IN THE CUSTOMS, EXCISE & SERVICE TAX APPELLATE TRIBUNAL
West Block No. 2, R.K. Puram, New Delhi – 110 066.
Principal Bench, New Delhi

COURT NO. IV

DATE OF HEARING : 11/01/2019.
DATE OF DECISION : 22/03/2019.

Service Tax Appeals No. 50099 and 50101 of 2016

[Arising out of the Order-in-Appeal No. 55 and 54/ST/DLH/20 dated 30 October 2015 passed by The Commissioner (Appeals – I), Service Tax, New Delhi.]

M/s Subway Systems India Private Ltd. Appellant

Versus

CST, Delhi – II Respondent

Appearance

Shri Abhishek A. Rastogi, Advocate – for the appellant.

Shri Vivek Pandey, Authorized Representative (DR) – for the Respondent.

CORAM : **Hon'ble Shri Bijay Kumar, Member (Technical)**
Hon'ble Ms. Rachna Gupta, Member (Judicial)

Final Order No. 50411-50412/2019 Dated : 22/03/2019

Per. Rachna Gupta :-

This order disposes of two appeals arising out of common order-in-appeal No. 55 and 54/ST/DLH/20 dated 30 October 2015 and issue also being common to both the appeals. Factual matrix relevant for adjudication is that the appellant M/s Subway Systems Pvt. Ltd. (SSIPL) are registered with the Service Tax Commissionerate, New Delhi under the category of franchise service. The appellant is a 100% subsidiary company of M/s Subway System International BV (SIBV), a Netherland based company.

1.1 After the course of the audit of appellant's record as was conducted during 20 June 2008 to 24 June 2008 it was observed that SSIPL/appellant entered into a master license agreement dated 01/10/202 with SIBV for developing franchise and service Sandwich shops to be known as franchise to SSIPL. The Department further observed that as per the said agreements Clause 3.03 thereof each franchise was liable to pay weekly royalty and an amount equal to 8% of their total gross sales and an advertising fee equal to 4.5% of their total gross sales and the appellant had further to pay royalty amount @ 35% to SIBV of all fee and royalties derived from each and every sandwich shop that is the franchise in India. However, it was noticed that the appellants were discharging their tax liability qua the royalty amount received from the franchise which was equal to 8% of the total gross sales, but, no liability was being discharged for an amount received equal to 4.5% of the weekly gross sales towards the contribution referred to as Subway Franchise Advertisement Fund Trust (SFAFT). Resultantly show cause notice No. I-26(494)ST/APR (Gr.III)14/2008/4253 dated 13 February 2009 was served upon the appellant proposing the recovery of service tax alongwith the interest and penalty as follows :-

(i) Service tax amounting to Rs. 10,06,940/- on account of reverse charge mechanism being the recipient of services ;

(ii) The service tax amounting to Rs. 1,44,624/- on account of non-payment of service tax on value of withholding tax ;

(iii) Service tax amounting to Rs. 30,86,667/- on account of non-payment of service tax on the amount recovered as Franchise Advertisement Fund ;

(iv) Service tax amounting to Rs. 3,83,711/- on the "amount shown as amount received but unidentified" in balance sheet.

1.2 The said show cause notice was originally adjudicated vide order No. 28/NK Mallick/2013-14 dated 18/02/2014 vide which the demand on the amount received but unidentified and the demand on account of Franchise Advertisement Fund alongwith the respective education cess was confirmed alongwith the interest and the proportionate penalties. Being aggrieved, the appeal was preferred. Commissioner (Appeals) vide the orders under challenge/order-in-appeal No. 56/ST/DLH/20 dated 30 October 2015 rejected the appeal resultantly the appellant is before this Tribunal.

2. We have heard Shri Abhishek A. Rastogi, learned Advocate for the appellant and Shri Vivek Pandey, learned DR for the Department. Learned Counsel for the appellant had conceded the liability as confirmed about the amount received but unidentified

and acknowledged for the same to have been deposited alongwith the interest and the proportionate penalty. However, with respect to the demand confirmed on account of Franchise Advertisement Fund it is submitted that the said demand is about the contribution for an advertisement Fund (SFAFT) which do not qualify as a franchise service for not being covered under the definition of "franchise" under Section 65 (47) of the Finance Act, 1944. The said contribution was collected by the appellant acting merely as a pure agent without providing any service. Learned Counsel has placed reliance on the decision in the case of **Kumar Beheray Rathi vs. CCE, Pune – III – 2014 (34) S.T.R. 139 (Tri. – Mumbai)**. It is submitted that the order under challenge has failed to consider that under Rule 5 (2) of Service Tax (Determination of Value) Rules 2006 vide which the expenditure or costs incurred by the service provider as a pure agent as the recipient of service has to be excluded from the value of taxable services. It is further submitted that the amount collected in SFAFT, the utilization thereof is undertaken by the franchise themselves and there is no control of the appellant upon the said amount. Even after the said amount remotely benefited the appellant had still cannot be the consideration for the service provided by the appellant as that of "franchise". Above all the said amount is reflected as a liability in the books of account of the appellant and is not accounted as income. The decision of **Philips India Ltd. vs. CCE, Pune – 1997 (91) E.L.T. 540 (S.C.)** is relied upon, whereby it was held that the advertisement expenses shared by the dealer thereby do not form part of the assessable value. The appellant also relied upon the decision of **Intercontinental Consultants & Technocrafts Pvt. Ltd. vs. Union of India – 2013 (29) S.T.R. 9 (Del.)**, wherein it was held that for valuation of taxable service only consideration which is paid as *quid pro quo* can be brought to the charge. Finally, it is impressed upon that there is no malafide intent on the part of the appellant to evade any payment of service tax as is alleged question of imposition of penalty does not at all arises. Order under challenge is accordingly prayed to be set aside and appeal is prayed to be allowed.

2.1 Rebutting these arguments, it is submitted on behalf of the respondent that the amount collected by the appellant in the name of Subway Franchise Advertisement Fund, in the account of SFAFT is nothing but a bifurcation of the gross value received by the appellant, for providing the service of "franchise". The bifurcation is with the intend of evading/short paying the service tax liability. Section 67 of the Finance Act is being impressed upon to submit that the amount of Franchise Advertisement Fund is not the expenses but is the part of the income of the franchisor being paid to him as is very much part of the payment clauses of the franchise agreement. From any set of imagination same cannot be considered being excluded from the gross value/transaction value. Justifying the impugned order appeal is prayed to be dismissed.

3. After hearing both the parties at length, keeping in view the rival contentions and perusing the entire record including the impugned 'Franchise Agreement', we are of the considered view as follows :-

> Out of the several demands proposed vide impugned show cause notice, the original Adjudicating Authority confirmed two demands :
>
> > (a) on the unaccounted amount of liability shown in balance sheet
> > (b) on the amount collected from Franchise in the name of Advertisement Fund.

4. With respect to former liability, the same has duly been conceded by the appellant and stands discharged too. Now the controversy only remains about the value given by the Franchise to the appellant/Franchiser in the name of Franchise Advertisement Fund. The said Franchise Advertisement Fund is 4.5% of the weekly gross sales which is paid in addition to 8% of weekly gross sales as 'Royalty'. Thus, the main controversy to be adjudicated by us is as follows :-

> Whether bifurcating the amount of weekly gross sales into the payment of royalty (@ 8% thereof) and the payment towards Franchise Advertisement Fund (@ 4.5% thereof) takes the later value out of the ambit what is called as transaction value/the gross value.

4.1 Normally what is the integral part of service provided forms the part of gross value as was also held by Tribunal Kolkata in

Naresh case reported as **2008 – TIOL – 1016 – TRI. – KOL.** Value is derived from the price and value is the function of price themselves. This is the conceptual meaning of value. Section 67 is the sole repository of law governing value of taxable service no ambiguity persists in Section 67 of the Act whatever is included in the section has to be considered as the value for taxable service. The wording of the said provision being absolutely clear no other interpretation can be attributed to the same. We draw our support from the decision of Apex court in the case of **Government of Andhra Pradesh vs. P. Laxmi Devi – (2008) 4 SCC 720**, wherein it was held that if the words used in a taxing statute are clear, one cannot try to find out the intention and the object of the statute. Thus the correct assessable value of the service provided since service commands that value only and that should only be taxed without any hypothetical rule of computation of value of taxable service under Section 67 of the Act. Section 67 reads as follows :-

> "7. Section 67 of the Act deals with valuation of taxable services. This Section was amended w.e.f. April 18, 2006. Un-amended provision reads as under:
>
> > **"67. Valuation of taxable services for charging service tax.** - For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service provided or to be provided by him.
> >
> > *Explanation 1.* - For the removal of doubts, it is hereby declared that the value of a taxable service, as the case may be, includes, -

(a) the aggregate of commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker;

(b) the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;

(c) the amount of premium charged by the insurer from the policy holder;

(d) the commission received by the air travel agent from the airline;

(e) the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;

(f) the reimbursement received by the authorised service station from manufacturer for carrying out any service of any motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer; and

(g) the commission or any amount received by the rail travel agent from the Railways or the customer,

but does not include -

(i) initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;

(ii) the cost of unexposed photography film, unrecorded magnetic tape or such other storage devices, if any, sold to the client during the course of providing the service;

(iii) the cost of parts or accessories, or consumable such as lubricants and coolants, if any, sold to the customer during the course of service or repair of motor cars, light motor vehicle or two wheeled motor vehicles;

(iv) the airfare collected by air travel agent in respect of service provided by him;

(v) the rail fare collected by rail travel agent in respect of service provided by him;

(vi) the cost of parts or other material, if any, sold to the customer during the course of providing maintenance or repair service;

(vii) the cost of parts or other material, if any, sold to the customer during the course of providing erection, commissioning or installation service; and

(viii) interest on loans.

Explanation 2. - Where the gross amount charged by a service provider is inclusive of service tax payable, the value of taxable service shall be such amount as with the addition of tax payable, is equal to the gross amount charged.

Explanation 3. - For the removal of doubts, it is hereby declared that the gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.”

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, bet he amount as may be determined in the prescribed manner.

(2) Where the gross amount charged by a service provider, for the service provided or to be provided is

inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

(3) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

(4) Subject to the provisions of sub-sections (1), (2) and (3), the value shall be determined in such manner as may be prescribed.

Explanation. - For the purposes of this section.

(a) "consideration" includes any amount that is payable for the taxable services provided or to be provided;

(b) "money" includes any currency, cheque, promissory note, letter of credit, draft, pay order, travellers cheque, money order, postal remittance and other similar instruments but does not include currency that is held for its numismatic value;

(c) "gross amount charges" includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and [book adjustment, and any amount credited or debited, as the case may be, to any account, whether called 'suspense account' or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.]"

8. After the amendment, Section 67 of the Act is as follows :

Section 67. Valuation of taxable services for charging service tax. -

(1) Subject to the provisions of this Chapter, service tax chargeable on any taxable service with reference to its value shall, -

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

(2) Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged.

(3) The gross amount charged for the taxable service shall include any amount received towards the taxable service before, during or after provision of such service.

(4) Subject to the provisions of sub-sections (1), (2) and (3), the value shall be determined in such manner as may be prescribed.

Explanation. - For the purposes of this section, -

(a) ["consideration" includes -

(i) any amount that is payable for the taxable services provided or to be provided;

(ii) any reimbursable expenditure or cost incurred by the service provider and charged, in the course of providing or agreeing to provide a taxable service, except in such circumstances, and subject to such conditions, as may be prescribed;

(iii) any amount retained by the lottery distributor or selling agent from gross sale amount of lottery ticket in addition to the fee or commission, if any, or, as the case may be, the discount received, that is to say, the difference in the face value of lottery ticket and the price at which the distributor or selling agent gets such ticket.]

(c) "gross amount charged" includes payment by cheque, credit card, deduction from account and any form of payment by issue of credit notes or debit notes and [book adjustment, and any amount credited or debited, as the case may be, to any account, whether called "Suspense account" or by any other name, in the books of account of a person liable to pay service tax, where the transaction of taxable service is with any associated enterprise.]"

5. On the reading of above definition, it is clear that both prior and after the amendment the value on which service tax is payable has to satisfy that (i) the value is the gross amount charged i.e. the entire contract value between the service provider and the service recipient without deduction of any expenses ; (ii) the amount charged should be for "for such service provided" that the gross amount charged by the service provider has to pay for the service provided. By using the word "for such service provided", the Act has provided a nexus between the amount charged and the service provided.

6. For appreciating the first ingredient we revert to the master license dated 01/10/2002 between the SIBV and SIIPL authorizing the later to enter into series of franchise agreements to develop franchise and service sandwich shops in the territory of Republic of India. Clause 3 thereof is the payment clause vide which SIBV is entitled to receive 33% of all the fees and royalties derived by SSIPL. Clause 3.03 talks about the payment received

by SSIPL from the franchise it develops in furtherance of said master license. It reads as follows :-

> "3.03 Master Licensee shall also cause payments of all weekly royalties and advertising fees due from all Sandwich Shops franchised pursuant to this Agreement, to be delivered to Master Licensee or the Franchise Advertising Fund (FAF) timely by the Franchisees and deposited in Master Licensee's and FAF's respective bank account. Pursuant to the Franchise Agreements, Franchisees shall pay weekly a royalty in an amount equal to Eight Percent (8%) of their total Gross Sales and an advertising fee in an amount equal to at least Three and One Half Percent (3.5%) of their total Gross Sales. ("Gross Sales" means all sales or revenues, including catering or delivery, from their Sandwich Shop's business, inclusive of value-added tax.)"

7. The afore-said 33% of the royalties as to be paid to the master licensee (SIBV) is out of the payment of fees and royalties as collected from the franchisees. Though Clauses 3.00 and 3.05 mentioned that the said 33% excludes the advertisement fee but it is received in the context of providing 'franchise service' from SSIPL to the franchise (various Subway Sandwich Shop in the Territory of India). Also the said advertising fee is nothing but is @4.5% of the amount collected out of weekly gross sales. The royalty @8% is also the part of said weekly gross sales and is admittedly taxable. Thus, we are of the opinion that by merely mentioning that for master licensee 33% of all the fees collected shall exclude advertising fee does not takes that amount out of the tax net of the amount received

from franchisees for providing them the 'Franchise Service'. Thus the sole reason of this advertisement fee is also the part of the contract value. More so, this value is not at all the expense incurred by the franchise for advertising his own outlet but this is the amount out of his income from the sales passed on to the service provider SSIPL in lieu of the franchise agreement between the two. Hence, we are of the firm opinion that this 'Franchise Advertisement Fund' is despite a different nomenclature of being a different fund but actually is the value received by the appellant for providing franchise service to its franchisees.

8. Coming to the second ingredient it is observed that the appellant/ assessee had submitted that advertising service is not the part of franchise service and that the amount is not to be retained by SSIPL but is to be diverted back to the respective franchisees for advertisement in their local area the same has been rebutted by the department submitting that it is SSIPL only which ultimately is getting the benefit out of the said service. To adjudicate, the same we first look into the definition of franchisees/franchise service. As per Section 65 (105) (zze) 'franchise service' is :

> any service provided or to be provided to a franchise by the franchiser in relation to franchise.

8.1 The Finance Act, 2005 had substituted this definition w.e.f. 16/06/2005 as follows :-

> Franchise means an agreement by which the franchise is granted representational right to sale or manufacture the goods or to provide service or undertake any process identified with franchiser, whether or not a trade mark, service mark, trade name or logo or any such symbol, as the case may be, is involved.

8.2 Thus after the amendment, the franchise service is not confined merely to the representational right to sale or manufacture goods or to provide the service but it extends to any process identified with franchiser with respect to the trade mark, service mark, trade name etc. The amount, in question, is the part of the weekly gross sales being given by the service recipient to the service provider mutually consenting for the same to be used for the process identified by SSIPL to advertise the subway brand/trade name. Hence, it is not simplicitor on advertising service, but is very much the part of the franchise service rather than by the appellant to the franchisees. Hence, definitely qualify for "for such service provided". From the above discussion, we are of the firm opinion that the amount of weekly gross sales @ 4.5% but for franchise advertisement fund is nothing but the part of gross value of the contract for providing the franchise service and, hence, was equally taxable as 8.5% of the said weekly gross sales is taxable.

9. The case laws as relied upon by the appellant are not applicable to the facts and circumstances of the present case for the simple reason that present is not issue between dealer and

manufacture. It is a case of providing the franchise service where representational right to use or identify/advertise the trade name is very much part of the franchise service itself. Similarly, **Intercontinental Consultants and Technocrats Pvt. Ltd.** (supra) is also not applicable in view of the above discussion about Section 67 of the Act in accordance where off the valuation of taxable service is nothing more or nothing less than the consideration paid as *quid pro quo* for the service. As already discussed above even 4.5% of weekly gross value, irrespective given as franchise advertisement fund, is the value as a *quid pro quo* service.

9.1 The argument of appellant to be acting merely as a pure agent is also held not sustainable because appellant being the franchiser is simultaneously getting benefit out of the advertisements. More so, the money fixed for advertisement was not the expenditure separately either on the part of franchiser or on the part of the franchise but is very much the part of the franchise fee given to franchiser in compliance of the terms of the franchise agreement between the two.

9.2 Finally coming to the issue of show cause notice being barred by time, we have already observed that the bifurcation of weekly gross sales by the appellant is a mere strategy to cut short its tax liability. Thus we opine that the element of mis-representation is very much apparent on part of the appellant that too with an intent to evade payment of tax. The decision of

Hon'ble Apex court in the case of **Nizam Sugar Factory – 2006 (197) E.L.T. 465**, as relied upon by the appellant is therefore not applicable to the present case. Resultantly it is held that the Department was entitled to invoke the extended period as per proviso to Section 73 (3) of the Act. Show cause notice dated 13/02/2009 proposing the demand for the period w.e.f. April 2007 to March 2008 is therefore denied to be barred by time. As a result of entire above discussion, we do not find any infirmity with the order under challenge. Same is accordingly upheld. Consequent thereupon both the appeals stand dismissed.

(Order pronounced in open court on 22/03/2019.)

(Rachna Gupta)
Member (Judicial)

(Bijay Kumar)
Member (Technical)

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