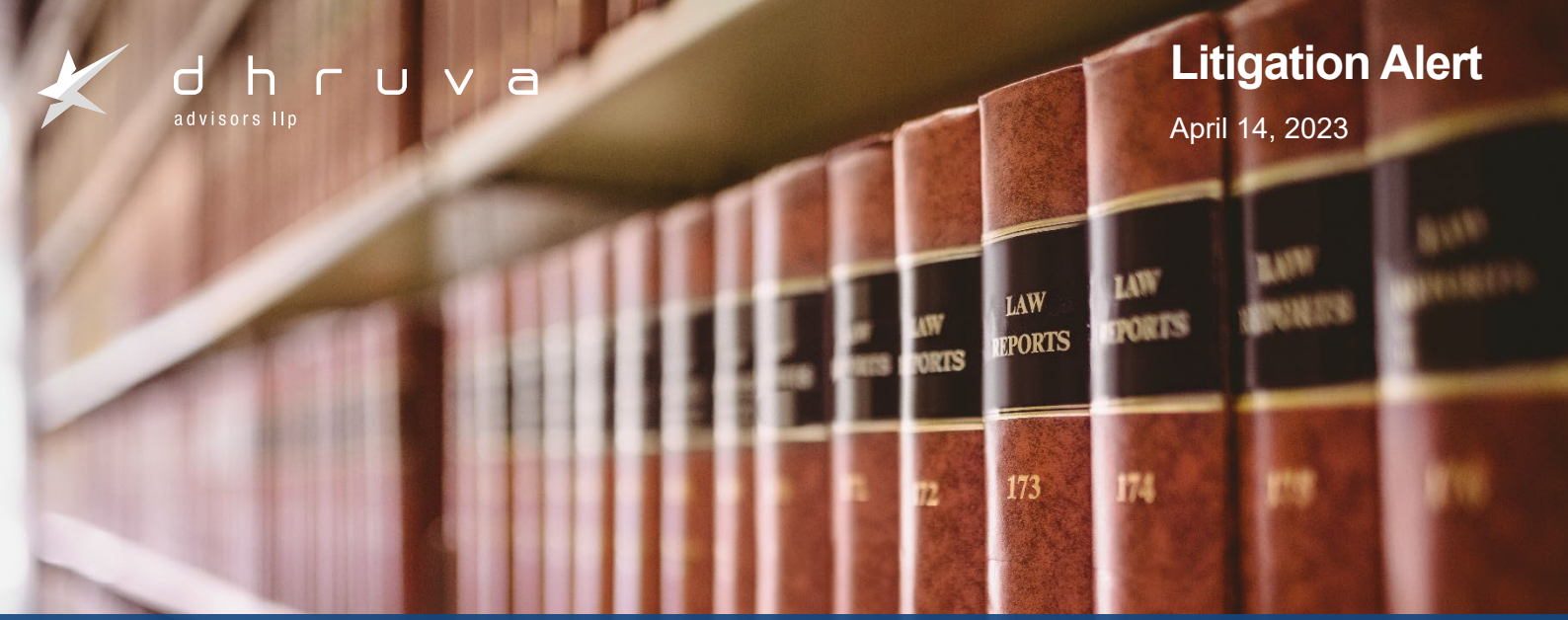

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Litigation Alert

April 14, 2023

Designs imported in paper form are taxable as "services" and not "goods"

Commissioner of Customs, Central Excise and Service Tax Versus Suzlon Energy Ltd. [1]*- Supreme Court*

The Supreme Court reversed the decision of the Mumbai Tribunal wherein the demand of Service Tax had been dropped on the ground that "once the design imported and cleared in paper form are assessed as 'goods' by the Customs Authority, the said activity cannot be taxed both as goods and services" and held that a design imported for manufacturing of Wind Turbine Generators is leviable for service tax under the category of 'Design Services'.

Facts of the case:

- M/s Suzlon Energy ('the Respondent') is manufacturer of wind turbine generators ('WTG') and entered into an agreement with its sister concern in Germany for Engineering, Design & Drawing ('Designs') of various models to be used in manufacturing of WTG in India.
- The Respondent imported and cleared the said designs as "Paper" under Chapter Sub-heading No. 49119920 of the Customs Tariff and claimed benefit of 'Nil' rate of customs duty under Notification No. 021/2002 for BCD and Notification No. 020/2006 for CVD.
- An audit was conducted by the department, and it was pointed out that the Respondent had not paid service tax on the import of said designs.
- Subsequently, the department issued a show cause notice ('SCN'), for the period from June 2007 to September 2010, demanding service tax on the import of the designs under the category of 'Design Service' under section 65(35b) read with section 65(105)(zzzzd) of the Finance Act, 1994
- The Adjudicating Authority confirmed the demand and passed the Order in Original against the Respondent.
- Aggrieved by this, the Respondent preferred an appeal before the Customs, Excise and Service Tax Appellate Tribunal, Mumbai ('Tribunal').

Findings of the Tribunal

- The Tribunal considered the fact that the Respondent imported the Designs in the form of paper and these are classified as goods under section 2(22)(e) under the Customs Act, 1962. Thus, the same activity cannot be taxed as goods as well as services.
- The Tribunal decided the matter[2] in favour of the Respondent and held that the designs are 'goods'

[1] 2023 (4) TMI 409 - SUPREME COURT

[2] 2018 (5) TMI 985 - CESTAT MUMBAI

and not 'services' relying on the judgement in the case of Sojitz Corporation[3]

- Aggrieved by the Tribunal's order, the Revenue filed an appeal before the Hon'ble Supreme Court.

Contention made by the Revenue:

- These designs are tailormade and would thus constitute "services". Merely putting it the designs in physical form (in the form of paper) would not make them "goods".
- Placing reliance on the case of BSNL[4], the revenue pointed out the difference between the term "sale of goods" and "contract of service". The Revenue in their support quoted an example to state that when a doctor administers pills during the treatment of a patient in a hospital, it is not tantamount to sale of medicines. It is purely rendition of a service.
- The 'Dominant Nature Test' is a test to determine whether a contract is for supply of goods or a service. The intention of the contracting parties in transfer of goods and services, separately, in an indivisible manner or in a composite manner is required to be considered. The Revenue further quoted a scenario where a patient has been advised to undergo heart surgery and the insertion of a stent. The instance involves both the supply of goods (stent) and supply of services (medical services/surgery), However what matters is the intention of the contracting parties. Here neither the hospital nor the patient intends to sell or buy the stent. What is important is "rendition of medical service".
- Similarly what matters in the present case is "design services" for manufacturing of WTG and hence it should be construed as service and liable for service tax.

Contention by the Respondent

- Placing reliance on the case of Hindustan Shipyard Ltd [5], the respondent submitted that what matters is the individual existence of a thing which is to be delivered, before its delivery to the party, ('Designs' in the present case), which decides that the contract is one for the sale of goods and not of services.
- The respondent relied upon the judgement in the case of Associated Cement companies[6] to state that any media which contain drawings and designs would be construed as sale of goods as these items are movable and would be covered under section 2(22)(e) of the Customs Act irrespective of the fact that they are tailormade.
- Relying upon the decision in the case of Tata Consultancy Services[7], it was argued that intellectual property once put into a media in any form like books, canvas (in case of painting) computer discs or cassettes and marketed would becomes 'goods'.
- Hence transfer of goods for a price cannot be subject to service tax.

Supreme Court decision:

- The definition of design services is a wide and conclusive one and only excludes service of interior designing and fashion designing.
- Although such designs may be shown as "goods" in a bill of entry, this itself cannot lead to exclusion from the purview of the definition of 'design service'.
- Blueprints of designs in paper form are subject to service tax as per board clarification dated March 18, 2011, on issue of applicability of indirect taxes on packaged software.
- There can be two different levies under a different head by applying the aspect theory and, as per settled positions of law, the same activity can be taxed both as goods and services provided the contract is indivisible. In this regard reliance was made on BSNL[4]

[3] 2008 (10) TMI 35 - CESTAT NEW DELHI
[4] 2006 (3) TMI 1 - SUPREME COURT
[5] 2000 (7) TMI 864 - SUPREME COURT
[6] 2001 (1) TMI 248 - SUPREME COURT
[7] 2004(11) TMI 11 – SUPREME COURT

- Accordingly, the Supreme Court set aside the order of CESTAT and held that the respondent is liable to pay service tax on imported of “design services” as defined under Section 65(35b) read with section 65(105) (zzzzd) of the Finance Act, 1994

Dhruva Comments

Taxability of software, designs and drawings has always been a grey area due to its inherent nature of intangibility.

This judgement distinguishes the landmark judgments in the case of Associate Cement Companies and Tata Consultancy Services wherein it was held that intellectual property, once put on to a media would become “goods” and sale of canned software is to be taxed as “goods”.

This decision could have far-reaching ramifications on various issues like import of software, other intellectual property, taxability of ocean freight under Customs Act as well as other laws like service tax, GST etc.

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Hope you will find this alert useful. For any queries in relation to this tax alert, you can reach out to Dhruva Advisors LLP.

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