

Article

Sales Tax Net on Builders: Is There a Way Out?

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Problem Statement -This paper critically analyses the levy of sales tax on the builders for the sale of real estate which is an immovable property. The paper explains the judgment of Courts and the controversies which arose from it with respect to imposing sale taxation on builders. It also deals with the legislature's act of amending the respective VAT Act in pursuance to the Court decision. The Bombay High Court judgment dated 10th April 2012 in the case of Maharashtra Chamber of Housing Industry And Ors v. State of Maharashtra And Ors has been analyzed. The intention of Madhya Pradesh legislature in making amendments to their VAT Act has also been looked into. Lastly, the author's view regarding the Goods and Service Tax Act to be a potential alternative to the problem has been provided.

Introduction

Government in a bid to resurrect its fiscal position needs tax revenues. There is no incongruity in the opinion that the existing statutes pertaining to taxable transactions are all dark and grey where the legislature can in an adroit manner levy a new tax by fitting it into one of the existing statutes. But the inclusion of builders and developers to the sales tax net has imposed an unanticipated tax liability upon them and which they consider has been illegally fastened. Before appreciating or criticising the issue involved it is imperative to look at the genesis point of the controversy.

Synthesis of Taxation

The power to legislate is engrafted under Article 246 of the Constitution and the

entries for the three lists of the seventh schedules. Parliament and the state legislatures are empowered to levy tax on the sale and purchase of goods under Entry 92-A of List-1¹ and Entry-54 of List-2² respectively. However, a pertinent question which has to be answered is whether these provisions empower the legislature to levy tax on the sale of goods within the periphery of works contract. The Supreme Court answered this question in its landmark judgement of State of Madras v. Gannon Dunkerley & Co.³ where it held that a works contract cannot be vivisected into sale of goods and supply of labour and services. As there is no sale of goods in the movable form in works contract no sales tax can be levied.

This decision of the Court imposed complete restriction on the power of the

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State Government to levy tax on the sale of goods within works contract. Government craving for more revenue approached the Central Government requesting to take necessary legal step so as to levy sales tax on indivisible works contract. Thus, 61st law commission was established. In pursuance to the report submitted by the law commission⁴ 46th amendment was introduced to the Constitution via which a new Clause (29-A)⁵ has been incorporated in Article 366 of the Constitution which empowers the legislature to levy the tax on the transfer of property in goods whether as a good or in some other form within a works contract. Now, a transaction which is not a sale has been 'deemed' to be a sale. Supreme Court has upheld the amendment in the case of Builders Association of India v. Union of India⁶ and directed that the taxable quantum under works contract is not the full contract price but only that amount which pertains to the transfer of property in goods.

Relevant Judgements in Nutshell

From time to time builders and developers have challenged the levy of VAT on these transactions. The law of the land was set by the Supreme Court in the case of *K.Raheja Development Corporation v. State of Karnataka*.⁷

Facts of the case- The appellant, who carried on the business of real estate development and allied contracts, entered into development agreements with owners of lands. It got the plans sanctioned and after approval constructed residential apartments and commercial complexes. In most cases before construction it entered into agreements with the intending purchasers. The agreement provided that on completion of the construction the residential apartment or the commercial complex would be handed over to the purchasers, who would get an undivided interest in the land also. The appellant was entitled to terminate the agreement and

dispose of the unit if a breach was committed by the purchaser.

The pertinent fact in this case is that no transfer deed/sale deed/conveyance deed in respect of Constructions of the Residential or Commercial units are executed by the developer company in favour of the purchasers to transfer the ownership. Revenue took the stand that there was transfer of property in goods pursuant to a works contract. However, company took the stand that they were owners of land and an owner could not be said to be carrying on works contract on behalf of others.

Decision- The Apex Court held that agreement entered into before the completion of construction would be considered to be works contract and the agreement entered into after the completion of construction would not be within the ambit of works contract.

Disregarding the facts of above case this judgement of Court was interpreted by legislature to mean that all the agreement entered into before the completion of construction would be a works contract and they started levying tax upon it.⁸ But as the saviour of the builders the Allahabad High Court came up with its decision in *Assotech Realty Private Ltd. v. State of UP and Another*⁹ repelling the attempt to impose sales tax on real estate.

In this case the petitioner was engaged in the business of developing the land. It purchased the land and through allotment letter it allotted the flat to various prospective allottees. However, it was to remain the property of the petitioner and no right would accrue to the allottees till a sale deed is executed and registered. It was held that petitioner is constructing the flat not for and on behalf of the prospective allottees but otherwise. The right, title and interest continue to remain with the petitioner. Thus, it cannot be treated as works contract and the goods involved in the construction of immovable property is not subject to VAT.

The government of Maharashtra pursuant to the judgement of Supreme Court in the matter of K.Raheja case amended the definition of sale under Sec.2 (24) to include an agreement for the building and construction of immovable property which is not a works contract

So the contract even though was entered into before the completion of construction was not considered to be works contract.

These judicial pronouncements of Court still left the builders and developers with some ray of hope that they can still protect themselves from the extravagant levy of tax. But the enthusiasm of the legislature to impose tax on the real estate knew no bounds and they were determinant to levy VAT on developers and builders via amendments made in the VAT Act.

Approach of State Legislatures

The government of Maharashtra pursuant to the judgement of Supreme Court in the matter of K.Raheja case amended the definition of sale under Section 2(24)¹⁰ to include an agreement for the building and construction of immovable property which is not a works contract. Maharashtra Housing Chamber and Industry filed a writ petition in the High Court of Bombay questioning the legislative competence of the state legislature imposing VAT on newly constructed properties.¹¹ The High Court in its judgement has upheld the constitutional validity of amendment made in the definition of sale in the MVAT Act.

Inspite of the above judgement the provision is still shrouded by gray clouds because there is lack of clarity as to whether this amended definition of sale cannot be read to mean building and construction of immovable property which is not a works contract.

In the writ petition filed by Maharashtra Housing Chamber and Industry a notification dated 9 July 2010 was also challenged.¹² The notification was issued in exercise of power conferred by Section 42(3A)¹³ which provides for a composition scheme. Notification stated that 1% VAT would be payable on the aggregate value of the agreement or the value as per the Bombay Stamps Act whichever is higher as composition amount. The Court did not go into the constitutional validity of the composition scheme as it is available at the option of the registered dealer.

However, the notification stated that 1% VAT is paid on the contract price of flats mentioned in the agreement of sale i.e VAT is imposed on the sale of an immovable property even though there is no deemed sale.

Similarly **Madhya Pradesh state legislature** has amended their VAT Act. Section 9-B¹⁴, Tax on building has been inserted by VAT (Amendment) Act, 2011 by exercising its power under Entry 49 of List II.¹⁵ Under the Constitution, List II of the Seventh Schedule provides by Entry 49 the power to levy tax on land and buildings. Under Entry 63 of list II¹⁶ the state has the power to prescribe the stamp duty. Can the state government levy tax on the building under Entry 49 and stamp duty on building under Entry 63 simultaneously for if an extended meaning is given to Entry 63 List II to include land and building then it would result in conflict as both the entries would then substantially cover the same subject matter.

This amendment by the Madhya Pradesh state legislature has resulted into levy of tax on the same subject- matter by the same institution making it multi layer taxation.

Is There A Way Ahead?

On analysing the above issues the problematic area that can be identified is the unclear, obscure law provisions. The need of the time is to have a law which is

as clear as a crystal bowl with a gold fish in it. A step in that direction has been set up by tabling Goods and Service Tax Act in the Parliament which is expected to bring comprehensive indirect tax reform and bring unification in the taxing statutes. GST

Act may protect the builders and contractors from multilayer of taxation. This can be one way to prevent the burden of escalated taxation on builders. Let us all optimistically wait for it's implementation.

Endnotes

- 1 Tax on the sale or purchase of goods other than newspapers, where such sale or purchase takes place in the course of inter-state trade or commerce.
 - 2 Rates of stamp duty in respect of documents other than those specified in the provision of List 1 with regard to the rates of stamp duty.
 - 3 1958 (9) STC 353.
 - 4 The Law commission recommended that Entry 54 of the State List may be amended or the fresh entry may be inserted in the State List.
 - 5 Article 366 (29A) "Tax on the sale or purchase of goods" includes-
(b) a tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract.
 - 6 73 STC 370.
 - 7 (2005) 5 SCC 162.
 - 8 In pursuant to K.Raheja judgment various amendments in VAT Act like in Maharashtra, Delhi and Madhya Pradesh etc. have been made.
 - 9 207-TIOC-207-HCALL-CT.
 - 10 Section 2(24) amended by Maharashtra Act XXV of 2007.
 - 11 Maharashtra Chamber of Housing Industry And Ors v. State of Maharashtra And Ors, 2012-VIL-35-BOM.
 - 12 *Id.*
 - 13 Sub-section (3A) inserted by The Maharashtra Tax Laws (Levy and Amendment) Act, 2010, Section 14, (w.e.f. 1-5-2010).
 - 14 Section 9-B inserted by VAT (Amendment) act, 2011 w.e.f. 1-4-11.
 - 15 Taxes on lands and buildings.
 - 16 Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.
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