Service Tax on Restaurant Service

Stakeholders have raised various questions and many controversies have developed consequently, since the Finance Minister levied the service tax on all restaurants irrespective of whether they had license to serve alcoholic drinks on 1st April 2013. Before this, restaurants who had either a facility of air-conditioning or central air-heating system in any part of their premises and who had a license to serve alcoholic drinks for human consumption, were covered under the service-tax net. As a result, since 1st April, 2013, the condition of holding a license to serve alcoholic drinks for human consumption has been done away with, and all restaurants having the facility of air-conditioning or central air-heating system in any part of their premises at any time during the concerned financial year, are liable to pay service tax. The author discusses here the core issues relating to service tax with reference to restaurants and their services. Read on…

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Endless questions and controversies have arisen after the Finance Minister levied service tax on all restaurants whether they had license for alcoholic liquor from 1st April 2013. Before this, only those restaurants were covered under the service tax net, which had the facility of air condition or central air heating system in any part of the restaurants and had license to serve alcoholic drinks for human consumption. Since 1st April 2013, the condition of having a license for alcoholic drinks for human consumption has been done away with, and all restaurants having a facility of air conditioning or central air heating in any part at any time during the financial year are liable to the service tax.

The service tax on restaurant service is restricted to service portion in activity of supply of service of food or any article for human consumption or any drink. However, it is very difficult to determine service portion in this type of service. Therefore, the Rule 2C of Service Tax (Determination of Value) Rules, 2006 has specified the manner of determination of value as a specified percentage of total amount charged.

Core Issues relating to Service Tax

Taxability before and after 1st July 2012

Before 1st July 2012, taxable services provided by the restaurants were defined under the Section 65 (105) (zzzzv). Essential conditions that determined the criteria for taxability were:

(1) Restaurants serving food or beverages has air-conditioning facility or central air-heating facility and

(2) They also have a license to serve alcoholic beverages.

However, since 1st July 2012, the clause (i) of Section 66E declared service portion in activity of supply of food or any article for human consumption or any drink provided by any person in any manner as a service. Also, the Section 65B(44) that defined service is wide enough to include the services provided by the restaurants.

However, with effect from 1st April 2013, the condition that restaurants, eating joints or mess shall have a license to serve alcoholic beverages is deleted *vide* the Notification No. 3/2013-ST, dated 1/3/2013. Thus, with effect from 1st April 2013, these service providers will be liable to pay service tax even if they do not have a license to serve alcoholic beverages provided other conditions, i.e. having air-conditioning or central air-heating system, are satisfied.

Restaurants, Eating Joints or Mess are Covered

All the restaurants, eating joints and mess having the facility of air condition or central air heating are liable to service tax. Macmillan dictionary defines a restaurant as *a building or room where meals and drinks are sold to customers sitting at tables. Oxford dictionary defines an eating joint as an establishment of specified kind, especially one where people meet for eating, drinking or entertainment.* Merriam-Webster dictionary defines a mess as *a place where meals are regularly served to a group*.

Meaning of Air-Conditioning and Central Air Heating

The definition of air-conditioning does not specify the nature of air-conditioning; hence, air-conditioning in a restaurant can be of either of central, window or split. Also, the definition of air-conditioning specifies that the facility of air-conditioning can be provided at any time during a financial year, which means that even if such a facility is available for a day during a financial year, conditions for levy of service tax are met. As per the Item No. 19 of Notification No. 25/2012-ST, dated 20/6/2012, restaurants having a facility of *central* air-heating will not be eligible for exemption. Now, the word used here is Central air-heating system. So, places where air-heating system is not centralised, i.e. air-heating through machine provided locally in a room or at a place, will not be considered for service tax.

Partially Air-Conditioned Restaurants are Covered

As per Item No. 19 of Notification No. 25/2012- ST, dated 20/6/2012, if restaurants do not have the facility of air-conditioning in any part of the establishment, it will be exempt from service tax. Now the question arises, will a 2000 sq. ft. restaurant having air-conditioning in 100 sq. ft. area only be liable to tax? The answer will be *yes*, since to be under the service-tax net, air-conditioning system must be installed in any part of the establishment. Therefore, partially air-conditioned restaurants are also covered under the service-tax net.

Provisions relating to Valuation and Abatement for Restaurant Service

Section 67 provides that where service tax is chargeable on any service with reference to its value, such value shall be the gross amount charged by the service provider for such service provided or to be provided. The service tax on restaurant service is restricted to service portion in activity of supply of service of food or any article for human consumption or any drink. However, it is very difficult to determine service portion in this type of service. Therefore, the Rule 2C of Service Tax (Determination of Value) Rules, 2006 has specified the manner of determination of value as a specified percentage of *total amount* charged. According to the Rule 2C, 40% of the total bill will be considered as service portion in this type of activity. Hence, restaurant services enjoy the abatement of 60% on total bill value and service tax shall be levied on the 40% of the total bill. Effective rate of service tax, after abatement, for restaurant service is 4.94%.

For more clarity, relevant portion of Rule 2C of Service Tax (Determination of Value) Rules, 2006 is reproduced: *Subject to the provisions of Section 67, the value of service portion, in an activity wherein goods being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity at a restaurant shall be the specified percentage of the total amount charged for such supply, in terms of the following Table, namely:*

Sl. No.	Description	Percentage of Total Amount
(1)	(2)	(3)
	Service portion in an activity wherein goods, being food or any other article of human consumption or any drink(whether or not intoxicating) is supplied in any manner as a part of the activity, at a restaurant	40

Meaning of *Total Amount*

Service tax is chargeable on 40% of the *total amount* of the bill or invoice raised. So, it is very important to know the meaning of *total amount* to get the clear idea of what should be included and excluded from the *total amount*. *Total amount* has been defined in *Explanation* 1 to Rule 2C of Service Tax (Determination of Value) Rules, 2006. It defines *total amount* as a sum total of the gross amount charged and the fair market value of all goods and services supplied in or in relation to the supply of food or any other article of human consumption or any drink (whether or not intoxicating), whether or not supplied under the same contract or any other contract, after deducting— (i) the amount charged for such goods or services, if any; and (ii) the value added tax or sales tax, if any, levied thereon.

It has also been provided that fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Issues regarding Cenvat Credit

The *Explanation 2* to rule 2C of the valuation rules specifically clarifies that service provider is not entitled to credit of duties or cess paid on any goods classifiable under Chapter 1 to 22 of the Central Excise Tariff. It means the service provider can take credit of other input, input services and capital goods. This has been clarified in the Para No. 8.4.3 of CBEC's *Education Guide.*

Bill should Separately Show Amount of Service Tax

The big question that arises on taxability of restaurant services is if the service tax should be shown separately in the invoice, since according to the State VAT laws, assessees who pay VAT on lumpsum basis are not required to show VAT amount separately in the invoice. However, it is specifically provided in the service-tax laws that service tax, education cess and secondary and higher education cess have to be shown separately in the invoice. It cannot be just shown as 12.36% or 4.944%. Also it has to be shown separately as service tax charged, education cess and secondary & higher education cess. If the service tax is not shown separately in the invoice, maximum penalty under the contravention *Issue of invoice with incorrect or incomplete details* is ₹10,000.

VAT to be Excluded from Invoice while Calculating Service Tax on Total Bill Amount

The service tax on restaurant services was levied with effect from 1st May 2011. The CBEC had issued certain clarifications *vide Circular No. 139/8/2011- TRU, dated 10/5/2011*, which are valid under the present law also. In this circular, question number 4 relates to the topic under consideration which is reproduced:

Sl.No.	Queries	Clarification
1	2	3
4	Is the value added tax imposed by States required to be included for the purpose of service tax?	For the purpose of service tax, State Value Added Tax (VAT) has to be excluded from the taxable value.

Thus, in computing the total amount for calculating service tax, VAT amount payable on such activity is not to be included. If VAT amount is included in the *Gross Amount Charged*, there will be a cascading effect while calculating the amount of service tax which is undesirable from the viewpoint of taxation laws. Thus, VAT should be excluded from *Gross Amount Charged*.

Provisions regarding Point of Taxation and Invoice for Restaurant Services

The point of taxation in case of restaurant services will be governed by the Rule 3 of the point of taxation rules. As per the Rule 3 of Point of Taxation Rules, 2012, the point of taxation in case of restaurant service shall be:

(a) time when the invoice for the service provided or to be provided is issued. As per rule 4A of Service Tax Rules, invoice shall be issued within 30 days from the date of completion of service. In case invoice is not issued within 30 days from the date of completion of service, the point of taxation shall be the date of completion of service.

(b) in case where the person providing the service receives payment before the time specified above, the date of receipt of payment shall be the point of taxation.

In restaurants, customers order food items and normally receive the bill immediately. Since all activities of the provision of service, issue of bills and receipt of payment take place in span of few hours, the date of issue of bill by restaurant shall be the basis for the purpose of determination of point of taxation.

How Invoice/Bill should Look Like?

In case of restaurant services, service tax shall be levied after considering the abatement of 60%. Now, the service tax shall be levied @ 4.944% (40% of 12.36%) or @ 12.36% on 40% value of total bill. It is advisable to charge a service tax @ 4.944% on the total bill. Also, 4.944% shall be shown separately. Below given is the example of what a bill in a restaurant should like:

Taxable Value-

Cost	**Amount**
Food Items	**A**
Beverages	**B**
Service Charges(if any)	**C**[% of (A+B)]
Total Amount*	A+B+C
Service Tax on Total Amount-4.944% ie.12.36% of 40% of Total Amount i.e. SRT	
EC SHEC	4.8%of(A+B+C) 2% of SRT 1% of SRT

*Exclusive of VAT

Service Tax on Home Delivery—A Controversy

It is a critical issue since restaurants have already started collecting service tax on home delivery. Ideally, there should not be any service tax on home delivery, because the legislature has taxed the restaurant services with a pre-condition of having air-conditioning or central air-heating system, and service tax is chargeable from customers only when they use those services of the restaurants; the letter of TRU dated 28/02/2011 (Annexure A) where in Para 1.1 states:

The big question that arises on taxability of restaurant services is if the service tax should be shown separately in the invoice, since according to the State VAT laws, assessees who pay VAT on lumpsum basis are not required to show VAT amount separately in the invoice.

1.1.1Restaurants provide a number of services normally in combination with the meal and/or beverage for a consolidated charge. These services relate to the use of restaurant space and furniture, air-conditioning, well-trained waiters, linen, cutlery and crockery, music, live or otherwise, or a dance floor. The customer also has the benefit of personalized service by indicating his preference for certain ingredients e.g. salt, chilies, onion, garlic or oil. The extent and quality of services available in a restaurant is directly reflected in the margin charged over the direct costs. It is thus not uncommon to notice even packaged products being sold at prices far in excess of the MRP.

So it is clear from the above that service tax in restaurants is levied on the use of its space, furniture, air-conditioning, crockery, etc., and, in home delivery,

all such services are absent. Also the Para 1.6 under the heading Scope of new services in Annexure A specifically clarifies that there is no service tax on home delivery. The relevant portion of the D.O. letter D.O.F. No. 334/3/2011-TRU is presented:

> *1.6 The levy is intended to be confined to the value of services contained in the composite contract* ***and shall not cover either the meal portion in the composite contract or mere sale of food by way of pick-up or home delivery****, as also goods sold at MRP. Finance Minister has announced in his budget speech 70% abatement on this service, which is, inter-alia, meant to separate such portion of the bill as relates to the deemed sale of meals and beverages. The relevant notification will be issued when the levy is operationalized after the enactment of the Finance Bill.*

From the above TRU letter, it should be clear that there is no service tax on home delivery only if it is a free home-delivery. If the restaurants are charging extra then there will be levy of service tax on such charges for home-delivery. However, as per the Section 66E which describes the declared services. Section 66E(i) of the Finance Act, 1994 defines declared service as:

(i) service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity.

Now, if we go by the provisions of declared services, the words used here are *supplied in any manner as a part of the activity* and this would cover the home-delivery and pick-up services also. So, if this view is resorted to by department, it is very well substantiated by the provisions of declared services. Hence, the issue is quite controversial. It requires a clarification from the CBEC if the letter of TRU issued prior to 1st July 2012, still holds good under the current law or the services of home-delivery is taxable after 1st July 2012.

Contentious Issue regarding 'Registration' for Restaurant Services

A very important issue arises when it comes to registration under the service tax for restaurant services. Under the Section 69(2), everyone who is liable to pay service tax has to mandatorily get itself registered. A provider of taxable services is required to get itself registered when its *aggregate value of taxable service* in a financial year exceeds ₹9 lakh.

Now, it has become very important to know the meaning of *aggregate value*. As per Explanation (B) to

Notification No. 33/2012-ST, *aggregate value* means the total value of taxable services charged in the first consecutive invoices issued during a financial year but does not include values charged in invoices issued towards such services which are exempt from whole of service taxes leviable thereon under the Section 66B of Finance Act, 1994 under any other notification. It must be noted that the meaning of *aggregate value* under the Service Tax (Registration of Special Category) Rules, 2005 has not been amended. It appears that the definition of *aggregate value* for the purpose of registration should also be taken to be that under the Notification No. 33/2012-ST.

Now, the issue here arises when registration should be taken. What should be the monetary limit for the purpose of registration? It is because of the Rule 2C of Service Tax (Determination of Value) Rules, 2006, restaurant services enjoy abatement of 60% and only 40% of the total value is taxable. It can be interpreted that registration should be taken when the *aggregate value* of taxable service exceeds ₹9 lakh in a financial year, but in practical the taxable service will exceed ₹9 lakh only when bills of ₹22,50,000 are raised. This is because when bills of ₹22,50,000 are raised, only taxable services in it exceed ₹9 lakh (₹22,50,000*40% = ₹9 lakh). Now, this issue is debatable; but if we go by the language of the Explanation (B) to Notification No. 33/2012-ST, it can be interpreted that when bills of ₹22,50,000 are raised, the taxable component liable to service tax in it is only 40% of the total bill. So logically, only taxable component should be liable for the service tax. For example, if a restaurant owner issues the bill of ₹100, taxable component of services in it is ₹40 only. Non-taxable component of the bill is ₹60 which is relatable to food. Thus, we have to take

only taxable value of the bill. The issue is debatable and requires clarification by the department.

Payment of Service Tax and Threshold Exemption

This is also a critical issue. As per the Notification No. 33/2012-ST, dated 20/06/2012, service providers are entitled to the benefit of exemption notification, provided the *aggregate value* of taxable service does not exceed ₹10 lakh in the preceding financial year. The definition of *aggregate value* specifically excludes amounts raised towards wholly exempt services. Thus, while calculating the limit of ₹10 lakh, those amounts that do not form the part of taxable value should be excluded. Conclusion here is that service tax, in case of restaurant services, is required to be paid only when the bills of ₹25 lakh are raised (₹25,00,000*40% = ₹10,00,000). So, service providers are required to pay the service tax only when they issue bills of ₹25 lakh. However, this issue is also debatable and it requires clarification by the department.

Service Provided by Restaurants and Caterers—How it is Different?

It is simple yet complicated. Difference in nature of services provided by restaurants and caterers is evident yet it has to be explained. While restaurants have fixed place of serving, fixed menu, fixed way of serving their customers, outdoor caterers do not decide the place of service, quantity of food, preparation and serving of food, etc. In restaurant services, customers cannot negotiate the prices with restaurant owners, while in outdoor catering, customers have every chance of negotiating the price with the service providers.

Other Important Issues

There are quite complicated issues with regard to the restaurant services for which clarifications are issued by Circular No. 139/8/2011-TRU, dated 10/5/2011:

1.	If there are more than one restaurant belonging to the same entity in a complex, out of which only one or more satisfy both the criteria relating to air-conditioning and license to serve liquor, will the other restaurant(s) be also liable to pay Service Tax?	Service Tax is leviable on the service provide by a restaurant which satisfies two conditions: (i) it should have the facility of air conditioning in any part of the establishment and (ii) it should have license to serve alcoholic beverages. Within the same entity, if there are more than one restaurant, which are clearly demarcated and separately named, the ones which satisfy both the criteria is only liable to service tax.
2.	Will the services provided by taxable restaurant in other parts of the hotel e.g. swimming pool, or an open area attached to a restaurant be also liable to Service Tax?	The taxable services provided by a restaurant in other parts of the hotel e.g. swimming pool, or an open area attached to the restaurant are also liable to Service Tax as these areas become extensions of the restaurant.
3.	Is the serving of food and/or beverages by way of room service liable to service tax?	When the food is served in the room, service tax cannot be charged under the restaurant service as the service is not provided in the premises of the air-conditioned restaurant with a licence to serve liquor. Also, the same cannot be charged under the Short Term Accommodation head if the bill for the food will be raised separately and it does not form part of the declared tariff

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