

# WHITE PAPER

*“Service Tax on activities related to Hiring of Equipment”*

**Udyog**Software



## SERVICE TAX ON ACTIVITIES RELATED TO HIRING OF EQUIPMENT

Heavy equipment required for infrastructure and construction contracts is commonly taken on hire and returned after use. The question of service tax on such transactions remains in some confusion, as there is a tax on sales on similar transactions.

In this piece I look at some variants of the transaction and the service tax liability thereon, in the following sequence:

- Renting out of own equipment
- Taking on hire and then renting out of equipment
- Facilitation of transactions of renting out equipment

### Hiring / Renting out of Equipment

Provision of equipment to a customer for a charge is an activity done for a consideration and is thus a service. However, some services were deemed to be sales by a constitutional provision much before services became taxable. These activities are enumerated in Article 366 (29A) of the Constitution and include the transfer of right to use any goods:

“(29A) “tax on the sale or purchase of goods” includes—  
(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;”

### Transfer of the Right to use any Goods: Deemed to be a Sale

It is seen from the above extract that the Constitution of India empowers a levy of tax, as if on the sale or purchase of the goods, on the transfer of the right to use any goods. Sale and purchase of goods within the states is taxed by the states as per the division of taxing powers in the Constitution. Accordingly, the transfer of right to use any goods is taxed by the states as a deemed sale though there is no transfer of title and the goods may be returned to the owner after a stipulated period. For example, in the Andhra Pradesh VAT Act 2005, section 2(28) which defines “sale” contains an Explanation IV as follows:

“A transfer of right to use a goods for any purpose (whether or not for a specified period) for cash, deferred payment or other valuable consideration shall be deemed to be a sale.”

The VAT Acts of other states carry similar provisions.

### Supply of goods without transfer of the Right to Use: a Taxable Service

If there is supply of goods with permission to use them, but without transfer of the right to use them (which remains with the owner), this is a service. To obviate any doubt on this, it is ‘declared’ to be a service, in the list of ‘declared services’ in section 66E of the Act. Section 66E with the relevant entry reads as follows:

“66E. Declared services.

The following shall constitute declared services, namely:-

(f) Transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods”.

### Need to distinguish deemed Sale / Service for Tax on Hiring out Equipment

Thus, within the category of hiring out equipment to a customer, there are two kinds of transaction:

- (i) Deemed sales, in which the right to use the goods is also transferred to the customer; and
- (ii) Declared service, in which only the goods are made available for use, without transfer of the right to use them. The crucial point of difference between these two kinds of transaction is whether the right to use the goods is also transferred along with the goods or whether there is only permission to use the goods

## Criteria for identifying supply of equipment without transfer of right to use it

Whether right to use had been transferred in a case of hiring out of equipment arose for decision of the Andhra Pradesh High Court in the case of Rashtriya Ispat Nigam Limited v CTO, Judgement dated 6 February 2002 in Civil Appeal No. 31 of 1991 (<https://indiankanoon.org/doc/757639/>). In this case the petitioner made equipment available to contractors for use in specified work of the petitioner, and charged for this. The state government sought to tax the charges as consideration for “transfer of the right to use” and therefore as a deemed sale. The High Court noted that while the contractors were given custody of the equipment, they were allowed to use the equipment only for the specified purpose and there is no transfer of the right to use as such in favour of the contractor.

This view taken by the High Court in Rashtriya Ispat Nigam Limited was confirmed by the Supreme Court on 6 March 2002 in the appeal filed by the state government against the judgment of the High Court [Appeal (Civil 31 of 1991)]. The Supreme Court observed as follows:

“In the impugned order, it is stated, and rightly so in our opinion, that the effective control of the machinery even while the machinery was in use of the contractor was that of the respondent company; the contractor was not free to make use of the machinery for the works other than the project work of the respondent or move it out during the period the ‘machinery was in his use; the condition that the contractor would be responsible for the custody of the machinery while it was on the site did not militate against respondent’s possession and control of the machinery.”(Para 3)

The judgment is reported as 2013 (31) STR 513 (SC). It is seen from the judgment that when the goods are given on hire for a specific purpose and cannot be used freely for other purposes, the owner retains effective control and has not transferred the right to use the goods. This is not a deemed sale.

The Supreme Court had again discussed how to distinguish these two modes of transfer of goods, in the case of Union of India v Bharat Sanchar Nigam Limited, 2006 (2) STR 161 (SC), in which it had noted and approved of the judgment of the AP High Court in the case of Rashtriya Ispat Nigam Limited. In the said BSNL case, the Supreme Court identified the ingredients of transfer of the right to use goods as follows:

- There must be goods available for delivery;
  - There must be a consensus ad idem as to the identity of the goods;
  - The transferee should have legal right to use the goods - consequently all legal consequences of such use including any permission or licences required therefor should be available to the transferee;
  - For the period during which the transferee has such legal right, it has to be to exclusion of the transferor - this is the necessary concomitant of the plain language of the statute, viz., a ‘transfer of the right to use’ and not merely a licence to use the goods;
  - Having transferred, the owner cannot again transfer the same right to others.
- Both judgments have been followed and relied upon by the service tax department in its ‘Education Guide’ on the taxation of services. Therein the department gives an example which is close to the situation that is currently under consideration:

S. No.	Nature of Transaction	Whether Transaction involves Transfer of Right to Use
2	Supply of equipment like excavators, wheel loaders, dump trucks, cranes, etc.; for use in a particular project where the person to whom such equipment is supplied is subject to such terms and conditions in the contract relating to the manner of use of such equipment.	The transaction will not involve transfer of right to use such equipment as in terms of the agreement the possession and effective control over such equipment has not been transferred even though the custody may have been transferred along with permission to use such equipment.
	Return of such equipment after a specified time, maintenance and upkeep of such equipment.	The receiver is not free to use such equipment in any manner as he likes and conditions have been imposed on use and control of such equipment.

In the above example, the person who is taking the equipment on hire is not free to use it in any manner that he may like but is circumscribed with conditions on his use and control of the equipment. The CBEC views this as transfer of goods without transfer of effective control on them and therefore opines that this is not a transfer of the right to use the goods, which remains with the owner. The owner has only allowed the customer to use the goods. This would be subject to service tax.

## Example of providing equipment with transfer of the right to use it

If the equipment is handed over to the person who is taking it on hire to be freely used without restrictions during the specified period, it will amount to transfer of both custody and possession, and thus a transfer of the right to use it. In that case it would attract a tax on leasing as a deemed sale under the state government laws. An example was decided by the AP High Court in the case of Viceroy Hotels Limited, as referred below.

In the case of Viceroy Hotels Limited, Tank Bund Road, Hyderabad, v CTO (WP 17092 of 2010), the petitioner had taken audio-visual equipment on hire from the supplier and rented it to the user who used it for conferences held in the hotel. The petitioner, Viceroy Hotels, charged the user and retained the difference after paying the supplier. It claimed that service tax had been paid on the transaction and that it was not a transaction of which sales tax could be demanded. However, the court, after examining the bills raised, observed that the equipment had been handed over to be freely used as per the customer's requirements during the period of hire, and that this transfer of the right to use to the customer attracted tax as a deemed sale. The case report can be perused at <https://www.apct.gov.in/portal/others/17092.doc>.

## Locus of Taxable Event for Deemed Sale

The taxable event in transactions of transfer of the right to use goods is not the delivery of the goods but the transfer of the right to use them. The right to use is transferred by agreement; therefore, the state in which the agreement is concluded and signed is the state that will tax the transaction. This was concluded on 9 May 2000 by the Supreme Court sitting as a five-member bench in the Appeal (Civil) 4500 of 1989 of 20th Century Finance Limited v State of Maharashtra, which has been followed by high courts thereafter. A case report can be perused at <https://indiankanoon.org/doc/767586/>

## Hiring Equipment and then renting it out

In certain transactions, an entity may take equipment on hire from the owner / supplier, and in turn hire them out. There are two separate transactions here. The details of the two transactions must be examined in terms of the foregoing, to determine separately whether each involves a transfer of the right to use and therefore attracts a tax on sale, or whether it does not involve transfer of the right to use and therefore attracts service tax.

## Facilitation of Hiring / Renting out Equipment

Another activity that may be carried out by an entity in connection with the hiring of equipment is facilitation of the transaction of hiring, by bringing together the two parties. This is the service of an intermediary, defined as follows in Rule 2(f) of the Pop Rules:

“(f) “intermediary” means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a provision of a service (hereinafter called the ‘main’ service) or a supply of goods, between two or more persons, but does not include a person who provides the main service or supplies the goods on his account.”

Rule 9 of the Place of Provision Rules 2012 provides that the location of the provider of intermediary service is identified as the place of provision of the service:

“9. The place of provision of following services shall be the location of the service provider:-  
(a) ...  
(b) ...  
(c) Intermediary services  
(d) ...”

Thus, even if the customer is outside India, the service is treated as provided in India. It is not on the negative list, and is therefore taxable. The commission & expenses (if any) charged for the service will be taxable value.

**Content Courtesy:**

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