



THE CHAMBER OF TAX CONSULTANTS

3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020

●Tel.: 2200 1787 / 2209 0423 / 2200 2455 ●E-mail: office@ctconline.org

●Website: www.ctconline.org

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Jai hind College, A. V. Room, 4th Floor, A Road,

Churchgate, Mumbai – 400 020

ISSUES UNDER MIXED & COMPOSITE SUPPLY

CA Aditya Surte

1. INTRODUCTION

At the very outset, we must first come to consensus as to the need and consequence of identifying a supply as a composite or a mixed supply. Identifying a transaction as a composite or mixed supply is essential to determine the applicable rate of tax. The Indian GST tariff has seven rates of taxes as of today – 0%, 0.25%, 3%, 5%, 12%, 18% and 28%. Additionally there is a cess on demerit and sin goods resulting in more tax slabs. Multiple tax slabs breed classification disputes. Similarly, provisions relating to time of supply and place of supply of goods are at a variance than those for services under the GST law. As such, in case of a transaction involving supply of goods and services, identifying whether the supply is classified as a supply of goods or supply of services is critical to know when and how much of tax is to be paid and whether the transaction is in the nature of intra-State or inter-State supply.

2. WORKS CONTRACT VIS-À-VIS COMPOSITE SUPPLY

- 2.1.** A composite contract involving supply of goods and labour, popularly known as “works contract” under the earlier sales tax laws, has an elaborate and well known history. Under the erstwhile tax regime, the controversy was primarily with regard to the power of the State Governments to tax the sale element involved in such contracts. That aspect of the controversy has been put to rest under the GST regime, with the Centre and States having equal power to levy GST.
- 2.2.** Sec.2(119) of the CGST Act, 2017 defines a works contract to mean a contract for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any **immovable property** wherein transfer of property in

goods (whether as goods or in some other form) is involved in the execution of such contract.

2.3. Para 6 of Schedule II appended to the CGST Act states that following composite supplies shall be treated as a supply of services:

(a) works contract as defined in clause (119) of section 2.

2.4. We may, therefore, conclude that a works contract is a composite supply in relation to an immovable property. Any contract wherein transfer of property in goods (whether as goods or in some other form) is involved and such contract is in relation to a **movable property** would no longer qualify to be a works contract. The contract will then have to be looked at from the lenses of a “composite supply”.

2.5. Another aspect that must be noted is that the crux of whether a particular supply would be classified as a composite supply or works contract lies in the determination of the fact as to whether the supply is in relation to a movable or immovable property. There have been a number of advance rulings delivered by the Authorities of different States on this very aspect already. Following are a few instances of advance rulings delivered by the Maharashtra ARR:

- Giriraj Renewables (Order No. GST-ARA-01/2017/B-01 dated 17/02/18)
- Fermi Solar Farms (Order No. GST-ARA-03/2017/B-03 dated 03/03/18)
- Eiffel Hills & Dales Developers (P.) Ltd. (GST-ARA-46/2018-19/B-119 dated 25/09/18)
- Allied Digital Services (GST-ARA-90/2018-19/B-159 dated 19/12/18)

3. HISTORY OF COMPOSITE & MIXED SUPPLY

3.1. The concept of composite and mixed supply is akin to that of “bundled services” under the erstwhile Service Tax regime. Sec. 66F of the Finance Act, 1994 defined a “bundled service” to mean a bundle of provision of various services wherein an element of provision of one service was combined with an element or elements of provision of other services. The taxability of such bundled services was determined under sub-section (3) of sec. 66F as follows:

(a) If various elements of a bundled service were naturally bundled in the ordinary course of business, it was to be treated as provision of a single service which gave the bundle its essential character.

(b) If various elements of such service were not naturally bundled in the ordinary course of business, it was to be treated as provision of the single service which resulted in highest liability of service tax.

3.2. Clause (a) of sub-section (3) of section 66F of the Finance Act, 1994 is what we know today as “composite supply” and clause (b) is what has been propounded as “mixed supply” under the GST law.

4. MEANING OF COMPOSITE AND MIXED SUPPLY

4.1. Composite Supply

- 4.1.1. Sec. 2(30) of the CGST Act defines a “composite supply” to mean a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.
- 4.1.2. On a close examination of the definition, following essential characteristics of a composite supply are noticed:
- a) The supply should consist of two or more taxable supplies;
 - b) The supply may be of goods or services or both, or any combination thereof;
 - c) Such supplies should be naturally bundled and supplied in conjunction with each other in the ordinary course of business;
 - d) One of the supplies should be a principal supply.
- 4.1.3. Sec. 2(90) of the CGST Act defines a “principal supply” as the supply which constitutes the predominant element of a composite supply and to which any other supply forming part of that composite supply is ancillary.
- 4.1.4. The phrases “naturally bundled” and “predominant element” have not been defined under the Act.

4.2. Mixed Supply

- 4.2.1. Sec. 2(74) of the CGST Act defines a “mixed supply” as two or more individual supplies of goods or services, or any combination thereof, made in conjunction with each other by a taxable person for a single price where such supply does not constitute a composite supply.
- 4.2.2. On studying the definition of mixed supply, following characteristics become evident:
- a) The goods and/or services supplied together have an identity independent of each other. These goods or services can be bought and sold individually and the supply of one does not necessitate the supply of the other.
 - b) No individual price is assigned to any of the goods and/or services supplied together and they are deliberately supplied for a single consolidated price.
 - c) The supply should not constitute a “composite supply”. This means that the supplies are not naturally bundled and supplied conjointly in the ordinary course of business, and none of the supplies qualifies as the principal supply.

d) If the goods or services are sold separately, then it shall neither be a mixed supply nor a composite supply. Let us call it “segregated/independent supply”.

4.2.3. A question that crops up is whether composite supply requires separate charges for each of its constituent supplies or charging a single price would reclassify a transaction as mixed supply, which would otherwise have been classified as composite supply? My answer to the question is in the negative. While it is clear that charging a single price is a pre-requisite for a supply to be classified as mixed supply, there is no condition as to the method of charging when it comes to a composite supply. The primary point of distinction between a composite and mixed supply, in my view, is the test of naturally bundled v/s artificially bundled. Two or more supplies, when offered together as a naturally bundled bouquet in the ordinary course of business, would qualify to be a composite supply irrespective of the fact whether a single price is charged for the entire bundle or separate prices are assigned to each supply.

5. “NATURALLY BUNDLED” & “ORDINARY COURSE OF BUSINESS”

- 5.1. As stated in Para 4.1.4, the phrase ‘naturally bundled’ has not been defined in the Act. As per Merriam-Webster Dictionary ‘naturally’ is something that is by natural or inherent character and a ‘bundle’ is a group of things fastened together for convenient handling or a package offering related products or services at a single price. As such, it may be said that ‘naturally bundled’ is something that is, by its character, inherently fastened together for convenience.
- 5.2. The CBEC Education Guide on Taxation of Services released in the year 2012 attempts to explain the concept of “naturally bundled” by way of an example of air transport services provided by airlines wherein an element of transportation of passenger by air is combined with an element of provision of catering service on board. Another example provided is that of a hotel providing a 4-D/3-N package with the facility of breakfast. This is a natural bundling of services in the ordinary course of business.
- 5.3. Whether the supplies are bundled in the ordinary course of business, would depend upon the normal or frequent practices followed in the area of business to which the supplies relate. The CBEC Education Guide goes on to list some of the indicators to ascertain such normal and frequent practices:
- **The perception of the consumer or the service receiver** – If a large number of service recipients of such bundle of services reasonably expect such services to be provided as a package, then such package could be treated as naturally bundled in the ordinary course of business.
 - **Majority of service providers in a particular area of business provide similar bundle of services.** In the example of air transport services along

with catering service on board, majority of the airlines provide a bundle of these services.

- **The nature of the various services in a bundle of services** – The nature of services is such that one of the services is the main service and the other services combined with such main service are incidental or ancillary services which help in better enjoyment of the main service.

5.4. These indicators can be equally adopted to determine what constitutes a naturally bundled supply of goods or services or both. No straight jacket formula can be laid down to determine whether a supply is naturally bundled and conjointly supplied in the ordinary course of business. Each case must be individually examined in the backdrop of several factors.

6. IDENTIFICATION OF PRINCIPAL SUPPLY IN CASE OF COMPOSITE SUPPLY

6.1. By the very definition of composite supply, a transaction can be classified as such only if one of its constituent supplies is identified as the principal supply. Principal supply is the supply which gives the entire bundle its essential character.

6.2. Principal supply, by definition, is the supply which constitutes the predominant element of the bundle. What constitutes the predominant element remains to be open for determination on a case-to-case basis. Arguments can be made in favour of determination based on proportion of value/cost of the supplies. However, it would not be prudent to determine the principal supply based solely on the value criteria. In this regard, we may note the decision of the West Bengal AAR in the case of *Alok Bhanuka (Case No. 4 of 2019 dated 26/03/2019)* in which despite the value of spare parts constituting the major portion of the value of supply, the principal supply was held to be that of a service.

6.3. The primary criteria for determination of the predominant element, therefore, remains to be the **primary object** of the transaction and the **intention of the parties** while entering into it. This takes us back to the decision in *Bharat Sanchar Nigam Ltd. v. Union of India [2006] 145 STC 91 (SC)* wherein the Hon'ble Supreme Court observed as follows:

*"The test for composite contracts remains to be – did the parties have in mind or intend separate rights arising out of the sale of goods. The test for deciding whether a contract falls into one category or the other is as to what is "the substance of the contract". We will, for the want of a better phrase, call this the **dominant nature test**. (Paras 45 and 46)"*

6.4. In *Hindustan Aeronautics Ltd. v. State of Karnataka [1984] 55 STC 314 (SC)* the Supreme Court observed that *"even in a contract purely of work or service, it is possible that articles may have to be used by the person executing the work, and property in such articles or materials may pass to the other party. That would not*

necessarily convert the contract into one of sale of those materials. In every case, the court would have to find out what was the primary object of the transaction and the intention of the parties while entering into it..."

- 6.5. By virtue of definition of principal supply under section 2(90), the concept of 'dominant intention test' has been given statutory recognition in GST. Therefore, it becomes necessary to identify the intention of the parties and contractual terms to determine the principal supply.

7. ISSUES

7.1. Whether supply of two or more goods or services or both, or any combination thereof, one of which is exempt from tax or not leviable to tax, can be said to be a composite supply?

7.1.1. The issue crops up owing to the definition of "composite supply". A composite supply means a supply consisting of two or more **taxable supplies**.

7.1.2. "Taxable supply" has been defined u/s 2(108) of the CGST Act to mean supply of goods or services or both which are **leviable to tax** under this Act. The term used is "leviable to tax", which means that the supply should be subject matter of tax under this Act. This would include supplies which are liable to tax at certain rate as well as supplies that are exempted from tax by way of notifications. An exempt supply is a species of taxable supply as while it is leviable to tax, the tax has been exempted due to the public policy of the Government.

7.1.3. Going by the logic stated in the above Para, we may conclude that supply of two or more goods or services or both, one of which is wholly exempt from tax, would still qualify to be a composite supply, subject to other conditions being met. (Also see Karnataka AAR Advance Ruling No. KAR ADRG 26/2018 dated 13/11/2018 in the case of Columbia Asia Hospitals Pvt. Ltd.)

7.1.4. However, the CGST Act also contains a formal definition of "exempt supply" in sec. 2(47) which reads as under:

*"exempt supply means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act, and **includes non-taxable supply**" (emphasis supplied).*

7.1.5. Non-taxable supply is defined u/s 2(78) to mean a supply which is **not leviable to tax** under the Act. Examples include alcoholic liquor for human consumption, aviation turbine fuel, etc.

7.1.6. The question that remains to be answered now is whether supply of two or more goods or services or both, or a combination thereof, one of which is a non-taxable supply, would qualify to be a composite supply or not.

Let us now discuss some product/service specific issues:

7.2. Product / service specific issues

- 7.2.1. CMS Ltd. is engaged in the business of manufacturing diesel engines. It also provides after sales services on account of engines supplied by them and also by various other parties, which includes supply of spare parts, maintenance services, rebuilding of engines and batteries. It has executed AMC with the end customers to provide such maintenance services, which are provided for a fixed charge based on the nature of maintenance activity such as preventive maintenance, routine maintenance, general inspection, checking of safety controls, supply of consumables and other repairs and replacements. The underlying transaction in all agreements involves rendering of maintenance services along with supply of necessary parts, if and when necessary. Whether the transaction is of the nature of mixed supply or a composite supply? If it is held to be a composite supply, what is the principal supply?
- 7.2.2. SWA is a charitable trust running a hostel for the needy and poor students. They offer lodging and boarding facilities besides compulsory personality development training which includes computer awareness, communication skills in English and other foreign languages for a consolidated fee of Rs.22,500 per head with no option to choose the facilities. To sharpen the communication and entrepreneurship skills of the students it arranges lectures of stalwart personalities. The hostilities also get the benefit of a library within the premises, daily morning yoga classes and various sports activities at no extra cost. SWA wishes to know whether the supply of all the aforementioned services can be considered as a composite supply. If yes, what would be the principal supply?
- 7.2.3. Mr. Chungyalpa owns a private boarding house. He has entered into a MOU with Sunshine Educational Society to provide hostel accommodation facility exclusively to the students of the school run by the Society. The facility shall include lodging, housekeeping, laundry, medical assistance and food. The consideration is a consolidated charge on the individual boarder for the combination of services. The services are provided to both day boarders and boarders requiring lodging facilities. Mr. Chungyalpa wishes to know whether in the following circumstances the supply would be considered as a composite or a mixed supply:
- 7.2.3.1. Rs.70,000 per head per annum is charged to the day boarders as a consolidated amount for facilities without lodging and laundry facilities and Rs.1,50,000 per head per annum is charged to the boarders requiring lodging facilities. No choice is granted to the boarders to choose the facilities to be availed.

- 7.2.3.2. What if he segregated the charges for lodging, boarding and each individual facility and offered a package based on the facilities to be availed by each boarder?
- 7.2.3.3. What if there were no day boarders and he charged a flat amount of Rs.1,50,000 per head per annum to the boarders inclusive of all the facilities?
- 7.2.4. GSK Ltd. is a company engaged in the sale of pharmaceutical products, diagnostic kits, etc. They have adopted a business model of placing their own medical instruments at the premises of unrelated hospitals or laboratories and supplying the pharmaceutical products, reagents, diagnostic kits, etc. to be used in such equipment by executing an agreement. The medical equipment are placed at the hospitals without any consideration and the hospital staff is authorised to use the machines during the period of contract without any restriction. However, the title and ownership of the machines remains with GSK Ltd. The agreement further states that the hospitals / labs at which such equipment is installed are bound to procure specified minimum quantity of reagents, calibrators, disposals, etc. from the applicant for a specified price during the tenure of the agreement. These products are supplied against a tax invoice. If the hospitals fail to procure the minimum quantity of products, GSK Ltd. is entitled to recover the amount equal to the deficit in the volume. GSK Ltd. contends that the transfer of right to use the equipment, being without any consideration, is not liable to tax and the supply of products are only liable to tax @ 5%. Is GSK Ltd.'s contention correct?
- 7.2.5. DC & Sons is in the business of building bus-bodies on the chassis supplied by its customers as per the customer's specifications. The contract specifies the type of body to be built, type of wood to be used for the floor and sides, aluminium sheets to be used for panels, rubber and other material to be used for cushions of seats, number of seats to be installed, etc. along with labour charges for building the body. All the material required for building the body is procured by DC & Sons. A single price is charged depending on the type of body and material to be used. Bodies of motor vehicles are covered by HSN code 8707 and charged to tax @ 28%, whereas manufacturing services on goods owned by others is covered by SAC 9988 and charged to tax @ 18%.
- 7.2.5.1. Whether the aforesaid activity is a composite supply? If yes, what is the principal supply?
- 7.2.5.2. DC & Sons is also a dealer of commercial vehicles. The invoice for sale of chassis to the customer is prepared on 23-04-19. Thereafter, the chassis is brought to the body shop to build a body based on the owner's specifications. The invoice for body building is raised on

7.2.5.3. 30-04-19. Whether the activity of bus body building would qualify as a composite supply of goods or services?

7.2.6. Innotech Kitchens is in the business of sale of modular kitchens. Upon receiving an order, Innotech deploys its personnel to the site to take measurements and required information and dimensions for setting up the modular kitchen. These measurements are then converted into a design which is shared with the customer for final approval. After the design is approved by the customer, Innotech procures the requisite material to build the modular kitchen. This material is directly sent to the site for necessary installation and fitment to complete the order. Innotech charges a single price. Materials required are – Kitchen chimney, exhaust fan, storage cabinets, door panels, handles, washbasin, sanitary fittings, platforms, etc. Additionally, the customer may opt to purchase electronic and other equipment such as ovens, geysers, cooking range, toasters, etc. at an additional cost.

7.2.6.1. Whether the design and supply of modular kitchen is a works contract, composite supply or mixed supply?

7.2.6.2. Whether the supply of electronic equipment along with the modular kitchen is a composite supply or a standalone supply of such equipment? What if a single price is charged for the kitchen and equipment?

7.2.6.3. What will be the conclusion where the design is not prepared by Innotech but is provided by the customer?