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Import of engineering design and drawings liable to service tax even if considered as goods under customs – SC

26 April 2023

Summary

The Supreme Court has quashed the Tribunal's order and held that engineering design & drawings (EDD) of various models imported by the assessee for the purpose of manufacturing of a wind turbine generator (WTG) are leviable for service tax under the category of 'design services'. The SC stated that merely because the EDD prepared and supplied by the sister company were shown as 'goods' under the Customs Act and in the bill of entry, that by itself cannot be a ground to take such services out of the definition of 'design services'. The SC has found the Tribunal's finding - that the assessee is not liable to pay the service tax under 'design services' as the custom authority considered the same as 'goods' - is erroneous.

Facts of the case

- MS Suzlon Energy Limited (assessee) is engaged in manufacturing WTGs. It entered into an agreement with its sister concern outside India for purchasing engineering design and drawings to be used exclusively for manufacturing a WTG in India.
- While importing, the assessee classified the imported designs under 'paper' in the bill of entry filed with the custom authorities and claimed benefit of nil rate of duty.
- The Revenue issued a show cause notice, raising the demand of service tax on the value of 'design services' imported by assessee. The said demand was subsequently confirmed vide an order-in-original.
- Aggrieved by the order-in-original passed by the Commissioner, confirming the demands of service tax and levying the interest and penalty, the respondent filed appeals before the Customs Excise & Service Tax Appellate Tribunal (CESTAT).
- The CESTAT observed that the 'design and drawings' are classified as 'goods' under customs and the taxation of goods and services are mutually and explicitly conceived levies. So, the same activity cannot be taxed as both. Consequently, the CESTAT set aside the order-in-original on the ground that 'drawing and design' are to be treated as goods, and so, it cannot be treated as service.
- Aggrieved by the decision of the CESTAT, the Revenue has filed an appeal before the SC.
- Issue before the SC is whether the activity of import of 'Engineering Design & Drawings' from the sister concern companies is classifiable under the taxable category of 'design services' under service tax law.

SC observations and ruling [Civil Appeal Nos. 11400-11401/2018 dated 10 April 2023]

- **Designs are customised for the assessee:** The SC noted that designs are exclusively made for and used by the assessee. The SC stated that in terms of Circular No. 15/2011-Customs dated 18 March 2011, the imported designs are akin to packaged software and would therefore be subjected to service tax. Despite the above, the bill of entry was presented, treating the same as 'paper' for which the duty payable was 'nil'. Therefore, neither any custom duty, nor any service tax, was paid on the said transaction.

- **Same activity can be taxed as goods and services:** The SC noted that the definition of 'design services' is wide and conclusive under the service tax law and merely because the EDD prepared and supplied by a sister concern company were shown as 'goods' under the Customs law, the same by itself cannot be a ground to take it out of the definition of 'design services'.

As per the settled position of law now, the same activity can be taxed as 'goods' and 'services', provided the contract is indivisible.

- **Intention of the parties:** The SC emphasised that distinction between the sale of goods and contract for service depends upon the fact that whether the contracting parties intend to transfer goods and services separately or in an indivisible manner. Basis this and present factual matrix, the SC held that in the present case, the activity of import of engineering design and drawings is classifiable under 'design service'. Accordingly, the SC has allowed the present appeal in favour of the Revenue.
- **Remitted matter back:** The matter was remitted back to the CESTAT to consider other grounds raised by the assessee, viz., whether the services (if any) rendered by a foreign entity will fall within the purview of 'design services' and whether the department was justified in invoking the extended period of limitation.

Our comments

In the case of BSNL, the SC has held that in any event, different aspects of a given transaction can fall within the legislative competence of two legislatures, and both would have the power to tax that aspect. Even in the present case, the SC has reiterated that the same activity can be taxed as 'goods' and 'services', provided the contract is indivisible. Also, the intent of contracting parties is crucial for determining whether the transaction is of the sale of goods or provision of service.

In light of the SC's ruling, the levy and valuation aspects may have to be evaluated in case of transactions of royalty, as the same shall be added in assessable value of goods and leviable to service tax as well.

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