

# TAX ALERT

## Transfer of right to use amounts to deemed sale or service

BT Associates is a premier Indirect Tax Consultant in Kolkata, delivering high quality services to clients in the area of Indirect Taxation. The firm covers the entire range of indirect taxes including specialized service offerings that are specific to different business needs.



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**Transfer of Right to use goods** for cash, deferred payment or valuable consideration is considered as **deemed sales** under sub-clause (d) of Article 366(29A) of Constitution of India. “**Deemed sales**” means the transfer of the right to use goods where the effective control and possession of the goods are vested with the transferee. The term transfer of right to use goods explains that the ownership rights are transferred by the transferor to the transferee so as to enable the transferee to use goods at his own will to the exclusion of the transferor.

“**Taxable Service**” means any services provided or to be provided to any person, by any other person in relation to supply of tangible goods for use, without transferring the right of possession and effective control of the good.

### Objective:

A recurring challenge in indirect taxes is that of double taxation of a single transaction. The challenge comes about because a particular transaction is both deemed to be a supply of goods, in terms of the State Sales Tax/Value Added Tax definitions, as well as provision of services, under the Central Service Tax Law.

**The settled law is that one transaction can be either a service or a sale hence both VAT and Service Tax cannot be levied on the same transaction.**

The important attribute that would help in classifying whether a transfer of right to use goods is service or deemed sales are as follows:

- Effective control and possession: The essence of a transfer is the acquisition of a right by the transferee and the corresponding loss of it by the transferor. When applied to goods, it would mean the passing of the goods from the hands of the transferor to the hands of the transferee. If the effective control and possession over the goods is given to the transferee it would be a transfer of the right to use goods as deemed sales and if the owner retains effective control over the equipment, then it would be a case of a mere permissive use or license to use.
- Liberty to use: Transfer of a right to use goods implies that full liberty is vested in the transferee to have the right to use goods to the exclusion of all other including the owner of goods.
- Return of goods/termination of use: If the transfer of a right to use goods is for a limited period of time and at

the end of the time period or if any terms of the agreement are breached then the control is transferred from the hands of the transferee to the transferor then it would amount to mere permissive use and would attract service tax.

- Contract Specific: Other attributes like the intention of the parties, mode of use and several other surrounding and relevant aspects have to be considered to come to the conclusion whether or not under a particular contract, there is transfer of right to use any goods. A mere contract of hiring, without transfer of control, may be a contract of bailment and not a contract for transfer of right to use goods.

Thus, the **essential difference between the transfers of the right to use goods as deemed sales and service** is the transfer of the effective control and possession of the goods. Whether a transaction is a transfer of the right to use the goods or service is essentially a question of fact which has to be determined in each case having regard to the terms of the contract. The transfer of effective control and possession of the goods in such cases play a vital role in determining whether it is deemed sales or service.

### Some examples based on case laws will help understand the issue:

- In the case of **Rashtriya Ispat Nigam Limited vs CTO**<sup>1</sup> held that in terms of the particular contractual agreement the effective control and possession of the machinery that was used in the execution of the contracted works continued to remain with the company which was the owner of the machinery. As the transferor retains the effective control then it would be mere permissive use or license to use. The Court held that there was no transfer of the right to use the

machinery, in the complete absence of passage of control over the economic benefit of the property.

➤ In the case of **BSNL vs Union of India**<sup>2</sup> held that to constitute a transaction for the transfer of right to use goods, the transaction must have the following attributes:

- There must be goods available for delivery;
- There must be a particular identity of goods;
- The transferee should have a legal right to use the goods;
- For the period during which the transferee has such legal right, it has to be for the exclusion to the transferor;
- Having transferred the right to use goods during the period for which it is to be transferred, the owner cannot again transfer the same rights to others.

In short the transaction is treated as transfer the right to use the goods and considered as a “Deemed sale” only when the entire elements as discussed above are present in such transaction.

➤ The Constitution of India, under Article 366(12), defines goods to include all materials, commodities and articles. The expression goods include both tangibles and intangibles. In the case of **Tata Consultancy Services**<sup>3</sup> it was held that the as long as the intangible goods remained in an intangible form, they could be treated differently. However, once such intangibles are captured in some media which is a tangible form, the intangibles, too, become goods.

➤ In the case of **Hari Durga Travels**<sup>4</sup> the assessee was engaged in the business of providing buses on rental basis. The assessee entered into the agreement with the Delhi Transport Corporation for supplying the buses on rental basis. As per the terms of the agreement the assessee was obligated to keep the bus in presentable condition and take up necessary services for the maintenance and repairs of the bus and also the assessee shall be obliged to keep the Delhi transport corporation indemnified against all claims arising out accidental damages or loss caused during the operation of the buses. Thus, the terms of the agreement make it vividly clear that the possession and the effective control over the buses was with the assessee. The mere fact that the transport company has control over the revenue collected it does not amount to transfer of right to use the buses. The goods should be ultimately delivered for the transaction to constitute as ‘sale’ within the extended meaning defined by the Article 366(29A) of the Constitution of India and such transaction by itself would not be transfer of the right to use if effective control is retained by the owner.

➤ In the case of **Vikas Sales Corporation vs Commissioner of Commercial Taxes**<sup>5</sup> it is being held that purely because the agreement involves incorporeal rights, it cannot be exempted from sales tax. Hence, the incorporeal rights can also be considered as goods for the purpose of sales tax.

➤ In the case of **Mahyco Monsanto Biotech India Pvt. Ltd**<sup>6</sup> the assessee sold the cotton seeds impregnated with technology to make the plant resistant to insects. This technology is further sub licensed by the transferor to the various seed companies on a non exclusive and non transferable basis to use, test, produce and sell genetically modified hybrid cotton planting seeds. In return, the transferor receives one time fixed fee and consideration based on the sell of number of packets of the genetically modified seeds by the third party. The assessee argued that what was being provided was right to use the technology and the media (seed) which carried the technology was irrelevant. It referred to the section 2(28) of the MVAT Act according to which the transaction was in the nature of permissive use of technology and not sale. The High Court, ruled that the assessee had transferred the technology which was embedded in some media (seed) hence what has been transferred was the intangible technology. As the transfer was in the form of non transferable and non exclusive basis and the transferee was vested with complete control over the technology it would attract Value Added Tax.

➤ In the case of **Subway System India Pvt. Ltd**<sup>7</sup> entered into franchisee agreement with third party. In return the franchisee undertakes to carry on the business in the Subways Name. The agreement only provided for a very limited display right, for the use of logo or trade mark and the franchisee could not transfer or assign these exclusive rights to any third party. The Subway also reserves the right to compete with these franchisees. In return the petitioner received onetime fee which is paid when the agreement is signed and Royalty fee paid periodically. The assessee urged that the consideration received from the franchisee was not eligible for VAT since there was no effective control or possession transfer by the franchisor to the franchisee and the transfer was only for the permissive use of the intellectual property. Thus, there was no divesting of the rights and no territorial exclusivity given to the franchisee. The franchise agreement was valid for specified period time, once the time period of the franchise agreement is over all the rights of the franchisee will be terminated. The High court upheld the contention of the franchisor and approved that the said transaction would attract Service Tax and not VAT.

### Concept of Deemed Sales under GST:

Goods and Service Tax is introduced to eliminate different indirect taxes by way of integration of the prevailing taxes. It will ensure seamless credit in the unbroken value chain and prevent cascading of taxes. In view of the above background, the multiple taxable event (i.e. manufacture, sale, service rendered) is subsumed into **supply** of goods and service tax. In this respect it may be mentioned that although the sale has lost its relevance as taxable event, still

the definition of 'tax on deemed sale of goods' exists since the Article 366(29A) of the Constitution has not been deleted. Interestingly, some activities which have been defined as deemed sale of goods have been defined as 'service' in Para 5 of Schedule II of the GST Model Law. There is no legal bar in adopting definition in GST law, which is different from definition contained in the constitution of India. However, such differences can be source of confusion and litigation.

## CONCLUSION

Whether a transaction is a transfer of the right to use the goods or a service is essentially a question of fact which has to be determined in each case having regard to the terms of the contract. The transfer of effective control and possession of the goods in such cases plays a vital role in determining whether it is a deemed sales or service.

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<sup>1</sup>2002-TIOL-560-SC-CT

<sup>2</sup>2006-TIOL-15-SC-CT-LB

<sup>3</sup>2004-TIOL-87-SC-CT-LB

<sup>4</sup>2015-TIOL-1300-HCDEL-VAT

<sup>5</sup>2002-TIOL-608-SC-CT-LB

<sup>6</sup>2016-TIOL-1766-HC-MUM-VAT

<sup>7</sup>2016-TIOL-1766-HC-MUM-VAT



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