

Will SC's rationale on Sodexo vouchers go a long way for 'e-commerce'?

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Sale of goods or provision of services

Taxability of transactions as goods or services has plagued tax payers and vexed courts for some time. Supreme Court of India ("**Supreme Court**") has examined taxability of transactions in relation to software[1], composite services[2], sale of lottery tickets[3], catering services[4] from the perspective of whether the transaction was sale of goods or provision of services. Supreme Court is also expected to adjudicate on taxability of intellectual property agreements ("**IP Agreements**") [5] from this perspective. While courts have attempted to address these questions, this issue is likely to be conflated with competence of legislature of a State to tax certain transactions as *an intra-state* sale.[6] These complexities manifest especially in e-commerce transactions and it is unlikely that the litigation is going to end.

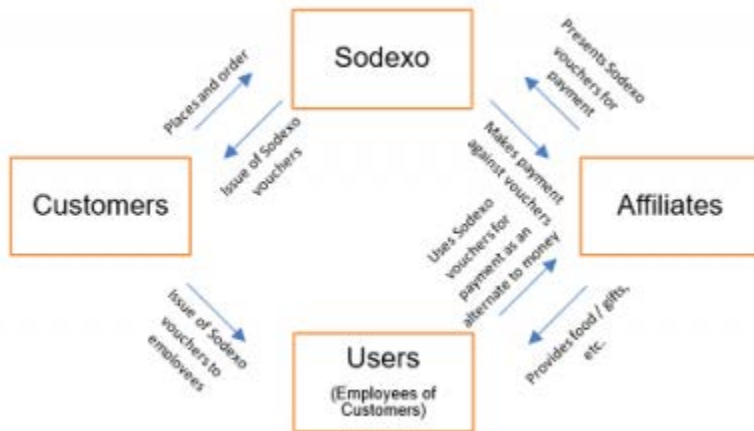
Recently, the Supreme Court while adjudicating the nature of transactions in relation to sale of pre-paid meal vouchers, i.e., goods or services, ("**Meal Vouchers**") for the purpose of Octroi and Local Body Tax ("**LBT**") applicable under Maharashtra Municipal Corporation Act, 1949 ("**Act**") held that provision of Meal Vouchers by the appellant company to its customers should be treated as services and not sale ("**Sodexo Case**").[7] The Supreme Court held that for the purpose of Octroi and LBT the intrinsic and essential character of such transaction was to provide services by the company and Meal Vouchers were pre-paid payment instruments that facilitated purchase of goods and services, including fund transfer, against the value stored on such instruments. The principles of this ruling should go a long way in providing clarity and certainty in respect of such dynamic transactions that involve pre-paid instruments.

Background Facts

Sodexo SVC India Private Limited ("**Sodexo**") is engaged in the business of providing pre-printed meal vouchers to its customers. Sodexo enters into contracts with companies ("**Customer**") which have a number of employees on its rolls to provide food meals and other items to employees up to a certain amount. Customers, upon receiving these Meal Vouchers, distribute them among its employees ("**Employees**"). Sodexo thereafter engages with restaurants, departmental stores, shops, etc. ("**Affiliates**") for utilization of these Meal Vouchers.

Employees use these Meal Vouchers to procure food and other items from the Affiliates. The used Meal Vouchers are then presented back to Sodexo for reimbursement. Sodexo reimburses the Affiliates as per the face value of the Meal

Vouchers after deducting the service charge payable to Sodexo by the Customer. Likewise, Sodexo also receives some specified service charges from the Affiliates. It is important to note that in this case, Sodexo was paying service tax on the applicable transactions. However, State tax authorities claimed that the transaction in relation to Meal Voucher was one of sale by Sodexo and hence, tax on sales was liable to be paid. The transaction is represented in the figure below:



Bombay High Court's Decision

The issue which arose for consideration before the Bombay High Court ("High Court") was whether Meal Vouchers can be treated as 'goods' for the purpose of levy of Octroi or LBT, or whether the aforesaid activity amounts to rendering service by Sodexo. Sodexo resisted the imposition of LBT primarily on the ground that it was providing services to its Customers and therefore such agreements were for service and not for sale of goods. However, the High Court negated the contention on the ground that the transaction satisfied the attribute tests laid down for goods by Supreme Court in *Tata Consultancy Services v. State of Andhra Pradesh*[8], i.e. (a) it should have utility; (b) it should be capable of being bought and sold; and (c) it should be capable of being transmitted, transferred, delivered, stored and possessed.

The High Court concluded that the transaction envisaged printing of Meal Vouchers by Sodexo which are then sold to its Customers. The Customers provided the Meal Vouchers to its Employees who utilized them at the Affiliates for the face value printed on it. The Meal Vouchers were used to pay price for the food items and beverages / good services of Affiliates distributed to Employees and were capable of being sold by Sodexo after they were bought into the limits of the city. Therefore Meal Vouchers had utility and were capable of being bought or sold and were capable of being delivered, stored and possessed.

Supreme Court's Judgment

The Supreme Court considered relevant provisions of the Act[9] along with Payment and Settlement Systems Act, 2007[10] and the principle laid down in *Bharat Sanchar Nigam Ltd. v. Union of India*[11] ("**BSNL**") and *Idea Mobile Communication Limited v. Commissioner of Central Excise and Customs, Cochin*[12], ("**Idea Mobile**") explaining the features of 'services' and 'goods'. The Supreme Court emphasized three fundamental reasons to come to the conclusion that Meal Vouchers were not 'goods' for the purpose of levy of Octroi and LBT.

a) Nature of Meal Vouchers

Supreme Court held that Meal Vouchers were not commodities which are sold. Analyzing the transaction, Supreme Court concluded that it was an arrangement by Sodexo to help its Customers by facilitating the provision for food and other items to its Employees for a specified amount as printed on the Meal Vouchers. These vouchers were printed for a particular Customer and were non-transferrable. Therefore, Sodexo was only a facilitator and a medium between Affiliates and Customers and the intrinsic and essential character of the entire transaction was to provide services by Sodexo.

b) RBI Guidelines

Business operations carried out by Sodexo were required to adhere to the Pre-paid Issuance and Operation of the Payments Instruments in India (Reserve Bank) Directions, 2009 issued under the Payment and Settlement Systems Act, 2007 and Revised Consolidated Guidelines, 2014. Examining the Revised Consolidated Guidelines, the Supreme Court observed that the nature of the transaction was to provide service and by no stretch of the imagination could Meal Vouchers be termed as 'goods'. Further, the Supreme Court drew an analogy of Meal Vouchers with SIM cards in light of the principles laid down by the Supreme Court in *BSNL* and *Idea Mobile* and held that since the Meal Vouchers could not be traded and sold separately, they could not be considered as 'goods'.

c) Facility by the Customer to their Employees

Lastly, Supreme Court relied upon Section 17 of the Income Tax Act, 1961 that states that the value of any fringe benefit or amenity as may be prescribed would form part of the salary paid by the employer to its employee. Value of food in exchange of the Meal Vouchers (distributed by Customer to Employees) is treated as an expenditure incurred by the Customer and amenity in the hands of Employee. Therefore, Meal Vouchers were not 'goods' within the meaning of Section 2(25) of the Act and thus not liable for either Octroi or LBT.

Analysis and Implications

In an era of competing legislative powers and complex transactions, the principles reiterated in this ruling should provide more clarity in relation to taxability of transactions. While providing clarity on identifying the nature of transactions and applying the law laid down by it in various cases, the Supreme Court has applied the law to a dynamic area of commerce and it is hoped that this ruling, along with similar precedents can be relied upon to bring clarity to similar issues relating to taxation of e-commerce transactions.[13] States have sought to impose sales tax for sale of goods by entities engaged in e-commerce activities. However, as the ruling of the Kerala High Court in *Flipkart Internet Private Limited v. State of Kerala*[14] ("**Flipkart Case**") demonstrates, taxation of e-commerce transactions also raises the question of whether the transaction is one of sale or service.

The judgment emphasizes the imperative need for a comprehensive Goods and Services Tax ("**GST**") Bill and the need to do away with anachronistic laws such as Octroi and LBT when more often than not they only muddy the over taxing framework in India. Internationally, such transactions are amenable to taxation and while no service provider claims special treatment, at the very least, the legislature can provide an efficient tax statute and structure.

International Practice

Customer loyalty and reward programs is an internationally well-recognized practice of garnering and retaining customers. Recently, Hilton Worldwide launched its largest campaign in recent times for exclusive room rates in return for customer loyalty.[15] In the USA, different states have different taxing arrangements in respect of redemption of

loyalty and reward points.[16] In England, another issue came up and was resolved before courts – whether credit can be taken in respect of input tax, when services are offered in connection with loyalty programs. This question was answered in favor of tax payers by the Court of Justice for European Union.[17]

In Australia, whether supply of rewards to a loyalty card holder against the points earned is a taxable supply depends on whether there is any consideration for the supply i.e. if the member does not pay any amount to obtain the reward (that is they redeem sufficient points to obtain the reward), they do not provide any monetary consideration for the supply of the reward. Accordingly, the supply of the reward to the member is only taxable where some consideration has been provided (for example, an amount paid by the member) and the other elements of prescribed regulations are met (including that the supply is not goods and service tax free or input taxed).[18]

Conclusion

While e-commerce companies too would like to see GST Bill see the light of day[19] news reports suggest that there may be barriers to be crossed before there is a level playing taxation field.[20] Since Government of India is serious about giving a fillip to increasing investments in India and the manufacturing sector, it would do well to expedite a comprehensive goods and services tax which rationalizes cost of services and goods to ultimate consumers and puts an end to the needless litigation.

[1] Tata Consultancy Services v. State of AP (2005) 1 SCC 308.

[2] Telecom services - Bharat Sanchar Nigam Ltd. & Anr. v. Union of India & Ors. (2006) 3 SCC 1, see also Xerox Modicorp Ltd. v. State of Karnataka (2005) 7 SCC 380.

[3] Union of India & Ors. v. Martin Lottery Agencies Limited (2009) 12 SCC 209.

[4] T.N. Kalyana Mandapam Association v. Union of India & Ors. (2004) 5 SCC 632.

[5] Tax payers have challenged Bombay High Court ruling holding that an IP Agreement may amount to sale for purpose of State sales tax laws – Tata Sons Limited v. State of Maharashtra (2015) SCC OnLine Bom 697. The appeal is currently pending adjudication in Supreme Court.

[6] State of A.P. v. National Thermal Power Corporation Ltd. (2002) 5 SCC 203.

[7] Sodexo SVC India Private Limited v. State of Maharashtra & Ors. Civil Appeal Nos. 4385-4386 of 2015.

[8] (2005) 1 SCC 308.

[9] Sections 2(25), 2(31A), 2(42), 127, 147 and 152P.

[10] Sections 2(1)(i) and 7.

[11] (2006) 3 SCC 1.

[12] (2011) 12 SCC 608.

[13] Tax demand on e-commerce companies quashed – authorities directed to re-examine transactions, Regulatory Hotline, Nishith Desai Associates, November 18, 2015, available at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/tax-demand-on-e-commerce-companies-quashed-authorities-directed-to-re-examine-transactions.html?no_cache=1&cHash=ca7fc5c3e4e306e3a6d2ae576e35d652.

[14] Writ Petition (C) 5348 & 6916 of 2015, Decided on October 13, 2015

[15] Hilton Worldwide launches its largest campaign ever with exclusive room rates not found anywhere else, Hindu Business Line, available at <http://www.thehindubusinessline.com/business-wire/hilton-worldwide-launches-its-largest-campaign-ever-with-exclusive-room-rates-not-found-anywhere-else/article8267927.ece>.

[16] Sales and Use Tax Implications of Loyalty Programs, Mary T. Benton, Mathew P. Hedstrom and Gregg D. Barton, Ed. Hellerstein J.D., *Journal of Taxation*, August 2015.

[17] Case C-53/09 and 55/09, HMRC v. Loyalty Management UK Ltd. and Baxi Group Ltd.

[18] Australian Taxation Office, Australian Government, Goods and Services Tax Ruling (GSTR 2012/1) available at <http://law.ato.gov.au/atolaw/view.htm?DocID=GST/GSTR20121/NAT/ATO/00001> (accessed on March 19, 2016)