Indirect Tax Alert

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PUNJAB & HARYANA HIGH COURT HOLDS NON-TAXABILITY OF LAND TRANSFER IN BUILDING CONTRACTS (WORKS CONTRACT)

The two member bench of the Hon'ble High Court of Punjab and Haryana in the case of ***CHD Developers Limited, Karnal vs. State of Haryana and others, Civil Writ Petition No. 5730 of 2014,*** has vide its order dated 22nd April 2015, held that value of immovable property involved in execution of building contracts, is to be deducted while levying tax under Haryana VAT Act on such building contracts, which were held to works contract by the Larger Bench of Supreme Court in the decision of ***Larsen and Toubro Ltd. v. State of Karnataka, (2013) 46 PHT 269 (SC).***

Background of the Case:

- M/s CHD Developers Limited (hereinafter referred to as 'Petitioner') is a developer engaged in the business of development and sale of apartments/flats/units. Interested buyers enter into a flat buyers' agreement with the Petitioner. The property is ultimately sold by execution of sale deed on payment of stamp duty on total consideration.
- A circular dated May 7, 2013 was issued by the Excise and Taxation Commissioner, Haryana stating therein that the developers entering into agreements for sale of constructed apartments or flats prior to or during construction, were chargeable to VAT. Consequently, a circular dated June 4, 2013 was issued regarding making of assessments on builders and developers. Subsequently, vide circular dated February 10, 2014, the circular dated May 7, 2013 was varied and value of the land was sought to be included for imposition of VAT.
- The developer being engaged in the sale of immovable property where stamp duty was paid and also there being no mechanism provided under the Act for computation of tax, the imposition of tax insisted by the authorities was unconstitutional and beyond the provisions of the Act and Rules. Hence, writ petition were filed by Petitioner along with 65 other Petitioners thereby praying for the following:

  (i) challenging the constitutional validity of Explanation (i) to Section 2(1)(zg) of the Haryana Value Added Tax Act, 2003 ("the Act") and Rule 25(2) of the Haryana Value Added Tax Rules, 2003 ("the Rules")in so far as they included the value of land for charging VAT on developers to be ultra vires the Constitution of India in so far as it violated Article 246 of the Constitution;

(ii) quashing the notices issued by respondent for charging tax on sale of flats/apartments/units and to make assessments of VAT;

(iii) for quashing the circulars dated May 7, 2013, June 04, 2013 and February 10, 2014 being in violation of the provisions of the Act;

(iv) challenging the constitutional validity of Section 42 and Section 9 of the Act read with Rule 49 of the Rules as being violative of Constitution.

- In some writ petitions, the challenge has been laid by petitioners to the assessment orders passed by the Assessing Authority thereby levying tax on the total value of contract relying upon the circulars issued by Haryana VAT Department and in others, the order of the Revisional Authority or the notice of assessment (which seeks to levy tax on basis of circulars), on the same premises has been assailed.

Judgment:

The Hon'ble Bench of Punjab and Haryana High Court analyzed the decision of Apex Court in the Raheja Case along with various other decision laying down the principles of works contracts, and dealt with the issues raised by the Petitioners. The detailed questions and observations of the Hon'ble High Court of Punjab and Haryana are as follows:

1. **Whether the developers and builders are works contractors and the agreement between the developer/builder/promoter and the prospective purchaser to construct a flat and thereafter sell the same with some portion of land, authorizes the State to impose VAT thereon?**

   - The Hon'ble High Court of Punjab and Haryana, while deciding the first issue, analysed the following landmark decisions rendered by the Hon'ble Supreme Court, on the issue of works contracts,

     (i) Bengal Immunity Co. Ltd. v. State of Bihar, AIR 1953 SC 252,

     (ii) State of Madras v. Gannon Dunkerley & Co. (Madras) Ltd. 1955 SCR 379,

     (iii) Builders' Association of India and others v. Union of India (1989) 2SCC 645,

     (iv) Gannon Dunkerley & Co. and others v. State of Rajasthan and others (1993) 1 SCC 364,

     (v) K. Raheja Development Corporation v. State of Karnataka (2005) 5 SCC 162,

     (vi) M/s Larsen & Toubro Limited v. State of Karnataka (2013) 46 PHT 269 (SC).

   - While analyzing all the aforementioned decisions, the Hon'ble Court concluded that the term "works contract" encompasses a contract in which one of the parties is obliged to undertake or to execute works. The activity of construction has all the attributes, elements and characteristics of works contract though essentially it may be a transaction of sale of flat. In a contract to build a flat, necessarily there will be an element of sale of goods included therein and therefore, building contracts are species of the works contract. Further, the Hon'ble Court observed that the States are empowered to levy sales tax on the sale of goods in an agreement of sale of flat which also has a component of a deemed sale of goods.

   - Once it was concluded that building contracts are works contracts, the Court moved on to examining the broad principles for determining taxable turnover relating to transfer of goods involved in the execution of such works contract. Where the developer/builder/promoter/contractor/ sub-contractor maintains proper books of account, it shall be the value of the goods incorporated in the works contract as per books

of account. On the other hand, where the developer/builder/ promoter/contractor/sub-contractor does not maintain proper accounts or the accounts maintained by him are not found worthy of credence, the charges towards labour, service and cost of land would be deducted by a formula prescribed by the State Legislature to that effect and to allow deduction of the amount thus determined from the value of the works contract, for assessing the value of the goods involved in the execution of the works contract.

- The activity of construction undertaken by the developer etc. would be works contract only from the stage he enters into a contract with the flat purchaser. However, the deduction permissible under various heads would depend upon facts of each case on the basis of material available on record. It has been clarified that where the agreement is entered into after the completion of the flat or the unit, there would be no element of works contract but in a situation, where agreement is entered into before the completion of construction, it would be a works contract and States would be empowered to levy tax on such transactions.

2. If the answer to the first issue is in the affirmative, whether the method of valuation of VAT on such agreements, can directly or indirectly, include the value of land by following the method of calculation of the taxable turnover in the manner expressed by the Commissioner vide circulars dated May 7, 2013, June 4, 2013 and February 10, 2014 and also in terms of Explanation (i) to Section 2(1)(zg) of the Act and Rule 25(2) of the Rules?

- Once it was concluded that building contracts are works contracts, the next question that arose for consideration was regarding exclusion of value of land in terms of provisions of HVAT Act and the Circulars issued therein.

- Instructions No. 952/ST-1 dated May 7, 2013 provides that the agreements/contracts entered by developers with prospective buyers for sale of apartments/ flats before the completion of construction constitutes 'works contract' and thus VAT was imposable on such transactions. Clause 4 of the said circular relates to measure of tax and deduction towards labour and other like charges. Circular dated June 4, 2013 was issued regarding making of assessments on builders and developers. In view of legal position enunciated hereinbefore, it is held that there is no illegality in the issuance of circulars dated May 7, 2013 and June 4, 2013. As regards validity of Circular dated February 10, 2014, the same was dealt with while dealing with constitutional validity of Section 42 and Rule 9.

- As regards Explanation (i) to Section 2(1)(zg) of the Act, it was observed that such section is not a charging provision which creates any liability for assessing VAT in a “works contract”. Said Explanation provides exclusion only in respect of labour and other service charges. It is in the definition clause of the Act and the provision does not embrace within its ambit, something which is otherwise prohibited by law. Thus, the said provision does not suffer from any vice or defect of unconstitutionality.

- Rule 25(2) of the Rules provides for deduction of charges towards labour, services and other like charges and where they are not ascertainable from the books of accounts maintained by a developer etc., the percentage rates are prescribed in the table provided in the said rule. It is necessarily required to provide mechanism to tax only the value addition made to the goods transferred after the agreement is entered into with the flat purchaser. The ‘deductive method' as prescribed under Rule 25 does not provide for any deduction which relate to the value of the immovable property. The legislature has not made any express provision for exclusion of value of immovable property from the works contract and its method of valuation has been left to the discretion of the rule making authority to prescribe. Essentially, the value of

immovable property and any other thing done prior to the date of entering of the agreement of sale is to be excluded from the agreement value. The value of goods in a works contract in the case of a developer etc. on the basis of which VAT is levied would be the value of the goods at the time of incorporation in the works even where property in goods passes later. Further, VAT is to be directed on the value of the goods at the time of incorporation and it should not purport to tax the transfer of immovable property. Consequently, Rule 25(2) of the Rules is held to be valid by reading it down to the extent that value of land and any other thing done prior to date of entering of Agreement is to be excluded. The State Government remains bound by its affidavit dated April 24, 2014 wherein it had stated that the tax is to be levied on transfer of property in goods involved in the execution of works contract. Neither any tax is leviable nor can it be levied on price of land involved in execution of works contract. The State Government has been instructed accordingly to bring necessary changes in the Rules inconsonance with the said observations of Court.

3. **Whether the provisions of Section 42 of the Act and also Section 9 of the Act read with Rule 49of the Rules would qualify to be legal and valid?**

- Sub-section (2) of Section 42 clarifies that a contractor shall not be under any liability to pay tax in respect of a "works contract", if the same has been paid by a sub-contractor and that his assessment has become final. This provision only safeguards the interest of the revenue in the event of failure on the part of the sub-contractor to discharge his liability of tax in respect of transaction entered by the sub-contractor with the contractor. The provision, thus, cannot be said to be arbitrary, discriminatory or unreasonable in any manner.

- Further, Section 9 of the Act read with Rule 49 of the Rules and the circular dated February 10, 2014 provide for determination of the tax under composition scheme which is optional and are not the charging provisions for the levy of VAT. Once a dealer opts for composition scheme which is optional, he gets various advantages and privileges which otherwise are not available to ordinary VAT dealers. The dealer is not under any bounden duty to subscribe to this scheme. In view of the aforesaid, it was held that neither Section 9 nor Rule 49 or Circular dated February 10, 2014 can be said to be faulted.

4. **Whether the alternative remedy of appeal etc. would debar this Court to entertain the present writ petitions?**

- While deciding on the issue of entertaining writ petition in presence of alternative remedy, the Hon'ble Court referred to the decision of ***Jindal Strips Limited and another v. State of Haryana and others (1996) 100 STC 45,*** wherein it was held that it is true that ordinarily when the statute provides an alternative remedy, and particularly when there is complete machinery for adjudicating the rights of the parties, which by and large depend upon the facts, the High Court should refrain from entertaining and adjudicating upon the rights of the parties, but to this principle, there are certain exceptions and a citizen, who can successfully cover this case in either of the exceptions, cannot be shown the exit door of his entry to the High Court and be compelled to go before the authorities concerned. One of the exceptions under which a petition may lie under Article 226 of the Constitution before the High Court without availing of an alternative remedy is when the very provisions of the statute are challenged as being ultra vires of the Constitution or repugnant to the Act itself, among other such exceptions.

- In view of the aforesaid decision, the Hon'ble Court, while allowing the present writ petitions, held that the remedy of writ jurisdiction cannot be shut down particularly when the *vires* of Explanation (i) to

Section 2(1)(zg) of the Act, Rule 25(2) of the Rules and circulars issued by the Excise and Taxation Commissioner have been challenged in the writ petitions.

Vide said decision, the Hon'ble High Court has ordered setting aside assessment orders where the assessing officer has already framed assessment, and ordered for fresh assessment to be carried out in such cases. Further, in cases where notice of assessment have been initiated and no orders passed, such assessment proceedings will have to be carried out only after the State formulates some guidelines for exclusion of land.

CONCLUSION:

The detailed judgment passed by the Hon'ble High Court of Punjab and Haryana is the first decision after it has been held by the apex Court that building contracts are works contracts in the matter of ***Larsen and Toubro Ltd. v. State of Karnataka, (2013) 46 PHT 269 (SC).*** The present decision has established a very essential principle of building contracts (works contract) that land transfer cannot be made exigible to tax under VAT or works contract. Following the decision of apex Court, it has now to be seen as to how the State of Haryana would bring amendment in the definition of "sale" in order to include the transfer of property in goods involved in the immovable property and the exclusion of value of land for levy of VAT/works contract. The state VAT Acts of Delhi, UP, Maharashtra and Karnataka have already been amended to exclude the value of land from the value of building contract for levy of VAT in such states.

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