



Levy of Service Charges/Tips for the distribution amongst the staff is a common practice in case of hotels/restaurants. In this matter, it would be apt to highlight that Department of Consumer Affairs Food and Public Distribution, New Delhi issued Guidelines No. J-24/9/2014-CPU(pt.) on dated 21st April 2017 provided that the levy of service charges would be subject to consent of the customers and no customer can be forced to pay the service charges. They would be voluntary in nature.

This article tries to analyse the taxability of the service charges in view of the guidelines issued by the Department of Consumer Affairs on the matter of collection of service charges by hotel/restaurant. Since the guideline seems to be binding on the hotel/restaurant therefore, they play a major role in deciding the taxability of the service charges in GST regime. Let's try to analyse the issue which has been a bone of contention for long and has been disputed by the department for inclusion in sales price.

Part-I-When Service Charges are Voluntary in Nature and Entry of the Customer to the Restaurant/Hotel is not considered as an implied consent to pay the service charges (Scenario Contemplated by the guidelines issued by the Department of Consumer Affairs)

1.What are Service Charges and how does the transaction takes place:

a) Component of Service to be provided by the hotel/restaurant is inherent in supply of Food, thus anything over and above the price of the product displayed on the menu card cannot be collected from the customer in name of service provided to the customer: *"A component of service is inherent in provision of food and beverages as ordered by the customer. Pricing of the product therefore is supposed to cover both the goods and service components."*

The guidelines clarifies that pricing of product is supposed to cover both goods and services components. That's the final price charged by the hotel/restaurant for the supply of the goods alongwith the delivery thereon. The price towards the service portion is already included in the price of the product displayed in the menu card therefore **no other amount can be charged in the guise of service portion of the food or beverages.**

This is also the most common contention laid down by the hotels/restaurants for service charges that amount of service charges has been collected towards service portion of the product being supplied and price displayed on the menu card is only towards cost of the food or beverages. The guidelines clearly negate this contention.

b) Placing of Order by the customer amounts to agreement to pay the price displayed on the menu card alongwith applicable taxes: *"Placing of an order by a customer amounts to his/her agreement to pay the prices displayed on the menu card alongwith applicable taxes. Charging for anything but the aforementioned, without express consent of the consumer, would amount to unfair trade practice under the Consumer Protection Act, 1986."*

Once a customer places an order, it's an agreement to pay the price displayed on the menu card and applicable taxes thereon for the provision of food and beverages. Hotel/Restaurant is supposed to charge the same price displayed on the menu card alongwith the taxes thereon. The circular further clarifies that charging anything excess but for the price displayed on the menu card, without express consent of the consumer, it would amount to unfair trade practice under the Consumer Protection Act, 1986.

Therefore, any other charges in the name of service charges firstly are not connected with the provision of foods and beverages by the hotel/restaurant and secondly when a customer places an order he only agrees to pay the price of the product displayed on the menu card and any other charges in excess of the price of the product cannot be collected from him except for his consent.

c) Tip or Gratuity paid is a transaction between the Customer and staff of the hotel/restaurant: Tip or Gratuity paid



by the customer is towards hospitality received by him/her, beyond the basic minimum service already contracted between him/her and the hotel management. It is a separate transaction between the customer and the staff of the hotel or restaurant, which is entered into, at the customer's discretion.

The basic minimum service is contracted between the hotel/restaurant and the customer. The charges for basic minimum service to be provided by the hotel/restaurant have already been included in the price of foods and beverages as displayed on the menu card alongwith the applicable taxes.

The tip or gratuity paid by the customer is a contract between the customer and staff of the hotel/restaurant towards the hospitality received by him beyond the basic minimum service assured by the hotel/restaurant. This transaction of tip/gratuity is entered into between the staff and the customer at customer discretion and hotel/restaurant has nothing to do with it as it has already displayed its price of the food and beverages for the goods and service part on the menu card.

d) Time at which the tip becomes payable: *“The point at which the customer decides to give a tip/gratuity is not when he/she enters the hotel/restaurant, and also not when he/she places an order. It is only after completing a meal that the customer is in a position to assess the quality of service, and decide whether or not to pay a tip/gratuity, and if so, how much. Therefore, if a hotel/restaurant considers that entry of a customer amounts to his/her implied consent to pay a fixed amount of service charge, it is not correct. Further, any restriction of entry based on this amounts to a trade practice which imposes an unjustified cost on the consumer, forcing him/her to pay service charge as a condition precedent to placing order of food and beverages, and as such it falls under restrictive trade practice as defined under Section 2(1)(nnn) of the Consumer Protection Act, 1986.”*

The circular further clarifies that when a customer decides to pay the tip. The following situations have been spelt out by the circular alongwith the point at which the customer decides to pay the tip.

Situation	Whether customer decides to pay the tip at this point
When he/she enters the hotel/restaurant	No
When he/she places an order	No
Whether the customer decides to pay the tip after completing the meal as he is in a position to assess the quality of service. Whether then he decides whether or not to pay a tip/gratuity, and if so, how much.	Yes

Thus, the point of determination of the tip/gratuity to be paid to the staff of the hotel/restaurant is only after completion of the service by the hotel/restaurant. The tip/gratuity does not becomes payable as soon as he enters into the hotel/restaurant.

The guidelines also clearly specify that payment of service charges cannot be made a pre-condition for placing the order otherwise it would be violation of the provisions of Consumer Protection Act, 1986. It's an amount decided after completion of service of foods and beverages looking to the nature of service and an amount decided between the consumer and the staff.

2. Whether service charges collected by the hotel/restaurant are part of Transactional Value for the purpose of levy of GST: Clause (c) of Section 15(2) of Central Goods and Services Tax Act, 2017 provides that

“(c) incidental expenses, including commission and packing, charged by the supplier to the recipient of a supply and any amount charged for anything done by the supplier in respect of the supply of goods or services or both at the time of, or before



delivery of goods or supply of services;”

The above clause can be divided into two parts i.e.

- Incidental expenses, including commission and packing, charged by the supplier to the recipient of a supply.
- Any amount charged for anything done by the supplier in respect of the supply of goods or services or both at the time of, or before delivery of goods or supply of services.

It is the second part of the clause (c), wherein service charges collected by the hotel/restaurant are sought to be treated as part of sale price on the premise that it's an amount charged for anything done by the supplier at the time or before the delivery of the goods or supply of services. The above contentions can be argued to be not valid contention on the basis of following arguments:

The basic premise upon which the said service charges were to be included in the transactional value has been clarified to be non-existent by the guidelines issued by the Department of consumer Affairs.

a) Whether service charges collected by the hotel/restaurant can fall into the limb of Section 15(2)(c) of CGST Act, 2017 of “any amount charged for anything done by the supplier at the time of, or before delivery of goods or supply of services”

The charges towards provision of food and beverages are included in the price shown on the menu card. Hotel/Restaurant cannot charge anything in excess of the price displayed for the food and beverages on the menu card. The hotel/restaurant is bound to provide the basic minimum services as assured on the basis of price displayed on the menu card.

The guideline issued by the Department Of Consumer Affairs clearly provides that question for payment of tip/gratuity comes into question on completion of the meal. Any amount is includible in the transaction value if it is for “any amount charged for anything done by the supplier at the time of, or before delivery of goods or supply of services”. The Price paid as service charge is not towards service provided by the hotel/restaurant but the services provided by the staff to the customer over and above the basic services assured by the hotel/restaurant and it's a contract between the customer and the staff and hotel/restaurant has nothing to do with it.

Therefore, service charges paid by the customer is not an amount to be paid to the supplier for anything done by him at the time of or before the delivery of goods or supply of services but amount payable to the staff by the customer.

b) Whether merely collection of service charges would result in them being added to the transaction value:

The next contention can be that as the amount is collected by the hotel/restaurant thus it forms part of price collected by the hotel/restaurant, therefore it has to be included in the transaction value. The amount charged from the customers can be excluded from the transactional value if it satisfies the conditions laid down under Rule 33. Rule 33 of the Central Goods and Service Tax Rules, 2017 enunciates principal of Pure agent and amount to be excluded from the purview of transactional value. A supplier has to first satisfy the condition of pure agent and once he satisfies those conditions then he has to satisfy the conditions as provided in Rule 33 for exclusion of charges from the purview of transactional value.

c) Whether hotel/restaurant can be considered as a pure agent for the purpose of collection of service charges:

The definition of pure agent as provided under the said rules is as follows:

Condition-1:-Pure Agent enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both.



Although there is no written agreement between customer of the restaurant and the restaurant but it can be said that when the hotel/restaurant charges service charges from the customer with the consent of the customer, then there is an implicit contract between the customer and the hotel/restaurant that this amount would be paid to the staff. Further as the guidelines issued by the department of consumer affairs clearly specify that payment of the tip/gratuities is a contract between the customer and the staff. Therefore even if the hotel/restaurant charges the amount from the customer, legally it is on or behalf of the staff of the restaurant. The hotel/restaurant or the restaurant can only charge upto the price of the food or beverages supplied as displayed on the menu card and tax applicable on the price thereon and the service charges are purely upon the consent of the customer and that too towards the services of the staff of the hotel/restaurant.

Taking one step ahead to conclusion, guidelines issued by the department of consumer affairs only allow the restaurant to charge from the customer price of the product and tax applicable thereon. When the guidelines do not allow the restaurant to charge amount in addition to the price of the product then going one step ahead it cannot also charge any tax additional to the tax applicable on the product. The guidelines significantly provide that

"In view of the above, the bill presented to the customer may clearly display that service charge is voluntary, and the service charge column of the bill may be left blank for the customer to fill up before making payment."

The guidelines can be deciphered for a better understanding as follows:

- The bill is to be prepared by the restaurant.
- The bill should clearly display that the service charges are voluntary.
- The column in the bill for service charges may be left blank.
- The blank column can be filled by the customer, if he wants to pay service charges.

Therefore, the theory goes that when an amount has to be decided for

- a transaction between the customer and staff of the restaurant,
- a transaction for which hotel/restaurant is not entitled to charge anything from the customer without his consent, and
- a transaction for which hotel/restaurant has been suggested to leave the space blank only to be filled by the customer, therefore, when a customer is asked to fill the consideration and that too after the preparation of the bill, it clearly shows that the amount is collected by the restaurant with an express consent of the customer that restaurant would act as the pure agent and pay the amount directly to the staff.

Further guidelines also admit that agreement of the customer to pay service charges is in no way related to the provision of food and beverages. Service of hotel/restaurant comes to an end with the provision of food or beverages to the customer and consideration for services rendered by the hotel/restaurant is the price shown on the menu card. Therefore, when a hotel charges amount as service charge it is nothing but an agreement with the customer to act as his pure agent to pay the amount to the staff of the hotel.

Condition-2:- Pure Agent neither intends to hold nor holds any title to the goods or services or both so procured or supplied as pure agent of the recipient of supply:-

In this regard guidelines clearly specify that payment of the tip/gratuities by the customer to the staff is decided once provision of food and beverages is complete. Therefore, any transaction payment of which is decided subsequent to the provision of food and beverages and is between persons other than the hotel/restaurant, then it is implied that restaurant or the hotel/restaurant does not have any role to play for in the transaction and once there is no role to play by the restaurant or the hotel/restaurant except for collection of the service charges, therefore no question



arises for the holding of any title thereof of the services. The services are purely provided by the staff directly to the customer over and above the basic services assured by the hotel.

Condition-3:-Pure Agent does not use for his own interest such goods or services so procured:-

Tip/Gratuity is a consideration given by the customer to the staff for the services received over and above the basic standard as assured by the restaurant or hotel/restaurant. The guidelines also admit that

“Tip or Gratuity paid by the customer is towards hospitality received by him/her, beyond the basic minimum service already contracted between him/her and the hotel management”

In this regard the guidelines clearly specify that payment of the tip/gratuity is a transaction between the customer and the staff which is decided once the provision of food and beverages is complete. Therefore, in such case there is no question of the services for which amount is charged as service charges are used by the hotel/restaurant in their own interest. The services are purely provided by the staff directly to the customer over and above the basic services assured by the hotel.

Condition-4:-Pure Agent receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account:-

This is the most important condition which has to be fulfilled by the restaurant or the hotel/restaurant. It should receive only that much amount as service charges which would be distributed between the employees. The customer gives his consent for the amount to be paid as service charges to the staff. Therefore, if the hotel/restaurant retains that amount of service charges collected from the customer, then it would be charging from the customer over and above the price of the product which is prohibited by the guidelines issued by the department of consumer affairs. Once the entire amount collected is distributed between the staff, the given condition is fulfilled. However, if the entire amount collected is not distributed, then firstly it's the violation of the guidelines issued by the Department of consumer Affairs and secondly it might be leviable to tax.

Conclusion: Thus, it can be concluded that the hotel/restaurant acts as a pure agent in the case of collection of service charges. However for the purpose of the amount of service charges collected by the hotel/restaurant from the purview of transactional value, it would have to satisfy additional conditions laid down in Rule 33 of CGST Rules, 2017. The same has been discussed herein below:

d) Conditions Laid down in Rule 33 of CGST Rules, 2017:

Following conditions have been laid load down for the purpose of exclusion of such amount from the transaction value of supply

- the supplier acts as a pure agent of the recipient of the supply, when he makes the payment to the third party on authorisation by such recipient;
- the payment made by the pure agent on behalf of the recipient of supply has been separately indicated in the invoice issued by the pure agent to the recipient of service; and
- the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in addition to the services he supplies on his own account.

All the three conditions are being fulfilled by the hotel/restaurant it acts as a pure agent when he makes payment to the staff of the hotel/restaurant, payment made or to be made to the staff is separately indicated in the invoice and the supplies procured by the hotel/ restaurant are in addition to the basic services assured by them to the customer.

Conclusion: Therefore any amount collected by the hotel/restaurant has to be excluded from the purview of



transaction value as the same is being collected as a pure agent by the supplier.

Part-II- Service Charges are not Voluntary in Nature and Entry of the Customer to the Restaurant/Hotel is considered as an implied consent to pay the service charges

In most of the cases till then, service charges were levied mandatorily upon the customers. It can very well be argued that the amount to be paid in the nature tip/gratuity became payable as soon as the customer enters the hotel/restaurant as it was a pre-condition by many of the hotel/restaurant at that time. As the customer entered the hotel/restaurant, he was bound to pay the service charges along with the price of the product and only the food would be served to them. It was not a contract between the customer and the waiter but a contract between the customer and the hotel/restaurant. Therefore, as an assumption it has been taken that it was mandatory for every consumer to pay the service charges.

Conclusion: As has been discussed in detail and held by Hon'ble Bombay High Court in the matter of **Sun-N-Sand Hotel Private Ltd. vs The State Of Maharashtra on 2 December, 1968**, once the service charges are mandatorily payable by the customer then it difficult to dissociate this part of the bill from the total contract which a customer enters into with the assessee when ordering any food. Therefore, service charges in such case would be treated as part of transaction value and thus tax would be leviable thereon. However, if the hotel/restaurant or the restaurant is able to prove that the service charges collected were subject to consent of the customer and payable to the staff, then service charges can be sought to be excluded on the same premise as discussed earlier in scenario subsequent to the issue of guidelines by department of consumer affairs.

3. Legal decisions for inclusion of service charges in the transaction value:

a) Sun-N-Sand Hotel Private Ltd. vs The State Of Maharashtra on 2 December, 1968:-Hon'ble Bombay High Court in the given matter upheld that

"16. In view of the conclusion which we have arrived at that the 10 per cent of the service charges charged to the customers are properly included in the sale price."

However, it would be apt that before reading into the conclusion we go into the observation made by the court which only further strengthens the conclusion that service charges which are not mandatory for every customer and are only voluntary contribution would not form part of selling price.

In the case of service charges, the customers have no option but to pay these charges when demanded by the assessee, irrespective of the fact whether the employees were serviceable or had rendered useful service.

The Hon'ble High Court further observed that

We are unable to accept the contention of the petitioner that what is charged to the customer in the hotel by the assessee inclusive of 10 per cent by way of service charges is really not the "sale price" for the goods which are offered and consumed by the customer in the establishment. Once it is found that there is no option to the customer whether to pay or not to pay the service charges at the rate of 10 per cent over and above the tariff, we find it difficult to dissociate this part of the bill from the total contract which a customer enters into with the assessee when ordering any food.

It was clearly observed that as there was no option before the consumer to not to pay the amount of service charge, therefore it was not possible to disassociate the amount payable by the customer from the sales price. The Hon'ble court further provided that

"It is not as if the sale price of food or articles supplied in the hotel has been statutorily fixed. It is all a matter of agreement between the customers and the assessee; accordingly when the assessee tells the customer the moment he (the customer)



enters the hotel, that for the purposes of goods supplied, the customer will have to pay not only the tariff rates which are fixed but also over and above it 10 per cent, by way of service charges, the sale price quoted must include service charges. We have already observed that so far as the customer is concerned, he has to note by virtue of the tariff card that he has to pay the tariff rates plus 10 per cent, as service charges plus 5 paise as sales tax per rupee; and all this is part of the contract or agreement between the customer and the assessee in respect of the price the customer has to pay for the food that is supplied to him. In other words, all this constitutes and goes into the formulation or fixation of the price for the goods supplied, and, therefore, it must be treated as "sale price" within the meaning of section 2(29) of the Bombay Sales Tax Act, 1959."

Thus, Hon'ble High Court clearly observed that the service charges in the given case were told to the customer the moment he enters into the hotel. The customer has to be pay for the purpose of goods supplied not only the amount fixed as tariff but also the service charges thereon. This has been clearly struck down by the Department of consumer affairs in their guidelines issued on dated 23rd April 2017 whereon they have clarified that

"The point at which the customer decides to give a tip/gratuity is not when he/she enters the hotel/restaurant, and also not when he/she places an order. It is only after completing a meal that the customer is in a position to assess the quality of service, and decide whether or not to pay a tip/gratuity, and if so, how much. Therefore, if a hotel/restaurant considers that entry of a customer amounts to his/her implied consent to pay a fixed amount of service charge, it is not correct."

b) Madras High Court in the matter of Hotel Ashoka vs The State Of Tamil Nadu on 28 October, 1976 Equivalent citations: 1977 40 STC 347 Mad

The facts of the case were similar to the case in the matter of Sun-N-Sand Hotel Private Ltd. vs The State Of Maharashtra on 2 December, 1968.

The case of the petitioner was that previously the workers were collecting tips from customers, that subsequently under an agreement entered into between the management and the employees under Section 12(3) of the Industrial Disputes Act, 1947, it was agreed that the employees would not collect tips from the customers and instead the management would collect 5 per cent of the tariff value of the articles served as service charges and utilise the service charges so collected by way of paying 50 per cent thereof immediately to the employees and appropriating the other 50 per cent to increase the wages and food allowance of the employees and also to introduce a provident fund scheme for the employees, that, therefore, the service charges so collected do not stand on a footing different from the tips previously collected by the employees and that, consequently, the same cannot be included in the taxable turn-over.

The Hon'ble High Court after referring to the various parts of the decision of Hon'ble Bombay High Court

"If we may say so, with respect, we entirely agree with the above reasoning and conclusion of the Bombay High Court. In view of this, we are of the opinion that the conclusion of the Tribunal in this case in including the service charges in the taxable turnover of the assessee is correct."

In the both the above cases, payment of service charge was mandatory. The situation might be different wherein Service Charges are payable after the consent of customer (is not mandatory in every case) and does not become payable on the entry of the consumer to the hotel/restaurant on the goods ordered by him.

c) Delhi High Court Commissioner Vat vs India International Centre on 19 November, 2010

In the given matter, Hon'ble High Court held that service charges collected by the organization are not part of the selling price following that the judgement as laid down by the Hon'ble Bombay High Court and Madras High Court were not applicable in the instant matter. This meant that the Hon'ble High Court did not refuted the conclusion of the earlier judgments given by the two high courts but only distinguished the facts of the case. The relevant extract of the judgement are as follows:



“No doubt, the proposition of law that whatever is charged from the customers becomes the sale price and therefore, the dealer is liable to pay sales tax thereon is unquestionable but at the same time it cannot be treated as absolute principle of law, which is to be applied in all circumstances, irrespective of the nature of the charge.

The Hon'ble High Court further observed that

*Normally, what happens is that whatever services in a restaurant or club are utilized by a member, a member may give tip to the waiter/employee **voluntarily**. This may be given in cash to such an employee by a person utilizing service while making payment of bill. In these circumstances, naturally component of that tip would not be reflected in the bill. However, in order to ensure that there is no heart burning in a situation where some of the employees are luckier enough as compared to another collecting more tips than the other, the employees may decide that all these tips be pooled so that the same are distributed among them equally. In order to facilitate this move on the part of the employees, management comes to their aid by collecting those tips on behalf of these employees. In these circumstances, we find force in the submission of Mr. Sangal that the respondent assessee is naturally a trusty who collects the amount on behalf of the employees and then distributes the same amongst them.*

“Emphasis Supplied”

It can be clearly observed that the emphasis of the Hon'ble High Court was on the word voluntarily and once it is established that the charges are voluntary then the same would not form part of the sales price.

Conclusion: In view of the discussion we can conclude for the scenario subsequent to the issue of the Guidelines by the Department of Consumer Affairs dated 21st April 2017 which is also the period subsequent to the implementation of GST that :

- a) Pricing of the product therefore is supposed to cover both the goods and service components.
- b) Placing of an order by a customer amounts to his/her agreement to pay the prices displayed on the menu card alongwith applicable taxes.
- c) Charging for anything but the aforementioned, without express consent of the consumer, would amount to unfair trade practice under the Consumer Protection Act, 1986.
- d) Tip or Gratuity paid by the customer is towards hospitality received by him/her, beyond the basic minimum service already contracted between him/her and the hotel management.
- e) Tip or Gratuity is a separate transaction between the customer and the staff of the hotel /restaurant, which is entered into, at the customer's discretion.
- f) The point at which the customer decides to give a tip/gratuity is not when he/she enters the hotel/restaurant, and also not when he/she places an order. It is only after completing a meal that the customer is in a position to assess the quality of service, and decide whether or not to pay a tip/gratuity, and if so, how much. Therefore, if a hotel/restaurant considers that entry of a customer amounts to his/her implied consent to pay a fixed amount of service charge, it is not correct.
- g) Further, any restriction of entry based on this amounts to a trade practice which imposes an unjustified cost on the consumer, forcing him/her to pay service charge as a condition precedent to placing order of food and beverages, and as such it falls under restrictive trade practice as defined under Section 2(1)(nnn) of the Consumer Protection Act, 1986.
- h) In view of the above, the bill presented to the customer may clearly display that service charge is voluntary, and



the service charge column of the bill may be left blank for the customer to fill up before making payment.

Therefore, if service charges were to be paid mandatorily by the customers and pre-decided at the entry point of the customer, then as per the principle laid down by Hon'ble Bombay High Court in the matter of Sun-N-Sand Hotel Private Ltd. vs The State Of Maharashtra on 2 December, 1968, it would be difficult to dissociate this part of the bill from the total contract which a customer enters into with the assessee when ordering any food. Therefore, service charges in such case would be treated as part of transaction value and thus tax would be leviable thereon. However, if the point of decision for payment of service charge arises after completion of service of hotel/restaurant to customer and is subject to the consent of customer thus voluntary in nature; service charges cannot be considered as part of the transaction value for the purpose of levy of tax. How does one prove it is a matter to be taken care of.