IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 03.06.2016

+ **W.P.(C) 2235/2011**

SURESH KUMAR BANSAL ..... Petitioner
Through: Mr Puneet Agrawal and Mr Sahil Kahol, Advocates.

versus

UNION OF INDIA & ORS. ..... Respondents
Through: Mr Vivek Goyal, CGSC with Mr Prabhakar Srivastav, Advocate for UOI.

AND

+ **W.P.(C) 2971/2011**

ANUJ GOYAL & ORS. ..... Petitioners
Through: Mr Puneet Agrawal and Mr Sahil Kahol, Advocates.

versus

UNION OF INDIA & ORS. ..... Respondents
Through: Mr Vivek Goyal, CGSC with Mr Prabhakar Srivastav, Advocate for UOI.
Mr Sanjoy Ghose, Additional Standing Counsel for the GNCTD with Mr Yash S. Vijay, Advocate for R-3/GNCTD.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. The Petitioners are individuals who have entered into separate agreements with a builder (M/s Sethi Buildwell Pvt. Ltd. - hereafter 'the

builder') to buy flats in a multi-storey group housing project named "Sethi Group - Max Royal" being developed by the builder in Sector 76, Noida, Uttar Pradesh.

2. The builder has in addition to the consideration for the flats also recovered service tax from the Petitioners, which is payable by him for services in relation to construction of complex and on preferential location charges.

3. The Petitioners are aggrieved by the levy of service tax on services 'in relation to construction of complex' as defined under Section 65 (105)(zzzh) of the Finance Act, 1994 (hereafter 'the Act') and *inter alia* impugn the explanation to Section 65(105)(zzzh) of the Act (hereafter 'the impugned explanation') introduced by virtue of Finance Act 2010 as being *ultra vires* of the Constitution of India. The Petitioners also impugn Section 65(105)(zzzzu) of the Act which seeks to subject preferential location charges charged by a builder to service tax. The Petitioners state that their agreement with the builder is a composite contract for purchase of immovable property and contend that in absence of specific provisions for ascertaining the service component of the said agreement, the levy would be beyond the legislative competence of the Parliament.

4. The controversy involved in these petition relates to the question whether the consideration paid by flat buyers to a builder/promoter/developer for acquiring a flat in a complex, which under construction/development, could be subjected to levy of service tax. According to the Petitioners, the agreements entered into by them with the builder are for purchase of immovable property and the Parliament does not have the legislative competence to levy service tax on such transaction. The Petitioners further claim that the Act and the rules made thereunder do not provide any machinery for computation of value of services, if any, involved in construction of a complex and, therefore, no such tax can be imposed.

Submissions

5. Mr Puneet Aggarwal, the learned counsel appearing for the Petitioners contended that the entries relating to taxation in List I and List II of the Seventh Schedule to the Constitution of India were mutually exclusive and the Parliament did not have the power to levy tax on immovable property; thus, the levy of service tax on agreements for purchase of flats was beyond the legislative competence of the Parliament.

6. He referred to the decision from the Supreme Court in ***Larsen & Toubro Ltd. and Anr. v. State of Karnataka and Anr.: (2014) 1 SCC 708*** and on the strength of the said decision contended that 'works contracts' have been interpreted in an expansive manner and would include an agreement entered into by a flat buyer with a builder. Thus, the State Legislatures would have the power to tax the element relating to transfer of property in goods which are involved in such contracts. Consequently, the power of Parliament to levy tax would be limited to only on the service component after excluding the value of goods as well as the value of land from such contracts. He submitted that since neither the Act nor the rules made thereunder provide any machinery provisions for ascertaining the service component of such composite contracts, the levy of service tax must fail. Mr Agrawal relied on the recent decision of the Supreme Court in ***Commissioner Central Excise and Customs, Kerala and Ors. v. Larsen & Toubro Ltd. and Ors.: (2016) 1 SCC 170*** in support of his contention that in order to levy tax, the Statute must clearly specify the three elements of taxation, namely, (i) the subject of tax; (ii) the person who is liable to tax; and (iii) the rate and measure of tax. He earnestly contended that since Section 65(105)(zzzh) read with Section 66 of the Act did not restrict the levy of service tax only to the service element of composite contracts, the said provisions could be applied only for imposition of service tax on

service contracts *simplicitor* and their application to composite contracts would render the said provisions unconstitutional.

7. Next, Mr Agrawal referred to the decision of this Court in ***G.D. Builders. v. Union of India and Anr.***: ***(2013) SCC OnLine Del 4543*** and pointed out that this Court had examined the challenge to levy of service tax on composite contracts, including in the context of Section 65(105)(zzzh) of the Act, and had upheld the levy even in absence of any rule for ascertaining the element of service component. He pointed out that this decision was overruled by the Supreme Court in ***Commissioner Central Excise and Customs, Kerala v. Larsen & Toubro Ltd.*** (*supra*) by accepting the Assessee's contention that the charging Section must itself specify that the service tax is only on the service element of a composite contract and the statutory framework must provide for machinery provisions to ascertain the value of such element for the purposes of service tax. He contended that since, in the present case, the provisions to ascertain the service element were insufficient, the levy of service tax must fail.

8. Mr Agrawal further contended that there was no service element in preferential location charges which were levied by a builder and the same related only to the location of the immovable property and, therefore, such charges were not exigible to service tax.

9. Next, Mr Agrawal contended that with effect from 1st July, 2012 the Act has been amended and service tax was imposed on all services other than those specified in the negative list. He submitted that services covered under Section 65(105)(zzzh) and 65(105)(zzzzu) are now sought to be taxed by virtue of Section 66E(b) read with Section 65B(22) and Section 65B(44) of the Act. He submitted that the challenge laid by the Petitioners to the provisions of Section 65(105)(zzzh) and 65(105)(zzzzu) of the Act would also be equally valid for the taxing provisions introduced with effect from 1st July, 2012.

10. Lastly, Mr Agrawal contended that for levy of service tax, it is necessary that there should be a service provider and service recipient. Therefore, only the services rendered after execution of the flat buyer's agreement could be subjected to tax as prior to the said date, in absence of the service recipient, the service in relation to construction of a complex, if any, is rendered by the builder to itself and cannot be subjected to service tax. He referred to the decision of the Supreme Court in ***Larsen & Toubro Ltd. v. State of Karnataka*** (*supra*) in support of this contention.

11. Ms Sonia Sharma, learned counsel appearing for the Revenue read extensively from the decisions of the Karnataka High Court rendered on ***12th December, 2012 in W.P.(C) 24050-51/2010*** (***Confederation of Real***

Estate Developers' Association and Anr. v. Union of India & Ors) and the Bombay High Court delivered on ***20th January, 2012 in W.P.(C) 1456/2010 (Maharashtra Chamber of Housing Industry and Anr. v. Unoin of India and Ors)*** wherein the challenge to the explanation to Section 65(105)(zzzh) and Section 65(105)(zzzzu) introduced by virtue of the Finance Act, 2010 was rejected. On the strength of the aforesaid decisions, she contended that the concerned legislative amendment introduced by the Finance Act, 2010, namely, insertion of explanation to Section 65(105)(zzzh) and clause (zzzzu), were valid and enforceable. She submitted that development of a project results in the substantial value addition on bare land and includes various services such as consulting services, engineering services, management services, architectural services etc. These services are subsumed in the taxable service as contemplated under Section 65(105)(zzzh) of the Act. She further submitted that as the gross charges include value of land and construction material, only 25% of the Base Selling Price (BSP) charged by a builder from the ultimate consumer is subjected to levy of service tax. However in case of preferential location charges, the entire amount charged by a developer is for value addition and, therefore, the gross amount charged for such services is chargeable to service tax under Section 66 read with Section 65(105)(zzzzu) of the Act.

Discussion and Conclusion

12. Service tax was introduced for the first time in India in 1994 by virtue of the Finance Act, 1994. In his Budget speech, the then Finance Minister explained that the service tax was being introduced on the recommendation of the Tax Reforms Committee - Dr. Raja Chelliah Committee on tax reforms - which had recommended imposition of tax on services as a measure for broadening the base of indirect taxes. He observed that service sector accounted for 40% of the GDP and there was no sound reason for exempting services from taxation. Chapter V of the Finance Act, 1994 contained the relevant provisions for the said levy. At the material time none of the specific entries under any of the Lists of the Seventh Schedule to the Constitution of India contemplated the levy of service tax; thus, the levy of service tax could be related only to the residuary entry in the Union List-Entry 97 of the List-I of the Seventh Schedule. Subsequently, the Constitution (88th Amendment) Bill, 2003 was introduced pursuant to which the Constitution was amended by, *inter alia*, insertion of Article 268A as well as Entry 92C in List-I of the Seventh Schedule to the Constitution of India. Article 268A(1) provided that taxes on services shall be levied by the Government of India and such tax shall

be collected in a manner as provided in Article 268A(2) of the Constitution of India.

13. However, Finance Act, 1994 continues to be the legislative enactment by virtue of which service tax is levied. The said Act has been amended extensively since its enactment in 1994. Over a period of time, various services were brought within the scope of the levy of service tax by expanding the definition of "taxable services" under Section 65(105) of the Act. The Finance Act, 2012 brought about a paradigm shift in the service tax regime; with effect from 1st July, 2012, Section 65(105) of the Act was deleted and all services as defined under Section 65B (44) except as specified under Section 66D of the Finance Act, 2012 (negative list) were chargeable to service tax.

14. In the present petition we are concerned with clauses (zzzh) and (zzzzu) of Sub-section 105 of Section 65 of the Act as were applicable at the material time. Clause (zzzh) was introduced in Section 65(105) of the Act by the Finance Act, 2005, with effect from 16th June, 2005, to bring services in relation to construction of a complex within the definition of 'taxable service'. When introduced, Section 65(105)(zzzh) of the Act read as under:-

"S.65 (105) "Taxable Service" means any service provided or to be provided:-

xxxx xxxx xxxx xxxx xxxx

(zzzh) to any person, by any other person, in relation to construction of complex"

15. The term "construction of complex" was defined under Section 65(30a) of the Act as under:

"(30a) 'construction of complex' means--

(a) construction of a new residential complex or a part thereof,· or

(b) completion and finishing services in relation to residential complex such as glazing, plastering, painting, floor and wall tiling, wall covering and wall papering, wood and metal joinery and carpentry, fencing and railing, construction of swimming pools, acoustic applications or fittings and other similar services; or

(c) repair, alteration, renovation or restoration of, or similar services in relation to, residential complex."

16. The term 'residential complex' is defined under Section 65(105)(91a) as under:-

"(91a) "residential complex" means any complex comprising of— (i) a building or buildings, having more than twelve residential units; (ii) a common area; and (iii) any one or more of facilities or services such as park, lift, parking space, community hall, common water supply or effluent treatment system, located within a premises and the layout of such premises is approved by an authority under any law for the time being in force, but does not include a complex which is constructed by a person directly engaging any other person for

designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person.

Explanation. — For the removal of doubts, it is hereby declared that for the purposes of this clause,

(a) "personal use" includes permitting the complex for use as residence by another person on rent or without consideration;

(b) "residential unit" means a single house or a single apartment intended for use as a place of residence;"

17. The Petitioners have referred to various circulars issued by the Central Board of Excise and Customs (CBEC) which, according to the Petitioner, clarified that the taxable service under clause (zzzh) did not cover builders who were developing and selling immovable property. In this context, Circular No.108/02/2009 - ST dated 29th January, 2009 is relevant. The relevant extract of the said Circular is reproduced below:-

"3. The matter has been examined by the Board. Generally, the initial agreement between the promoters / builders / developers and the ultimate owner is in the nature of agreement to sell'. Such a case, as per the provisions of the Transfer of Property Act, does not by itself create any interest in or charge on such property. The property remains under the ownership of the seller (in the instant case, the promoters/builders/developers). It is only after the completion of the construction and full payment of the agreed sum that a sale deed is executed and only then the ownership of the property gets transferred to the ultimate owner. Therefore, any service provided by such seller in connection with the construction of residential complex till the execution of such sale deed would be in the nature of 'self-service' and consequently would not attract service tax. Further, if the ultimate owner enters into a contract for construction of a

> residential complex with a promoter / builder / developer, who himself provides service of design, planning and construction; and after such construction the ultimate owner receives such property for his personal use, then such activity would not be subjected to service tax, because this case would fall under the exclusion provided in the definition of 'residential complex'. However, in both these situations, if services of any person like contractor, designer or a similar service provider are received, then such a person would be liable to pay service tax."

18. The counter affidavit filed on behalf of the Respondents also affirms the above Circular as clarifying that service tax was not applicable in respect of construction/development by a developer/builder engaged in the business of developing real estate for selling units to prospective buyers. It is affirmed on behalf of the Respondents that the "*Circular was issued within the existing law because at that time, no service tax was applicable on such services within the Finance Act, 1994. The same was specifically inserted by way of amendment in the Finance Act, 2010*". Thus, even according to the Respondents, prior to the Finance Act, 2010 -by virtue of which the impugned explanation to Section 65(105)(zzzh) and clause (zzzzu) were introduced - service tax was not chargeable on builders/developers who were engaged in construction of real estate residential projects and selling residential units in those projects to prospective buyers. Thus, unless the builder was rendering the service of

construction of a complex *simplicitor*, no service tax was chargeable for service covered under clause (zzzh) of Section 65(105) of the Act.

19. It is relevant to note that at the material time, Section 67 of the Act which provided for the valuation of taxable services for charging service tax, read as under:-

> "67 – Valuation of taxable services for charging service tax. – For the purposes of this Chapter, the value of any taxable service shall be the gross amount charged by the service provider for such service provided or to be provided by him.
>
> Explanation 1. – For the removal of doubts, it is hereby declared that the value of a taxable service, as the case may be, **includes**–
>
> (a) the aggregate of commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage by the stock-broker to any sub-broker;
>
> (b) the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;
>
> (c) the amount of premium charged by the insurer form the policy holder;
>
> (d) the commission received by the air travel agent from the airline;
>
> (e) the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;
>
> (f) the reimbursement received by the authorized service station from manufacturer for carrying out any service of any

motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer; and

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

but does not include –

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

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

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

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

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

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

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

viii. interest on loans.

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

Explanation. 3. - For the removal of doubts, it is hereby declared that the gross amount charged for the taxable service

shall include any amount received towards the taxable service before, during or after provision of such service."

20. By virtue of Finance Act, 2010, an explanation was added to Section 65(105)(zzzh) which is impugned in these petitions. After the insertion of the impugned explanation, the said clause read as under:

"S.65 (105) "Taxable Service" means any service provided or to be provided:-

xxxx xxxx xxxx xxxx xxxx

"(zzzh) to any person, by any other person, in relation to construction of complex"

[Explanation:. For the purposes of this sub-clause, construction of a complex which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer;]"

21. Clause (zzzzu) was also introduced in Section 65(105), the effect of which was to subject the preferential location charges charged by a builder to service tax as a taxable service. The said clause is set out below:

"S.65 (105) "Taxable Service" means any service provided or to be provided:-

xxxx xxxx xxxx xxxx xxxx

(zzzzu) to a buyer, by a builder of a residential complex, or a commercial complex, or any other person authorised by such

> builder, for providing preferential location or development of such complex but does not include services covered under sub-clauses (zzg), (zzq), (zzzh) and in relation to parking place.
>
> Explanation.—For the purposes of this sub-clause, "preferential location" means any location having extra advantage which attracts extra payment over and above the basic sale price;"

22. At this stage it is necessary to observe that the Respondents are not seeking to levy tax for taxable service under Section 65(105)(zzzza) of the Act (which was introduced by virtue of the Finance Act, 2007) as according to them builders engaged in constructing complexes and selling units are liable to pay service tax on the transaction with the purchaser only with effect from 1st July, 2010 by virtue of the impugned explanation to Section 65(105)(zzzh) of the Act. In the present petitions, it is not the case of the Respondents that builders/promoters/developers who develop residential complexes - such as the group housing project developed by the builder in this case - and sell dwelling units in the complexes to prospective users render taxable service under Section 65(105)(zzzza) of the Act, that is, services in relation to a works contract.

23. Although such composite contracts for development of complex and sale of units therein would fall within the scope of works contract as held by the Supreme Court in ***Larsen and Toubro v. State of Karnataka*** (*supra*), we do not propose to examine whether services involved in

construction of complexes is exigible to service tax as services in relation to execution of a works contract falling within the scope of Section 65(105)(zzzza) of the Act or under Section 65B(44) after the amendments brought about in the Act by virtue of Finance Act, 2012 – the said controversy is outside the scope of the present petitions and it would not be appropriate for us to examine it in these petitions [see ***Hindustan Polymers Co. Ltd. and Others v. Collector of Central Excise, Guntur: (1997) 11 SCC 302***].

24. Insofar as the impugned explanation is concerned, it is apparent that the same expands the scope of the taxable service as envisaged in clause (zzzh) of the Act. By a legal fiction, construction of a complex which is intended for sale by a builder or any person authorised by him before, during or after construction is deemed to be a service provided by the builder to the buyer. The only exception contemplated is where no sum is received from the prospective buyer prior to grant of the completion certificate. The grant of completion certificate implies that the project is complete and at that stage all services and goods used for construction are subsumed in the immovable property; thus at that stage sale of a complex or a part thereof to a buyer constitutes an outright sale of immovable property, which admittedly is not chargeable to service tax.

25. In cases where construction is carried on by a builder on behalf of or for another person it can hardly be disputed that the builder renders a host of services which are involved in construction. As submitted by the learned counsel for the Respondents, such services would normally include services in the nature of architectural services, engineering services, services in relation to development of infrastructure etc. A developer directly or through sub-contractor carries on myriad of activities for construction of a complex which apart from construction of buildings also involves planning, preparation of a layout plan, development of land, construction of sewer lines, development of infrastructure for supply of electricity and water, etc. In such cases, it cannot be disputed that no services are rendered by a builder; the controversy as to whether any services are rendered arises only in cases where the builder does not carry on the development activities on behalf of the purchaser but on his own but with an intention to sell the developed units; he enters into agreements with prospective buyers to sell fully developed units as and when such buyers are found. He may do so before commencing any construction/ development activity or during the course of developing the complex.

26. Service tax is essentially a tax on the value created by services as distinct from a tax on the value added by manufacturing goods.

Construction of a complex essentially has three broad components, namely, (i) land on which the complex is constructed; (ii) goods which are used in construction; and (iii) various activities which are undertaken by the builder directly or through other contractors. The object of taxing services in relation to construction of complex is essentially to tax the various activities that are involved in the construction of a complex and the resultant value created by such activities.

27. It is a usual practice for builders/developers to sell their project at its launch. Builders accept bookings from prospective buyers and in many cases provide multiple options for making payment for the purchase of the constructed unit. In some cases, prospective buyers make the payment upfront while in other cases, the buyers may opt for construction linked payment plans, where the agreed consideration is paid in instalments linked to the builder achieving certain specified milestones. Whilst it may be correct to state that the title to the unit (the immovable property) does not pass to the prospective buyer at the stage of booking, it can hardly be disputed that the buyer acquires an economic stake in the project and in one sense, the services subsumed in construction - services in relation to a construction the complex - are rendered for the benefit of the buyer. However, but for the legal fiction introduced by the impugned explanation,

such value add would be outside the scope of services because *sensu stricto* no services, as commonly understood, are rendered in a contract to sell immovable property.

28. The impugned explanation was enacted to principally bring about parity in various forms of arrangements entered into between the builders and prospective buyers for the purposes of levy of service tax. The object was to obliterate - for the purposes of levy of service tax - the distinction between a person who engages a builder to construct a unit for him and a person who enters into an arrangement to purchase a unit in a complex, which is under development, from a builder. The purpose and object of introducing the impugned explanation was explained in a circular dated 26th February, 2010 issued by the Central Board of Excise and Customs, the relevant extract of which is reproduced below:-

> "Service tax on construction services
>
> 8.1 The service tax on construction of commercial or industrial construction services was introduced in 2004 and that on construction of complex was introduced in 2005.
>
> 8.2. As regards payment made by the prospective buyers/ flat owners, in few cases the entire consideration is paid after the residential complex has been fully developed. This is in the nature of outright sale of the immovable property and admittedly no Service tax is chargeable on such transfer. However, in most cases, the prospective buyer books a flat before its construction commencement / completion, pays the consideration in installments and takes possession of the

property when the entire consideration is paid and the construction is over.

8.3 In some cases the initial transaction between the buyer and the builder is done through an instrument called 'Agreement to Sell'. At that stage neither the full consideration is paid nor is there any transfer in ownership of the property although an agreement to ultimately sell the property under settled terms is signed. In other words, the builder continues to remain the legal owner of the property. At the conclusion of the contract and completion of the payments relating thereto, another instrument called 'Sale Deed' is executed on payment of appropriate stamp duty. This instrument represents the legal transfer of property from the promoter to the buyer.

8.4 In other places a different pattern is followed. At the initial stage, instruments are created between the promoter and all the prospective buyers (which may include a person who has provided the vacant land for the construction), known as 'Sale of Undivided Portion of The Land'. This instrument transfers the property right to the buyers though it does not demarcate a part of land, which can be associated with a particular buyer. Since the vacant land has lower value, this system of legal instrumentation has been devised to pay lesser stamp duty. In many cases, an instrument called 'Construction Agreement' is parrallely executed under which the obligations of the promoter to get property constructed and that of the buyer to pay the required consideration are incorporated.

8.5 These different patterns of execution, terms of payment and legal formalities have given rise to confusion, disputes and discrimination in terms of Service tax payment.

8.6. In order to achieve the legislative intent and bring in parity in tax treatment, an Explanation is being inserted to provide that unless the entire payment for the property is paid by the prospective buyer or on his behalf after the completion of construction (including its certification by the local authorities), the activity of construction would be deemed to be a taxable service provided by the builder/ promoter/ developer to the prospective buyer and the Service tax would be charged

accordingly. This would only expand the scope of the existing service, which otherwise remain unchanged."

29. The use of a legal fiction is a well known legislative device to assume a state of facts (or a position in law) for the limited purpose for which the legal fiction enacted, that does not exist. The Parliament is fully competent to enact such legal fiction. In the present case the Parliament has done precisely that; it has enacted a legal fiction, where a set of activities carried on by a builder for himself are deemed to be that on behalf of the buyer. ***In J.K. Cotton Spinning and Weaving Mills Ltd. and Anr v. Union of India (UOI) and Ors. : (1987) Supp 1 SCC 350*** the Supreme Court held that "*It is well settled that a deeming provision is an admission of the non-existence of the fact deemed…The Legislature is quite competent to enact a deeming provision for the purpose of assuming the existence of a fact which does not really exist*". In ***G. Viswanathan v. Hon'ble Speaker Tamil Nadu Legislative Assembly, Madras and Ors.: (1996) 2 SCC 353***, the Supreme Court held that "*By the decision of this Court it is fairly well settled that a deeming provision is an admission of the non-existence of the fact deemed. The Legislature is competent to enact a deeming provision for the purpose of assuming the existence of a fact which does not even exist. It means that the Courts must assume that such a state of affairs exists as real, and should imagine as real the consequences and incidents which*

inevitably flow there from, and give effect to the same. The deeming provision may be intended to enlarge the meaning of a particular word or to include matters which otherwise may or may not fall within the main provision. The law laid down in this regard in East End Dwellings Co. Ltd. case (1952) AC 109 : (1951) 2 All. E.R. 587 has been followed by this Court in a number of cases, beginning from State of Bombay v. Pandurang: 1953Cri LJ 1049 and ending with a recent decision of a three Judge Bench in M. Venugopal v. Divisional Manager, LIC." In ***Manish Trivedi v. State of Rajasthan: (2014) 14 SCC 420****, the Supreme Court held that "It is well settled that the legislature is competent to create a legal fiction. A deeming provision is enacted for the purpose of assuming the existence of a fact which does not really exist. When the legislature creates a legal fiction, the court has to ascertain for what purpose the fiction is created and after ascertaining this, to assume all those facts and consequences which are incidental or inevitable corollaries for giving effect to the fiction." (also see: **State of Uttar Pradesh v. Hari Ram: (2013) 4 SCC 280**).*

30. The imposition of service tax by virtue of the impugned explanation is not a levy on immovable property as contended on behalf of the Petitioner. The clear object of imposing the levy of service tax in relation

to a construction of a complex is essentially to tax the aspect of services involved in construction of a complex the benefit of which is available to a prospective buyer who enters into an arrangement - whether by way of an agreement of sale or otherwise - for acquiring a unit in a project prior to its completion/development.

31. The controversy whether a legislature has the competence to enact a law has to be judged in the context of the pith and substance of that law. In ***Union of India v. H.S. Dhillon: (1972) 83 ITR 582(SC)***, a Constitution Bench of the Supreme Court applied the doctrine of pith and substance while in considering the question whether the levy of Wealth Tax Act on immovable property would retrench upon the legislative field reserved for the stakes under Entry 49 of List II of the Seventh Schedule of the Constitution of India.

32. In ***India Cements v. State of Tamilnadu****: (1991) 188 ITR 690 (SC)* the Supreme Court stated as under:

> "Certain rules have been evolved in this regard, and it is well settled now that the various entries in the three lists are not powers but fields of legislation. The power to legislate is given by Article 246 and other articles of the Constitution. See the observations of this Court in Calcutta Gas Co. v. State of West Bengal: AIR 1962 SC 1044. The entries in the three lists of the Seventh Schedule to the Constitution are legislative heads or fields of legislation. These demarcate the area over which

appropriate legislature can operate. It is well settled that widest amplitude should be given to the language of these entries, but some of these entries in different lists or in the same list may overlap and sometimes may also appear to be in direct conflict with each other. Then, it is the duty of the court to find out its true intent and purpose and to examine a particular legislation in its pith and substance to determine whether it fits in one or the other of the lists. See the observations of this Court in H.R. Banthia v. Union of India: [1970]1 SCR 479, Union of India v. H.S. Dhillon: [1972] 83 ITR 582(SC). The lists are designed to define and delimit the respective areas of respective competence of the Union and the States. These neither impose any implied restriction on the legislative power conferred by Article 246 of the Constitution, nor prescribe any duty to exercise that legislative power in any particular manner. Hence, the language of the entries should be given widest scope, D.C. Rataria v. Bhuwalka Brothers Ltd.: [1955] 1SCR 1071, to find out which of the meanings is fairly capable because these set up machinery of the Govt. (Sic). Each general word should be held to extend to all ancillary or subsidiary matters which can fairly and reasonably be comprehended in it. In interpreting an entry it would not be reasonable to import any limitation by comparing or contrasting that entry with any other one in the same list. It is in this background that one has to examine the present controversy."

33. In the case of ***Federation of Hotel & Restaurant Association of India, etc., v. Union of India (UOI) and Ors: (1989) 178 ITR 97 (SC)*** the Supreme Court explained:

"Indeed, the law 'with respect to' a subject might incidentally 'affect' another subject in some way; but that is not the same thing as the law being on the latter subject. There might be overlapping; but the overlapping must be in law. The same transaction may involve two or more taxable events in its

different aspects. But the fact that there is an overlapping does not detract from the distinctiveness of the aspects..."

34. We do not find any merit in the contention that the imposition of service tax in relation to a transaction between a developer of a complex and a prospective buyer impinges on the legislative field reserved for the States under Entry-49 of List-II of the Seventh Schedule to the Constitution of India.

35. Having stated the above, it is also essential to examine the measure of tax used for the levy. The measure of tax must have a nexus with the object of tax and it would be impermissible to expand the measure of service tax to include elements such as the value of goods because that would result in extending the levy of service tax beyond its object and would impinge on the legislative fields reserved for the State Legislatures.

36. In ***BSNL v. Union of India*: *(2006) 3 SCC 1***, the Supreme Court explained the question whether value of SIM Cards could be included in the cost of services. The Supreme Court referred to its earlier decision in ***Gujarat Ambuja Cements Ltd. v. Union of India: (2005) 4 SCC 214*** and quoted the following passage from the said judgment:-

"This mutual exclusivity which has been reflected in Article 246(1) means that taxing entries must be construed so as to

> maintain exclusivity. Although generally speaking, a liberal interpretation must be given to taxing entries, this would not bring within its purview a tax on subject-matter which a fair reading of the entry does not cover. If in substance, the statute is not referable to a field given to the State, the court will not by any principle of interpretation allow a statute not covered by it to intrude upon this field."

The Supreme Court further held that while a State may have legislative competence to levy sales tax, the same would not however permit the State to entrench on the Union List by including the value of service in the cost of goods sought to be taxed. The relevant passage from the said judgment is quoted below:-

> "No one denies the legislative competence of the States to levy sales tax on sales provided that the necessary concomitants of a sale are present in the transaction and the sale is distinctly discernible in the transaction. This 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. As was said in Larsen and Toubro v. State of Rajasthan: (SCC p. 395, para 47).
>
> > "The cost of establishment of the contractor which is relatable to supply of labour and services cannot be included in the value of the goods involved in the execution of a contract and the cost of establishment which is relatable to supply of material involved in the execution of the works contract only can be included in the value of the goods.""

37. Undisputedly, the contract between a buyer and a builder/promoter/ developer in development and sale of a complex is a composite one. The arrangement between the buyer and the developer is not for procurement of services *simplicitor*. As noticed hereinbefore, an agreement between a flat buyer and a builder/developer of a complex – who is developing the complex for sale is, essentially, one of purchase and sale of developed property. But, by a legislative fiction, such agreements, which have been entered into prior to completion of the project and/or construction of a unit, are imputed with a character of a service contract; the works involved in construction of a complex are treated as being carried by the builder on behalf of the buyer. However, indisputably the arrangement between the buyer and the builder is a composite one which involves not only the element of services but also goods and immovable property. Thus, while the legislative competence of the Parliament to tax the element of service involved cannot be disputed but the levy itself would fail, if it does not provide for a mechanism to ascertain the value of the services component which is the subject of the levy. Clearly service tax cannot be levied on the value of undivided share of land acquired by a buyer of a dwelling unit or on the value of goods which are incorporated in the project by a developer. Levying a tax on the constituent goods or the land would clearly intrude

into the legislative field reserved for the States under List II of the Seventh Schedule of the Constitution of India.

38. In ***Commissioner of Central Excise and Customs v. Larsen & Toubro*** (*supra*), the Supreme Court clearly explained the necessity for segregating the elements of services and sale of goods in a composite contract in the following words:-

> "At this stage, it is important to note the scheme of taxation under our Constitution. In the lists contained in the 7th Schedule to the Constitution, taxation entries are to be found only in lists I and II. This is for the reason that in our Constitutional scheme, taxation powers of the Centre and the States are mutually exclusive. There is no concurrent power of taxation. This being the case, the moment the levy contained in a taxing statute transgresses into a prohibited exclusive field, it is liable to be struck down. In the present case, the dichotomy is between sales tax leviable by the States and service tax leviable by the Centre. When it comes to composite indivisible works contracts, such contracts can be taxed by Parliament as well as State legislatures. Parliament can only tax the service element contained in these contracts, and the States can only tax the transfer of property in goods element contained in these contracts. Thus, it becomes very important to segregate the two elements completely for if some element of transfer of property in goods remains when a service tax is levied, the said levy would be found to be constitutionally infirm."

39. In the present case, we find that there is no machinery provision for ascertaining the service element involved in the composite contract. In order to sustain the levy of service tax on services, it is essential that the machinery provisions provide for a mechanism for ascertaining the

measure of tax, that is, the value of services which are charged to service tax.

40. Section 67 of the Act provides for valuation of taxable services. The said section as amended by Finance Act 2010 reads as under:-

> "67. Valuation of taxable services for charging Service tax - (1) Subject to the provisions of this Chapter, service tax chargeable on any taxable service with reference to its value shall,—
>
> (i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;
>
> (ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money, with the addition of service tax charged, is equivalent to the consideration;
>
> (iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner."

41. Prior to the amendment brought about by Finance Act 2010, Section 67 of the Act provided that the value of taxable services would be "*the gross amount charged by the service provider for such service rendered by him*". Section 67 of the Act was amended also to provide for value in cases where the consideration for the services was not wholly or partly consisting of money and in cases where the consideration for the service was not ascertainable.

42. Section 65(86) of the Act defines the expression "prescribed" to mean as " '*prescribed' by rules made under this Chapter*". Thus, by virtue of Section 67(1)(iii) of the Act, in cases where the consideration for provision of services is not ascertainable, the same was to be determined in accordance with the Rules made under the Act.

43. For the purposes of ascertaining the value of services, the Central Government has made Service Tax (Determination of Value) Rules 2006 (hereafter 'the Rules'). However none of the rules provides for any machinery for ascertaining the value of services involved in relation to construction of a complex.

44. Rule 2A of the Rules provides for determination of the value of service in execution of a works contract and prior to 1st July, 2012 the said Rule read as under:-

> "**2A. Determination of value of taxable services involved in the execution of a works contract**.- Subject to the provisions of section 67, the value of taxable service involved in the execution of a works contract (hereinafter referred to as works contract service), referred to in clause (8) of section 66E of the Act, shall be determined by the service provider in the following manner, namely:-
>
> (i) Value of works contract service shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

Explanation.- For the purposes of this clause,-

(a) gross amount charged for the works contract shall not include value added tax or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract;

(b) value of works contract service shall include, -

(i) labour charges for execution of the works;

(ii) amount paid to a sub-contractor for labour and services;

(iii) charges for planning, designing and architect's fees;

(iv) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;

(v) cost of consumables such as water, electricity, fuel used in the execution of the works contract;

(vi) cost of establishment of the contractor relatable to supply of labour and services;

(vii) other similar expenses relatable to supply of labour and services; and

(viii) profit earned by the service provider relatable to supply of labour and services;

(c) Where value added tax has been paid on the actual value of transfer of property in goods involved in the execution of the works contract, then, such value adopted for the purposes of payment of value added tax, shall be taken as the value of transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service under this clause.

(ii) Where the value has not been determined under clause (i),

the person liable to pay tax on the taxable service involved in the execution of the works contract shall determine the service tax payable in the following manner, namely:-

(A) in case of works contracts entered into for execution of original works, service tax shall be payable on forty per cent. of the total amount charged for the works contract:

Provided that where the gross amount charged includes the value of the land, in respect of the service provided by way of clause (8) of section 66E of the Act, service tax shall be payable on twenty five per cent. of the total amount including such gross amount;

(B) in case of other works contracts including completion and finishing services such as glazing, plastering, floor and wall tiling, installation of electrical fittings not covered under sub-clause (A), service tax shall be payable on sixty per cent. of the total amount charged for the works contract;

Explanation 1.- For the purposes of this rule,-

(I) "original works" means-

(i) all new constructions;

(ii) all types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;

(II) "total amount" means the sum total of gross amount and the value of all goods, excluding the value added tax, if any, levied on goods and services supplied free of cost for use in or in relation to the execution of works contract, under the same contract or any other contract:

Provided that where the value of goods or services supplied free of cost is not ascertainable, the same shall be determined on the basis of the fair market value of the goods or services that have closely available resemblance;"

45. Whilst Rule 2A of the Rules provides for mechanism to ascertain the value of services in a composite works contract involving services and goods, the said Rule does not cater to determination of value of services in case of a composite contract which also involves sale of land. The gross consideration charged by a builder/promoter of a project from a buyer would not only include an element of goods and services but also the value of undivided share of land which would be acquired by the buyer.

46. In ***Mathuram Agrawal v. State of M.P.: (1999) 8 SCC 667***, the Supreme Court held as under:-

> "In a taxing Act it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language. It is not the economic results sought to be obtained by making the provision which is relevant in interpreting a fiscal statute. Equally impermissible is an interpretation which does not follow from the plain, unambiguous language of the statute. Words cannot be added to or substituted so as to give a meaning to the statute which will serve the spirit and intention of the legislature. The statute should clearly and unambiguously convey the three components of the tax law i.e. the subject of the tax, the person who is liable to pay the tax and the rate at which the tax is to be paid. If there is any ambiguity regarding any of these ingredients in a taxation statute then there is no tax in law. Then it is for the legislature to do the needful in the matter."

47. A similar view was expressed by the Supreme Court in ***Govind Saran Ganga Saran v. CST: (1985) 155 ITR 144 (SC)*** wherein the Court held as under:-

> "6. The components which enter into the concept of a tax are well known. The first is the character of the imposition known by its nature which prescribes the taxable event attracting the levy, the second is a clear indication of the person on whom the levy is imposed and who is obliged to pay the tax, the third is the rate at which the tax is imposed, and the fourth is the measure or value to which the rate will be applied for computing the tax liability. If those components are not clearly and definitely ascertainable, it is difficult to say that the levy exists in point of law. Any uncertainty or vagueness ill the legislative scheme defining any of those components of the levy will be fatal to its validity."

48. In ***Commissioner Central Excise and Customs, Kerala v. Larsen & Toubro Ltd.*** (*supra*), the Supreme Court considered the question whether service tax could be levied on indivisible works contract under clauses (g), (zzd), (zzh), (zzq) and (zzzh) of sub-section 105 of Section 65 of the Act. The Court referred to various earlier decisions on the question whether a levy of tax could be sustained in absence of the machinery provisions and held that since neither the Act nor Rules provided for any machinery provisions to exclude the non-service element from a composite contract, the taxable services referred in clauses (g), (zzd), (zzh), (zzq) and (zzzh) of sub-section 105 of Section 65 of the Act could only refer to services in

relation to a service contract *simplicitor* and not to composite contracts. The relevant extract of the said decision is quoted below:-

> "A close look at the Finance Act, 1994 would show that the five taxable services referred to in the charging Section 65(105) would refer only to service contracts simpliciter and not to composite works contracts. This is clear from the very language of Section 65(105) which defines "taxable service" as "any service provided". All the services referred to in the said sub-clauses are service contracts simpliciter without any other element in them, such as for example, a service contract which is a commissioning and installation, or erection, commissioning and installation contract. Further, Under Section 67, as has been pointed out above, the value of a taxable service is the gross amount charged by the service provider for such service rendered by him. This would unmistakably show that what is referred to in the charging provision is the taxation of service contracts simpliciter and not composite works contracts, such as are contained on the facts of the present cases. It will also be noticed that no attempt to remove the non-service elements from the composite works contracts has been made by any of the aforesaid Sections by deducting from the gross value of the works contract the value of property in goods transferred in the execution of a works contract."

49. The Supreme Court further overruled the decision of this Court in ***G.D. Builders*** (*supra*) wherein this Court had, *inter alia,* held that clauses (g), (zzd), (zzh), (zzq) and (zzzh) of sub-section 105 of Section 65 of the Act would also take within their sweep indivisible composite works contracts. The Supreme Court further concluded that prior the enactment of the Finance Act 2007 - by virtue of which Section 65(105)(zzzza) of the

Act was introduced and Section 67 of the Act was amended - a composite contract was not taxable. This was so because in absence of Rule 2A of the Rules there was no machinery for excluding the non-service element from such composite works contracts involving an element of services and transfer of property in goods. Whilst the impugned explanation expands the scope of Section 65(105)(zzzh) of the Act, it does not provide any machinery for excluding the non-service components from the taxable services covered therein. The Rules also do not contain any provisions relating to determination of the value of services involved in the service covered under Section 65(105)(zzzh) of the Act. Thus the said clause cannot cover composite contracts such as the one entered into by the Petitioners with the builder.

50. In ***Maharashtra Chamber of Housing Industry*** (*supra*), the Bombay High Court upheld the constitutional validity of the impugned explanation by examining the object of the taxation. The Court held that the legislative competence must be determined with reference to the object of the levy and not with reference to the incidence of tax or the machinery provisions. As indicated above, we are also of the view that in the present case, the Parliament would have the legislative competence to levy service tax in relation to the services rendered in construction of a complex.

However, as explained in ***Commissioner Central Excise and Customs, Kerala v. Larsen & Toubro Ltd.*** (*supra*) in absence of machinery provisions to exclude non-service elements from a composite contract, the levy on services referred to in Section 65(105)(zzzh) could only be imposed on contracts of service *simplicitor* - that is, contracts where the builder has agreed to perform the services of constructing a complex for the buyer - and would not take within its ambit composite works contract which also entail transfer of property in goods as well as immovable property. The measure of tax assumes significance in such contracts as a levy of the service tax taking the gross amount charged by a builder for a composite contract would amount to a levy of service tax not only on the service element but also on the immovable property and the property in goods transferred or intended to be transferred to the ultimate buyer.

51. In ***CIT v. B. C. Srinivasa Shetty: (1981) 2 SCC 460***, the Supreme Court examined the levy of capital gains tax on sale of goodwill and had noted that the machinery provisions did not provide for calculation of capital gains - which is the measure of tax for imposition of tax on gains from sale of capital assets - where the cost of acquisition was not ascertainable. The Court held that the charging Sections and the computation provisions together constitute an integrated code and the

transaction to which the computation provisions cannot be applied must be regarded as never intended to be subjected to charge of tax.

52. It was stated that an Assessee is entitled to abatement to the extent of 75% and only 25% of the gross amount charged by a builder from a flat buyer is charged to service tax. It was suggested on behalf of the Revenue that this indicated that the value of the immovable property as well as the property in goods incorporated in the works would stood excluded. In our view, this issue also stands concluded against the Revenue by the judgment in the case of ***Commissioner of Central Excise v. Larsen and Toubro Limited*** (*supra*). In that case, the Supreme Court had affirmed the decision of the Orissa High Court in ***Larsen and Toubro Limited v. State of Orissa and Ors: (2008) 12 VST 31 (Orissa)*** wherein the Court held that Circulars or other instructions could not provide the machinery provisions for levy of tax. The charging provisions as well as the machinery for its computation must be provided in the Statute or the Rules framed under the Statute. The relevant extract from the decision of the Orissa High Court is reproduced below:-

> "This Court is of the opinion that if the Act is unworkable in the absence of necessary Rules, as has been held by several judgments referred to above, any assessment under the said Act cannot be enforced even if such an assessment order is made by an authority under the Act purportedly in accordance with the

provisions of the Act. The inherent infirmity of an assessment order passed on the basis of circulars which have no statutory sanction cannot be cured by an appellate order. In other words, if the assessment order itself is not sustainable on account of unworkability of the provisions under which they are purportedly made, no purpose would be served by filing appeal against the said order and this question cannot be decided by the appellate authority under the Act. In the instant case, both the assessing officer and the appellate authority are bound to follow the instructions contained in the circulars. Therefore, no purpose would be served by filing appeal before the appellate authority.

In order to constitute valid basis for taxation, the rate of deduction, specially a flat rate of deduction cannot be applied to calculate the taxable turnover in works contract. So those circulars cannot hold the field. As stated in the judgments referred to above, in the absence of any statutory basis for calculation of taxable turnover, the Act remains unworkable. Such gap in the statute cannot be filled up by the circulars which are purely ad hoc and administrative in nature and specially so when it relates to taxing law.

It is a well-settled principle that in matters of taxation either the statute or the Rules framed under the statute must cover the entire field. Taxation by way of administrative instructions which are not backed by any authority of law is unreasonable and is contrary to article 265 of the Constitution of India. Therefore, the impugned circulars are set aside as also the impugned orders of assessment. The assessee's liability to pay tax remains but in order to assess that the State has to act in accordance with the statutory prescription by framing Rules under its rule-making power under Section 29 of the Act and the assessing authority can pass fresh orders of assessment on the basis of such statutory Rules."

53. As noticed earlier, in the present case, neither the Act nor the Rules framed therein provide for a machinery provision for excluding all components other than service components for ascertaining the measure of

service tax. The abatement to the extent of 75% by a notification or a circular cannot substitute the lack of statutory machinery provisions to ascertain the value of services involved in a composite contract.

54. Insofar as the challenge to the levy of service tax on taxable services as defined under Section 65(105)(zzzzu) is concerned, we do not find any merit in the contention that there is no element of service involved in the preferential location charges levied by a builder. We are unable to accept that such charges relate solely to the location of land. Thus, preferential location charges are charged by the builder based on the preferences of its customers. They are in one sense a measure of additional value that a customer derives from acquiring a particular unit. Such charges may be attributable to the preferences of a customer in relation to the directions in which a flat is constructed; the floor on which it is located; the views from the unit; accessibility to other facilities provide in the complex etc. As stated earlier, service tax is a tax on value addition and charges for preferential location in one sense embody the value of the satisfaction derived by a customer from certain additional attributes of the property developed. Such charges cannot be traced directly to the value of any goods or value of land but are as a result of the development of the

complex as a whole and the position of a particular unit in the context of the complex.

55. In view of the above, we negate the challenge to insertion of clause (zzzzu) in Sub-section 105 of Section 65 of the Act. However, we accept the Petitioners contention that no service tax under section 66 of the Act read with Section 65(105)(zzzh) of the Act could be charged in respect of composite contracts such as the ones entered into by the Petitioners with the builder. The impugned explanation to the extent that it seeks to include composite contracts for purchase of units in a complex within the scope of taxable service is set aside.

56. These petitions were admitted by an order dated 21.07.2011 and the applications for stay of recovery filed along with the petitions were disposed of by directing that if any amount is collected on the basis of the impugned explanation, the same shall be refunded with the interest in case the Petitioners succeed. Accordingly, the concerned officer of Respondent No. 1 shall examine whether the builder has collected any amount as service tax from the Petitioners for taxable service as defined in Section 65(105)(zzzh) of the Act and has deposited the same with the respondent authorities. Any such amount deposited shall be refunded to the Petitioners

with interest at the rate of 6% from the date of deposit till the date of refund.

57. The petitions are disposed of in the aforesaid terms.

VIBHU BAKHRU, J

S.MURALIDHAR, J

JUNE 03, 2016
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