



**SUPREME COURT DECISION OF L & T (LARGER  
BENCH) TAXATION OF BUILDERS – FALL OUT  
ON OTHER CONTRACTS AND IMPACT ON DEEMED  
SALES**

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# L&T LTD (SC) LARGER BENCH

## DT.26.9.2013

- SC LB reconsidered its Division Bench ruling in **K. Raheja Development Corpn v. State of Karnataka; (2005) 5 SCC 162** as referred by its Division bench ruling in **L&T Ltd & Anr. v. State of Karnataka & Anr. SLP(C) No. 17741 of 2007**
- SC considered 14 appeals from Karnataka & 12 appeals from Maharashtra thus in all 26 appeals decided which include Promotors & Builders Asso. filed SLP # 17738 & 17709 of 2012 MCHI filed SLP (Civil) #21934 of 2012 dt 4 July 2012?
- SC ruling after 6 months of hearing, by LB of 3 Judges, for 26 appeals, running in 83 pages & 126 paras, referring 61st Law Commissions Report, 46th Amendment to Constitution, 28 prominent case laws of SC, English & Australian Court

# ANALYSIS OF THE SC JUDGMENT

- What is works contract
- What is the meaning of 'some other form'
- Dominant intention + Aspect theory
- Measure of tax
- Some other form
- Implications – liability for builders & developers -  
Other fall outs
- Summary
  - Concept
  - Action plan

# L&T LTD (SC) LARGER BENCH

## DT.26.9.2013

- Para 1 to 12: Facts of cases reconsidered & heard
- Para 13 to 16: BHC decision in MCHI & Ors – what it held
- Para 17 to 21: Arguments & Submissions (Karnataka)
- Para 22 to 38: Arguments & Submissions of Appellants in Maharashtra
- Para 39 to 43: Arguments & Submissions of Karnataka Govt
- Para 44 to 51: Arguments & Submissions of Maharashtra Govt
- Para 52 to 90: SC's reference to 61st Law Commissions Report, 46th Amendment to Constitution, 28 prominent case laws of SC, English & Australian Court distinguishing Sale Contract and Service / Works Contract; (Gannon Dunkerley, Builders Association of India, Rainbow Colorlab, ACC, B C kame, Hindustan Aeronautics, Hindustan Shipyard, Kone Elevators, BSNL, etc)
- Para 59: Stamp duty
- Para 60: Meaning of 'some other form'
- Para 64: Dominant intention
- Para 71 to 72: What is 'works contract'

# L&T LTD (SC) LARGER BENCH 26.9.2013

CONTD.....

- **Para 91 to 100:** SC framed its views & opinions on various aspects for levy of sales tax on goods involved in works contract
- **Para 101:** SC summarises legal positions qua levy of vat on goods involved in WC
- **Para 102 to 118:** Raheja Development's decision approved and applied it to Karnataka Law for L&T
- **Para 119 to 122:** Taxability of WC under MVAT Law discussed & decided
- **Para 123 to 125:** MVAT Rule 58(1A) read down & directed Mah. State Govt to bring clarity about deductions for Land & labour to compute value of goods involved in WC for a unit sold in an under construction building; Double Taxation shall be avoided

# WHAT IS WORKS CONTRACT - MCHI (BHC) 51:VST:168 (BOM)

- **Para 14:** " *The Division Bench of the BHC on examination of rival contentions has, inter alia, held;*

*(a) works contract have numerous variations and it is not possible to accept the contention either as a matter of principle or as a matter of interpretation that a contract for works in the course of which title is transferred to the flat purchaser would cease to be works contract;*

*(b) the provisions of MOFA recognise an interest of the purchaser of the apartment, not only in respect of the apartment which forms the subject matter of the purchase, but also an undivided interest, described as a percentage in the common areas and facilities;*

*(c) the amendment to Section 2(24) clarifies the legislative intent that a transfer of property in goods involved in the execution of works contract including an agreement for building and construction of immovable property would fall within the description of a sale of goods within the meaning of that provision and it brings within the ambit of that expression "transactions of that nature" which are referable to Article 366 (29-A)(b);*

*(d) by amended definition of the expression "sale" in clause (b)(ii) of the explanation to Section 2(24), the transactions which involve works contract have been covered;*

*(e) the amendment in Section 2(24) does not transgress the boundary set out in Article 366(29-A);*

*(f) Rule 58(1A) of the MVAT Rules provides that in the case of construction contracts where the immovable property, land or as the case may be, interest therein is to be conveyed and the property involved in the execution of the construction contract is also transferred, it is the latter component which is brought to tax; the value of the goods at the time of transfer is to be calculated after making the deductions which are specified under sub-rule (1); and*

*(g) Rule 58(1A) provides for a measure for the tax by excluding the cost of the land."*

# WHAT IS WORKS CONTRACT - MCHI (BHC)

## 51:VST:168 (BOM) CONTD.....

- Para 71: *".... To say that insertion of clause (29-A) in Article 366 has not undone Gannon Dunkerley-I in any manner, in our view, is not correct. **The narrow meaning given to the term "works contract" in Gannon Dunkerley-I now no longer survives.***
- Para 72: There is no doubt that to attract Article 366(29-A)(b) there has to be a works contract but then what is its meaning. The term "works contract" needs to be understood in a manner that the Parliament had in its view at the time of Forty-sixth Amendment and which is more appropriate to Article 366(29-A)(b).
- Para 76: ***"In our opinion, the term 'works contract' in Article 366(29-A)(b) is amply wide and cannot be confined to a particular understanding of the term or to a particular form. The term encompasses a wide range and many varieties of contract."***
- Para 94: For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, in our opinion, three conditions must be fulfilled:
  - (i) there must be a works contract,
  - (ii) the goods should have been involved in the execution of a works contract, and
  - (iii) the property in those goods must be transferred to a third party either as goods or in some other form.

In a building contract or any contract to do construction, the above three things are fully met. In a contract to build a flat there will necessarily be a sale of goods element. Works contracts also include building contracts and therefore without any fear of contradiction it can be stated that building contracts are species of the works contract.

# WORKS CONTRACT MEANS? TAXABLE EVENT IN WC?

## - DOMINANT INTENTION

- **Para 62:** *"The States have now been conferred with the power to tax indivisible contracts of works. ....by enlarging the scope of "tax on sale or purchase of goods" .... in Entry 54 of List II of Seventh Schedule when read with the definition clause 29-A, includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract. The taxable event is deemed sale.*
- **Para 64:** *"...Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract....."*
- **Para 66:** Leaving no ambiguity, it said that after the Forty-sixth Amendment, the sale element of those contracts which are covered by six subclauses of clause 29-A of Article 366 are separable and may be subjected to sales tax by the States under Entry 54 of List II and there is no question of the dominant nature test applying.
- **Para 71:** *"....To say that insertion of clause (29-A) in Article 366 has not undone Gannon Dunkerley-I in any manner, in our view, is not correct. The narrow meaning given to the term "works contract" in Gannon Dunkerley-I now no longer survives."*



## WORKS CONTRACT MEANS? TAXABLE EVENT IN WC?

### - DOMINANT INTENTION CONTD.....

- **Para 76:** *"In our opinion, the term 'works contract' in Article 366(29-A)(b) is amply wide and cannot be confined to a particular understanding of the term or to a particular form. The term encompasses a wide range and many varieties of contract."*
- **Para 91:** *"In our opinion, the tests laid down in Hindustan Shipyard after Forty-sixth Amendment are **not** of much help in determining whether a contract is a works contract or sale of goods."*
- **Para 92:** *"In our opinion, the distinction between contract for sale of goods and contract for work (or service) has almost diminished in the matters of composite contract involving both (a contract of work/labour and a contract for sale for the purposes of Article 366 (29-A)(b). Now **by legal fiction** under Article 366(29-A)(b), it is permissible to make such contract divisible by separating the transfer of property in goods as goods or in some other form from the contract of work and labour. A transfer of property in goods under clause 29(A)(b) of Article 366 is **deemed to be a sale of goods** involved in the execution of a works contract .... For this reason, the **traditional decisions** which hold that the substance of the contract must be seen **have lost their significance**. What was viewed traditionally has to be now understood in light of the philosophy of Article 366(29-A)."*

# WORKS CONTRACT MEANS? TAXABLE EVENT IN WC?

## - DOMINANT INTENTION CONTD.....

- Para 94 & 101(i): "***For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, in our opinion, three conditions must be fulfilled:***

*(i) there must be a works contract,*

*(ii) the goods should have been involved in the execution of a works contract, and*

*(iii) the property in those goods must be transferred to a third party either as goods or in some other form.*

***In a building contract or any contract to do construction, the above three things are fully met. In a contract to build a flat there will necessarily be a sale of goods element. Works contracts also include building contracts and therefore without any fear of contradiction it can be stated that building contracts are species of the works contract."***

- ***Para 96: "Value addition as a concept after Forty-sixth Amendment to the Constitution has been accepted by this Court in P.N.C. Construction (2007) 7 SCC 320. While dealing with this concept, the Court said that value addition was important concept which had arisen after the Forty-sixth Amendment by insertion of sub-clause (b) of clause (29-A) in Article 366. It has now become possible for the States to levy sales tax on the value of the goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods in a building contract. On account of the Forty-sixth Amendment in the Constitution the State Governments are empowered to levy sales tax on the contract value which earlier was not possible.***

## ARGUMENTS & SUBMISSIONS BY COUNSEL OF APPELLANTS IN MAHARASHTRA & GOVERNMENT COMPUTATION OF VALUE OF GOODS INVOLVED IN WC:

- **Para 29:** *"As regards constitutional validity of the provisions of Rule 58(1) and 58(1A) of MVAT Rules, it is submitted that these Rules and Rule 58(1-A) of the 2005 Rules include an element of profit earned by a Promoter/ developer on the sale of a flat. **There are no provisions to take the profit element from arriving at the value of goods. As a result income earned by the promoter/developer from the profit on sale of the flat also gets included in the value of goods and eventually the said income gets taxed. Imposition of such tax on the income of the promoter/developer is beyond the legislative competence of the State Government."***
- **Para 46:** *".... According to learned Advocate General, it has now become possible for the States to levy sales tax on the value of the goods involved in the works contract in the same way in which the sales tax was leviable on the price of the goods supplied in a building contract. This is where the concept of "value addition" comes in. It is on account of Fortysixth Amendment to the Constitution that the State Government is empowered to levy sales tax on the contract value which earlier was not possible.*

**ARGUMENTS & SUBMISSIONS BY MAHARASHTRA  
GOVERNMENT COMPUTATION OF VALUE OF GOODS  
INVOLVED IN WC: CONTD.....**

- ***Para 48: “.....The submission of the learned Advocate General is that transfer of immovable property cannot be taxed as a sale of goods but there is no constitutional bar to tax only the sale of goods element and separately tax the transfer of immovable property. Taxing the sale of goods element in a works contract under Article 366 (29-A)(b) read with Entry 54 List II is permissible, provided the tax is directed to the value of the goods and does not purport to tax the transfer of immovable property.”***

## COMPUTATION OF VALUE OF GOODS INVOLVED IN WC: OBSERVATIONS OF SC:

- **Para 68:** *“Though the tax is imposed on the transfer of property in goods involved in the execution of a works contract, the measure for levy of such imposition is the **value of the goods involved in the execution of a works contract.** Since, **the taxable event** is the transfer of property in goods involved in the execution of a works contract and the said transfer of property in such goods takes place when the goods are incorporated in the works, **the value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works and not the cost of acquisition of the goods by the contractor.**”*
- **Para 70:** *“The Forty-sixth Amendment leaves no manner of doubt that the States have power to bifurcate the contract and levy sales tax on the value of the material involved in the execution of the works contract. The States are now empowered to levy sales tax on the material used in such contract. In other words, clause 29-A of Article 366 empowers the States to levy tax on the deemed sale.”*

## COMPUTATION OF VALUE OF GOODS INVOLVED IN WC: OBSERVATIONS OF SC:

- Para 100: "***We have no doubt that the State legislatures lack legislative power to levy tax on the transfer of immovable property under Entry 54 of List II of the Seventh Schedule. However, the States do have competence 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..... In para 88 of Bharat Sanchar, the Court stated: "the aspects theory does not however allow the State to entrench upon the Union List and tax services by including the cost of such service in the value of the goods. Even in those composite contracts which are by legal fiction deemed to be divisible under Article 366(29-A), the value of the goods involved in the execution of the whole transaction cannot be assessed to sales tax". Having said that, the Court also stated that the States were not competent to include the cost of service in the value of the goods sold (i.e. the sim card) nor the Parliament could include the value of the sim card in the cost of services. But the statement in para 92(C) of the Report is clear that it is upto the States to tax the sale of goods element in a composite contract of sale and service. Bharat Sanchar thus supports the view that taxation of different aspects of the same transaction as separate taxable events is permissible.***"

# SOME OTHER FORM

- MEANING - Para 60
  - The expression “in some other form” in the bracket is of utmost significance as by this expression the ordinary understanding of **the term ‘goods’ has been enlarged** by bringing within its fold goods in a form other than goods. Goods in some other form would thus mean goods which have ceased to be chattels or movables or merchandise and become attached or embedded to earth. In other words, goods which have by incorporation become part of immovable property are deemed as goods. The definition of ‘tax on the sale or purchase of goods’ **includes a tax on the transfer or property in the goods as goods or which have lost its form as goods and have acquired some other form involved in the execution of a works contract.**
- Includes ‘immovable form’?
- Would abstract form mean other form?
  - What is the fate of M/s. Matushree Textiles (BHC)?

## SC SUMMARISES LEGAL POSITION QUA WC IN SALE OF A UNIT IN UNDER CONSTRUCTION BUILDING AT PARA 101:

- Para 101: SC summarises legal positions for levy of sales tax on goods involved in sale of a unit in under construction building :
- Para 101(i): "*(i) For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, **three conditions must be fulfilled:***
  - (1) *there must be a works contract,*
  - (2) *the goods should have been involved in the execution of a works contract and*
  - (3) *the property in those goods must be transferred to a third party either as goods or in some other form."*
- **Para 101(ii): "For the purposes of Article 366(29-A)(b), in a building contract or any contract to do construction, if the developer has received or is entitled to receive valuable consideration, the above three things are fully met. It is so because in the performance of a contract for construction of building, the goods (chattels) like cement, concrete, steel, bricks etc. are intended to be incorporated in the structure and even though they lost their identity as goods but this factor does not prevent them from being goods."**



## SC SUMMARISES LEGAL POSITION QUA WC IN SALE OF A UNIT IN UNDER CONSTRUCTION BUILDING AT PARA 101

- **Para 101(iii):** *“Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. The term “works contract” in Article 366 (29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. **Nothing in Article 366(29-A)(b) limits the term “works contract”.***
- **Para 101(iv):** *“Building contracts are species of the works contract.”*
- **Para 101(v):** *“A contract may involve both a contract of work and labour and a contract for sale. **In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.**”*
- **Para 101(vi):** *“The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A).... . The enforceability test is also not determinative.”*

## SC SUMMARISES LEGAL POSITION QUA WC IN SALE OF A UNIT IN UNDER CONSTRUCTION BUILDING AT PARA 101

- Para 101(vii): *"A transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made."*
- **Para 101(viii):** *"Even in a single and indivisible works contract, by virtue of the legal fiction introduced by Article 366(29-A)(b), there is a deemed sale of goods which are involved in the execution of the works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for the sale of goods and the other for supply of labour and services. In other words, the single and indivisible contract, now by Forty-sixth Amendment has been brought on par with a contract containing two separate agreements and **States have now power to levy sales tax on the value of the material in the execution of works contract.**"*

## SC SUMMARISES LEGAL POSITION QUA WC IN SALE OF A UNIT IN UNDER CONSTRUCTION BUILDING AT PARA 101

- Para 101 (xi): "***Taxing the sale of goods element in a works contract under Article 366(29-A)(b) read with Entry 54 List II is permissible even after incorporation of goods provided tax is directed to the value of goods and does not purport to tax the transfer of immovable property. The value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works even though property passes as between the developer and the flat purchaser after incorporation of goods.***"

## K. RAHEJA DEV. CORP. VS ST OF KARNATAKA (2005) 5 SCC 162 (SC) REFERRED TO

- Para 107: Raheja Development's SC ruling reproduced:
  - "(i) The definition of the term "works contract" in the Act is an inclusive definition.*
  - (ii) It is a wide definition which includes "any agreement" for carrying out building or construction activity for cash, deferred payment or other valuable consideration.*
  - (iii) The definition of works contract does not make a distinction based on who carries on the construction activity. **Even an owner of the property may be said to be carrying on a works contract if he enters into an agreement to construct for cash, deferred payment or other valuable consideration.***
  - (iv) The developers had undertaken to build for the prospective purchaser.*
  - (v) Such construction/development was to be on payment of a price in various installments set out in the agreement."*

## K. RAHEJA DEV. CORP. VS ST OF KARNATAKA (2005) 5 SCC 162 (SC) REFERRED TO

- Para 107: Raheja Development's SC ruling reproduced:
  - "(vi) The developers were not the owners. They claimed lien on the property. They had right to terminate the agreement and dispose of the unit if a breach was committed by the purchaser. A clause like this does not mean that the agreement ceases to be "works contract". So long as there is no termination, the construction is for and on behalf of the purchaser and it remains a "works contract".*
  - (vii) If there is a termination and a particular unit is not resold but retained by the developer, there would be no works contract to that extent.***
  - (viii) If the agreement is entered into after the flat or unit is already constructed then there would be no works contract. But, so long as the agreement is entered into before the construction is complete it would be works contract."***

## TAXABLE EVENT IN BUILDING CONSTRUCTION: STAGE FROM WHICH VAT LIABLE: IMPORTANCE OF DATE OF CONTRACT WITH FLAT BUYER

- Para 115: ***"It may, however, be clarified that activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government."***
- Para 117: ***"The submission of Mr. K.N. Bhat (Karnataka Govt) that the view in Raheja Development that when a completed building is sold, there is no work contract and, therefore, no liability to tax is not correct statement of law, does not appeal to us. If at the time of construction and until the construction was completed, there was no contract for construction of the building with the flat purchaser, the goods used in the construction cannot be deemed to have been sold by the builder since at that time there is no purchaser. That the building is intended for sale ultimately after construction does not make any difference."***

# APPROVAL OF K. RAHEJA DEV. RULING DT 5.5.2005 SC

- **Para 118.** *"We are clearly of the view that Raheja Development lays down the correct legal position and we approve the same."*
- Para 121: *"..... Thus, in our view, there is no merit in the challenge to the constitutional validity to the provisions of explanation (b)(ii) to Section 2(24) of MVAT which were amended with effect from 20.06.2006...."*  
Excerpts from Para 34 of BHC decision in MCHI:  
*" ..... Whether there is a works contract in a given case is for assessing authorities to determine....  
..... the amended definition in the State legislation in the present case provides a clarification or clarificatory instances...."*
- **Para 122:** *"We are in agreement with the above view and reject challenge to amendment to the provisions of explanation (b)(ii) to Section 2(24) of MVAT Act."*

## MODE OF VALUATION OF GOODS PROVIDED UNDER RULE 58(1A) NEEDS CLARITY FROM MAHARASHTRA STATE GOVT

- Para 123: "***Sub-rule (1A) was inserted into Rule 58 by a notification dated 01.06.2009....***  
..... ***The challenge was laid to Rule 58(1A) of the MVAT Rules before the Bombay High Court.....***"
- Para 124: "***The value of the goods which can constitute the measure of the levy of the tax has to be the value of the goods at the time of incorporation of goods in the works even though property in goods passes later. Taxing the sale of goods element in a works contract is permissible even after incorporation of goods provided tax is directed to the value of goods at the time of incorporation and does not purport to tax the transfer of immovable property. The mode of valuation of goods provided in Rule 58(1A) has to be read in the manner that meets this criteria and we read down Rule 58(1-A) accordingly. The Maharashtra Government has to bring clarity in Rule 58 (1-A) as indicated above. Subject to this, validity of Rule 58(1-A) of MVAT Rules is sustained.***"



## DOUBLE TAXATION TO BE AVOIDED

- Para 125: *"Once we have held that Raheja Development<sup>1</sup> lays down the correct law, **in our opinion**, nothing turns on the circular dated 07.02.2007 and the notification dated 09.07.2010. **The circular is a trade circular which is clarificatory in nature only.** The notification enables the registered dealer to opt for a composition scheme. The High Court has dealt with the circular and notification. **We do not find any error in the view of the High Court in this regard. Moreover, the Advocate General for Maharashtra clearly stated before us that implementation of Rule 58(1-A) shall not result in double taxation and in any case all claims of alleged double taxation will be determined in the process of assessment of each individual case."***
- Para 126: *"After having given answer to the reference, we send the matters back to the Regular Bench for final disposal."*

# WAY FORWARD POST L&T SC 26-9-2013

- Await for ruling from regular bench of SC in respective cases (MCHI, BAI, Promoters & Builders Asso., etc)
- Maharashtra Govt has to bring in clarity in Rule 58(1A) to grant proper deduction for value of land (Cost, FSI, TDR, SDRR, etc) & labour (various clauses) to arrive at value of goods which can be taxed as directed by SC in Para 124 of ruling
- Maharashtra Govt shall implement Rule 58(1A) such that it shall not result in double taxation in any case as committed by AG before SC in Para 125
- Computation Rule shall be modified such that goods used till the stage of execution of the agreement with flat purchaser is not taxed as held by SC in Para 115 & 117
- Till above verdict of SC is honored, assessment cannot be made & recovery be stayed
- BHC Ruling dt 30 Oct 2012 in Ashok R Gokani & Marathi Bandhkam Asso. held that “whether a contract constitutes a WC or involves an element of WC is a matter which shall be decided on facts of individual case in accordance with provisions of MVAT Act”

## WAY FORWARD POST L&T SC 26-9-13

- ADM relief orders shall be passed soon (2 days mentioned in circular) as confirmed by Commissioner in Trade Circular # 14T dt 6 Aug 2012 & 17T dt 25 Sep 2012
- Coercive recovery of tax, interest or penalty shall remain stayed in cases where dealer followed Trade Circular # 17T dt 25 Sep 2012 & obtained registration on or before 15 Oct 2012 and paid taxes & filed Returns upto 31 Oct 2012 as per directions of SC. The said payment shall be subject to final decision of SC.
- Interest & penalty shall not be levied in such a case where basic levy & computation mechanism is before SC abinito; Govt shall be fair to taxpayer
- New projects of RD Developers, shall apply composition scheme of 1% of agreement value or stamp duty value, whichever higher, or vat provisions depending upon facts of each case.

# SUMMARY – L&T (LB) SUPREME COURT

- The SC has held that
- Building contracts are species of works contract. The term work contract means to construct and has very wide connotation.
- Developer had undertaken to build for the flat purchaser and so long as there was no termination of the contract, the construction is for and on behalf of the purchaser and it remains the works contract.
- Just because a contract comprises both works contract and a transfer of immovable property [undivided shares in land] by itself would not take out its character from being 'works contract'.
- Article 366(29-A)(b) – the term works contract takes within its fold all genre of works contract and is not restricted to one species of contract to provide for labour and services alone. The Article does not limit the term works contract.

# SUMMARY – L&T (LB) SUPREME COURT CONTD...

- In composite contract [contract of work and labour and a contract for sale], the distinction between contract for sale of goods and contract for work is virtually diminished.
- The 'dominant nature test' has no application and the traditional decisions which have held the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A).
- 'Dominant intention' – need not be seen. Even if in the case of rendering service where the ultimate transaction is transfer of immovable property – it is open to the state to levy sales tax (VAT) on the material used in such contract. If such contract otherwise has element of works contract. Therefore, if there is a works contract it is possible that value of every transfer of property will be subjected to VAT

# SUMMARY – L&T (LB) SUPREME COURT

## CONTD...

- VAT is applicable on the value of the material transferred during the execution of works contract. Therefore, 'measure of levy of tax' has to be the value of goods at the time of incorporation of goods in the works even though property of goods passes later.
- [para 124]. Rule 58(1A) providing for land cost deduction based on 'Ready reckoner value' is read down accordingly i.e. Maharashtra Govt is directed to bring clarity in Rule 58(1A) as held by the SC. This gives hope that cost + GP method [appeal which is pending in SC in another case].
- It is likely that the SC may approve 'cost +GP' method of calculation of method of liability in yet to be heard in SC appeal. It is also likely that the State Govt. / Commissioner may come out with guidance in this respect.
- If a flat buyer books the flat when the construction is part completed, he is liable to pay tax only in respect of value of material which is passed subsequent to enter into contract. This supports the 'progressive method' of calculation of VAT based on cumulative booking of flats on periodical basis. In some cases, this may call for reworking. However, in large project this method may not be that practical.

# DEPARTMENTAL ACTION – EXPECTED

## Dept is likely to take following action:

- To initiate recovery of tax in cases where returns / MVAT audit report is filed but tax is outstanding.
  - Coercive method may be adopted for recovery by attaching bank account / recovering from debtors etc.
  - Wherever taxes collected not deposited - penal action may also be initiated.
  - Where returns are not filed and tax liability is not disclosed - ex-parte assessment with huge liability may be passed
  - Registration under the VAT Act will be strictly insisted and penal action for non-registration may start.
- Interim order of SC protecting the levy of interest and penalty is no more available & therefore dept. may initiate recovery thereof.
- ITC [wherever claimed] on purchases which are declared as 'hawala purchase' will be reversed and tax along with interest penalty required to be made good.
- Since the computation for each project / company is unique in its character; it is likely that dept. may dispute the same.
- Dept. is expected to come out with updated FAQ considering the observation of the SC. This FAQ ought to be in form of a Trade Circular.

# ACTION POINTS – BUILDERS / ASSOCIATION

## **What is expected from builder / MCHI / BAI and other trade bodies of builder:**

- Be prepared for assessments /departmental audit /scrutiny for all the years -2006-07 to 2012-13.
- Get the accounts audited u/s 61 of the MVAT act for periods 2006-07 to 2012-13.
- Approach the Ministry / Comm. of Sales tax and get clarity on
  - Computation of tax
  - Deduction in respect of land TDR and other incidental expenses
  - Cost plus GP method
  - Etc.



# ACTION POINTS – BUILDERS / ASSOCIATION

CONTD.....

- Approach Ministry:
  - Since the computation is prone to litigation; the ministry may be approached again to have the composition scheme of 1% effective from 20.6.2006. This will save lot of litigation and high handed assessments in the majority of the cases.
  - Get relief in interest and penalty in all cases whether applied for registration , filed return and pay taxes or filed audit report in time or not.
- Since the builders in majority of the cases were not registered have not filed the returns say for period 2006-07 in time, the time-barring limitation for assessment may be considered as 8 years and may not be rushed for all years at one go.
- Sympathetic approach may be taken and instalments granted in cases where builders have not been able to collect taxes [or may have collected partly] and are paying taxes from their pocket. On application, suitable instalments may be allowed to make such payments.

*THANK YOU*