
(1997) 01 KAR CK 0084

In the Karnataka High Court

Case No : Writ Appeal No's. 486 and 663 of 1994

KEC International Limited and another

APPELLANT

Vs

State of Karnataka and others

RESPONDENT

Date of Decision : 30-01-1997

Acts Referred:

Central Sales Tax Act, 1956 — Section 14, 15, 4, 5, 9
Constitution of India, 1950 — Article 286 (1), 366 (29A)
Karnataka Sales Tax Act, 1957 — Section 19 A

Citation : (1997) 105 STC 192

Hon'ble Judges : S.R. Venkatesha Murthy, J;P. Krishna Moorthy, J

Bench : Division Bench

Judgement

P. Krishna Moorthy, J.—These appeals are by the petitioners in the writ petitions, wherein, they had challenged the constitutionality of section 19A of the Karnataka Sales Tax Act and to restrain the respondents from deducting any amount as tax from the amounts due to each of the petitioner and for certain other incidental reliefs.

2. The petitioners had entered into contracts with the Karnataka Electricity Board for survey, design, erection, stringing and commissioning of transmission lines of different voltage ranging from 66 KV. to 400 KV. The Karnataka Sales Tax Act was amended in 1988 providing for tax in relation to the works contracts enumerated in the Sixth schedule to the Act. While so, section 19A of the Act was introduced with effect from April 1, 1988 making provisions for deduction of amounts payable to a dealer in respect of works contracts of the nature specified in the Sixth Schedule executed by them. By the above section, it was made obligatory for the Central Government, or any State Government, or an industrial, commercial or trading undertaking of the Central Government or of any State Government, or a local authority or a statutory body, to deduct from the amounts payable to the contractors, an amount at the rate of 2 per cent of the total amount payable to such dealers if the works contract executed is as specified under serial number 6 of the Sixth Schedule; or the rate of four per

cent of the total amount payable to such dealers, in respect of the works executed other than those specified in serial number 6 of the Sixth Schedule. This provision was mainly challenged by the petitioners on the ground that the deduction of tax on the total amount payable under a work contract is beyond the legislative competence of the State under entry 54 of the State List in that, it includes even the turnover or other components of the transaction which are not exigible to tax at all under the Sales Tax Act.

It is the case of the petitioners that, even collection of tax or recovery at source even as an incidental or ancillary power for speedy recovery or preventing evasion has to be confined to matters within the State List. The petitioners have also challenged the section on the ground that it is against article 286(1) of the Constitution in respect of outside the State sales and import and export sales having regard to the principles under sections 4 and 5 of the Central Sales Tax Act, 1956. Here again, the State cannot impose or authorise imposition of tax on these elements which are embedded in the total contract receipts, and which are excluded from the purview of State legislation. Article 366(29A) only enables legislation on sales tax on the transfer of goods involved in the execution of works contracts and the State cannot legislate on the total amount payable under a works contract. It is also contended that the provision contained in section 19A is arbitrary and without any adjudicatory machinery or mechanism, by which, either the Sales Tax Officer or the assessee-contractor, or the owner may make a fair determination of the likely tax liability which could be deducted at source.

3. The learned single Judge after noting the aforesaid contentions, upheld the constitutional validity of section 19A on the ground that it is a machinery provision and necessary adjustments will have to be made at the time of final assessment of tax. It was held by the learned Judge that, though the provision made u/s 19A is intended to cover situations arising under the Karnataka Sales Tax Act alone, it gets extended to transactions in relation to inter-State transactions only by reason of section 9 of the Central Sales Tax Act and in that view of the matter, section 19A is valid by the application of section 9 of the Central Sales Tax Act, the machinery provision can be made applicable to tax payable under the Central Sales Tax Act as well. On these findings, the learned single Judge dismissed the writ petition upholding the validity of section 19A of the Karnataka Sales Tax Act (hereinafter referred to as "the Act") and the appeals are filed by the writ petitioners against the above decision.

4. It is contended by the learned counsel for the appellants that the power under entry 54 of the Second Schedule to the Constitution has certainly in-built restrictions contained in article 286 and other provisions of the Constitution and the State laws. Even if section 19A is only a machinery provision, even then, it can be operative only in aid of and to advance the main power that is vested in the State and that, even the machinery provision cannot operate beyond the competence of the State Legislature. It is also contended that, even if by section

9 of the Central Sales Tax Act, the Machinery of the State sales tax enactment can be made use of for collection of tax under the Central Sales Tax Act. Even then there are other components which are included in the total amount payable under the works contract, which are not exigible to tax either under the State Act or under the Central Act and in that view of the matter, section 19A is beyond the legislative competence of the State Legislature and as such void. It is the correctness of this contention that has to be decided.

5. Section 19A of the Karnataka Sales Tax Act, so far as it is relevant, reads as follows :

"19A Deduction of tax at source. - (1) Notwithstanding anything contained in this Act, the Central Government, or any State Government, or an industrial, commercial or trading undertaking of the Central Government or of any State Government, or a local authority or a statutory body shall deduct out of the amounts payable by them to a dealer in respect of works contracts of the nature specified in the Sixth Schedule executed for them, an amount calculated, -

(a) at the rate of two per cent of the total amount payable to such dealers, if the works contract executed is as specified under serial number 6 of the Sixth Schedule; or

(b) at the rate of four per cent of the total amount payable to such dealers, if the works contract executed is other than those specified in serial number 6 of the Sixth Schedule :

Provided that no such deduction shall be made if the amounts payable by them to the dealer is less than rupees one lakh in year :

6. It is clear from the above provision that the authorities mentioned in the above section are bound to deduct out of the amounts payable by them to a dealer in respect of works contract of the nature specified in the Sixth Schedule executed by them, at certain rates prescribed under the above section. In other words, tax has to be deducted at source at a certain percentage on the total amount of the contract. The question to be considered is as to whether the State Legislature is competent to make a provision for advance tax based on the total amount of the contract without leaving out the components of sales or price of other services which are not exigible to tax at all either under the Karnataka Sales Tax Act or under the Central Sales Tax Act.

7. By the 46th amendment to the Constitution, a new clause, viz., clause 29A was introduced to article 366 of the Constitution of India. The aforesaid amendment made it possible for the State to levy the sales tax on the price of the goods and materials used in works contracts as if there was a sale of such goods and materials. The scope of the above amendment came to be considered by a Constitution Bench of the Supreme Court in Builders Association of India and Others Vs. Union of India (UOI) and Others, . In that decision, it was held by the Supreme Court that :

"The sales tax laws passed by the Legislatures of States levying taxes on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract are subject to the restrictions and conditions mentioned in each clause or sub-clause or sub-clause of article 286 of the Constitution."

It was further held that,

"After the 46th Amendment the works contract which was an indivisible one is by a legal fiction altered into a contract which is divisible into one for sale of goods and the other for supply of labour and services. After the 46th Amendment, it has become possible for the States to levy sales tax on the value of goods involved in a works contract in the same way in which the sales tax was leviable on the price of the goods and materials supplied in a building contract which had been entered into in two distinct and separate parts."

Even in such circumstances, the assessment of sales tax could not be made ignoring the restrictions and conditions incorporated under article 286 of the Constitution of India. It was ultimately held :

".....We are of the view that all transfers, deliveries and supplies of goods referred to in clause (a) to (f) clause (29A) of article 366 of the Constitution are subject to the restrictions and conditions mentioned in clause (1), clause (2) and sub-clause (a) of clause (3) of article 286 of the Constitution and the transfers and deliveries that take place under sub-clauses (b), (c) and (d) of clause (29A) of article 366 of the Constitution are subject to an additional restriction mentioned in sub-clause (b) of article 286(3) of the Constitution."

8. The question was again considered by their Lordships of the Supreme Court in *Gannon Dunkerley and Co. and Others Vs. State of Rajasthan and Others*, , while considering constitutional validity of section 5(3) of the Rajasthan Sales Tax Act. After considering the 46th Amendment and other provisions under the Constitution, their Lordships ultimately stated the conclusions in the following manner :

"(1) In exercise of its legislative power to impose tax on sale or purchase of goods under entry 54 of the State List read with article 366(29A)(b), the State Legislature, while imposing 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 is not competent to impose a tax on such a transfer (deemed sale) which constitutes a sale in the course of inter-State trade or commerce or a sale outside the State or a sale in the course of import or export.

(2) The provisions of sections 3, 4, 5 and sections 14 and 15 of the Central Sales Tax Act, 1956, are applicable to a transfer of property in goods involved in the execution of a works contract covered by article 366(29A)(b).

(3) While defining the expression "sale" in the sales tax legislation it is open to the State Legislature to fix the situs of a deemed sale resulting from a transfer

falling within the ambit of article 366(29A)(b) but it is not permissible for the State Legislature to define the expression "sale" in a way as to bring within the ambit of the taxing power a sale in the course of inter-State trade or commerce, or a sale outside the State or a sale in the course of import and export.

(4) The tax on transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract falling within the ambit of article 366(29A)(b) is leviable on the goods involved in the execution of a works contract and the value of the goods which are involved in the execution of works contract would constitute the measure for imposition of the tax.

(5) In order to determine the value of the goods which are involved in the execution of a works contract for the purpose of levying the tax referred to in article 366(29A)(b), it is permissible to take the value of the works contract as the basis and the value of the goods involved in the execution of the works contract can be arrived at by deducting expenses incurred by the contractor for providing labour and other services from the value of the works contract.

(6) The charges for labour and services which are required to be deducted from the value of the works contract would cover (i) labour charges for execution of the works, (ii) amount paid to a sub-contractor for labour and services, (iii) charges for obtaining on hire or otherwise machinery and tools used for execution of the works contract, (iv) charges for planning, designing and architect's fees, and (v) cost of consumables used in the execution of the works contract, (vi) cost of establishment of the contractor to the extent it is relatable to supply of labour and services, (vii) other similar expenses relatable to supply of labour and services, and (viii) profit earned by the contractor to the extent it is relatable to supply of labour and services.

(7) To deal with cases where the contractor does not maintain proper accounts or the account books produced by him are not found worthy of credence by the assessing authority the Legislature may prescribe a formula for deduction of cost of labour and services on the basis of a percentage of the value of the works contract but while doing so it has to be ensured that the amount deductible under such formula does not differ appreciably from the expenses for labour and services that would be incurred in normal circumstances in respect of that particular type of works contract. It would be permissible for the Legislature to prescribe varying scales for deduction on account of cost of labour and services for various types of works contract.

(8) While fixing the rate of tax it is permissible to fix a uniform rate of tax for the various goods involved in the execution of a works contract which rate may be different from the rates of tax fixed in respect of sale or purchase of those goods as a separate article."

9. In the light of the above principles, their Lordships then considered the provisions of the Rajasthan Sales Tax Act, especially section 5(3) of the Act which was challenged in the petition. It was held by their Lordships thus :

"A comparison of the provisions contained in sub-section (3) of section 5 read with section 2(t) and sub-section (1) of section 5 read with section 2(s) would indicate that in relation to works contracts the Legislature has made a departure in the matter of chargeability of the tax and by using the expression "turnover" instead of "taxable turnover" in section 5(3) it has enlarged the field of taxability to permit tax being levied on sales in the course of inter-State trade or commerce, sales outside the State and sales in the course of import and export and to ignore the conditions and restrictions placed by section 15 of the Central Sales Tax Act in relation to imposition of tax on goods which are declared to be of special importance in inter-State trade or commerce u/s 14 of the Central Sales Tax Act. The proviso to section 5(3) does not oblige the rule-making authority to frame a rule allowing deductions for the turnover of the amount of proceeds of sale of goods on which no tax is leviable under the Act so as to exclude the abovementioned sales from levy of tax. The rule-making authority would not be contravening the mandate of the statute if it does not allow deduction of the amount of proceeds for sale of goods on which no tax is leviable under the Act from the turnover."

Again at page 246, their Lordships observed as follows :

"The High Court has upheld the validity of sub-section (3) of section 5 by taking into account the provisions of sub-rule (2) of rule 29. But, while considering the said provisions the High Court has failed to notice that under clause (i) of sub-rule (2) of rule 29, transfer of property in goods involved in the execution of a works contract, on which no tax is leviable u/s 5, are not required to be deducted from the turnover. The High Court also failed to attach importance to the use of the word "turnover" (instead of word "taxable turnover") in sub-section (3) of section 5 as a result of which the amplitude of the incidence of tax has been widened so as to include transactions which are outside the sphere of taxation available to the State Legislature under entry 54 of the State List. We are, therefore, unable to uphold the decision of the High Court in this regard and it must be held that sub-section (3) of section 5 transgresses the limits of the legislative power conferred on the State Legislature under entry 54 of the State List inasmuch as it enables tax being imposed on deemed sales resulting from transfer of property in goods (whether as goods or in some other form) involved in execution of a works contract which take place in the course of inter-State trade or commerce, or which take place outside the State or which take place in the course of import and export within the meaning of sections 3, 4 and 5, respectively of the Central Sales Tax Act and it does not take into account the conditions and restrictions imposed by section 15 of the Central Sales Tax Act on goods declared to be of special importance in inter-State trade or commerce u/s 14 of the Central Sales Tax Act. Clause (i) of sub-rule (2) of rule 29 of the Rajasthan Sales Tax Rules also suffers from the same infirmity. Section 5(3) of the Rajasthan Sales Tax Act and clause (i) of sub-rule (2) of rule 29 of the Rajasthan Sales Tax Rules must, therefore, be held to be unconstitutional and void."

10. In the above view, their Lordships held that section 5(3) of the Act is unconstitutional and void.

11. It is, thus clear, that the power conferred on State Legislature under entry 54 of List II read with article 366(29A) has got in-built restrictions and it would give power to the State only to impose tax on certain elements or components which are included in the total turnover of a works contract. From the aforesaid decisions of the Supreme Court, it is clear, that, in exercise of its legislative power to impose tax in the States, the State Legislature is not competent to impose tax on a deemed sale which constitute a sale in the course of inter-State trade or commerce, or a sale outside the State or a sale in the course of import and export. So also the provisions of sections 3, 4 and 5 and sections 14 and 15 of the Central Sales Tax Act, 1956, are applicable to a transfer of property in goods involved in the execution of a works contract covered by article 366(29A) (b). So also, the value of the goods involved in the execution of works contract will have to be determined by taking into account the value of the entire works contracts and deducting therefrom the charges towards labour and services which would cover items (a) to (h) as stated in page 235 of the decision of the Supreme Court in Gannon Dunkerley and Co. and Others Vs. State of Rajasthan and Others, . This decision concluded that the State Legislature has no competence to impose a tax on the total amount payable under a works contract in exercise of its power under entry 54 of List II read with article 366(29A).

12. Learned counsel for the appellants-writ petitioners did not challenge the power of State Legislature to make a provision for collection of advance tax in respect of works contracts. But the challenge is that, section 19A authorises deduction of tax on the total amount of works contract without making any provision for deduction of value of certain components of the works contract amount which are not exigible to tax at all. From the aforesaid decision of the Supreme Court, it is clear that the entire amount payable under the works contract cannot be exigible to Central or State sales tax and the amount exigible to sales tax has to be calculated out of the total amount on the principles stated by their Lordships of the Supreme Court. Section 19A makes a provision for deduction of tax at certain percentages on the total amount payable to a dealer in respect of a works contract. In other words, the deduction has to be made at certain percentage even on the amount which are not exigible to tax at all which may sometimes form an integral part of the total amount. If such were the provision in the charging section, certainly it would have been constitutionally invalid. But it is held by the learned single Judge and also contended by the learned Government Pleader that section 19A being only a machinery provision, it is not liable to be attacked on the ground of constitutional infirmity on that ground. It is also contended by the learned Government Pleader that, at any rate, in the final assessment, the amounts can be adjusted and if any excess amount is collected, it can be refunded.

13. So, the question to be considered is as to whether section 19A can be

salvaged on the ground that it is only a provision for collection and prevention of evasion of tax. It is further contended that it is only an ancillary provision to the main charging section and that no finality is attached to the liability of a dealer. We are not inclined to agree with this contention. Though section 19A is only incidental and ancillary to the main charging section, even the conferment of such ancillary power must be within the competence of the State Legislature. The ancillary power can be provided or exercised only in aid of the main topic of the legislation and not in derogation of the same. In this context, it is pertinent to note the observation of the Supreme Court in *Khyerbari Tea Co. Ltd. and Another Vs. The State of Assam*, to the following effect :

"It may be conceded that when the Legislature constructs a machinery for the recovery of the taxes which it is within its competence to impose, the said machinery should have some rational or intelligent connection with the tax. In the absence of a rational nexus between the producer and the tax on goods carried, it may be open to a citizen to contend that the tax is not one justified by entry 56."

14. In *Cibatul Limited, P. O. Atul v. Union of India* (1979) ELT 407, the Gujarat High Court observed as follows :

"It is true that when Parliament levies a tax, it also provides machinery for collecting it. Ordinarily, if the levy of a tax is constitutionally valid, the machinery provided to make it effective does not suffer from a constitutional vice. However, when, under the Constitution, the Parliament has legislative competence to levy a particular tax and when it does so, it cannot competently enact the machinery section which in the name of collecting that particular tax collects something else which is not within the legislative competence of Parliament to levy or collect. Therefore, the general principle that if the charging section is intra vires, the machinery section cannot be ultra vires is subject to the exception that machinery section does not stretch its long arms to pick-up the forbidden fruit along with others. Parliament having levied a tax is entitled to provide the mode of its assessment and the method of its collection. However, the mode of its assessment and the method of its collection cannot entrench upon the legislative field earmarked exclusively for the States. In the instant case, though section 3 is valid (its constitutionality has not been challenged), section 4 suffers from a vice because it entrenches upon entry 54 in the State List."

15. In the light of the above decision, it is clear that even an ancillary provision cannot go beyond the legislative power of the State and has to confine itself to the power conferred on it within the entry in one or the other of the List enumerated in the Constitution.

16. A similar provision under Patna Act was considered by the Patna High Court in the decision in *Construction and Construction Vs. Union of India (UOI) and Others*, . Rule 26A(2) of the Bihar Rules, provided that, deduction shall be made from "all payments being made in respect of all works contracts executed,

whether in part or full, after 1st April, 1984," provided if the total value of works contract or contracts exceeds Rs. 25,000. The validity of these Rules was considered by the Patna High Court and the same grounds were urged against constitutional validity of the above provision. In that context, it was held :

"The contention on behalf of the petitioner is well-founded. If the words "all payments" are to be read to mean all payments including the amount paid on account of labour charges and other services rendered by the contractor, then sub-rule (2) or rule 26A has to be held to be invalid and unconstitutional."

17. From the principles deducible from the aforesaid decision, we are clearly of the view that section 19A of the Karnataka Sales Tax Act is beyond the legislative competence of the State. It includes not only the turnover which are exigible to tax under the Sales Tax Act but includes also the amounts which are outside the purview of entry 54 and also the amounts which are not exigible to sales tax at all under the State law or the Central law. The section is also arbitrary, in that, there is no machinery provided under the Act to determine even approximately the taxable turnover of a dealer for the purpose of collection of advance tax, as provided for, u/s 194C(4) of the Income Tax Act, 1961. We are not impressed by the contention that, even if the dealers pay amounts in advance, it can be finally adjusted. It is well-known that refund of excess tax paid to the State will take a long time to be refunded and under that guise, the petitioners cannot be deprived of their property without authority of law. In that view of the matter, we hold that section 19A is constitutionally invalid.

18. The learned single Judge has upheld the provision u/s 19A also on the ground that it gets extended to transactions in relation to inter-State transactions only by reason of section 9 of the Central Sales Tax Act and not otherwise. It is no doubt true that the machinery provisions contained in the State Sales Tax Act can be utilised for the purpose of collecting Central sales tax as well by provisions contained in section 9(2) of the Central Sales Tax Act, but that will not clothe the State Legislature with power to levy advance tax on the amounts which are not exigible to tax either under the State Act or under the Central Act. It is clear from the above decisions of the Supreme Court referred to above that a works contract may take in turnover which is exigible to tax either under the State Act or under the Central Act, there are other components in a works contract, viz., charges for labour and services which are not exigible to tax at all to be deducted from the value of the works contract for the purpose of determining the tax liability. No provision is made in section 19A even tentatively to give deductions for the aforesaid amounts and the amount is deducted at a flat rate from the total amount payable to the contractor which is not constitutionally permissible. As stated earlier, the power under entry 54 is restricted by various constitutional inhibitions and other provisions which are not reflected at all in section 19A of the Karnataka Sales Tax Act. Accordingly, we do not find our way to agree with the learned single Judge and in reversal of the same, we hold that section 19A of the Karnataka Sales Tax Act is constitutionally

invalid and liable to be struck down. As stated earlier, the power of the State Legislature for making a provision for collection of tax in advance cannot be doubted but in so far as section 19A is concerned, it directs deduction of tax at a flat rate from the total amount of the contract amount which is impermissible. The invalidity of the above section goes to the root of the imposition of the advance tax and in the absence of the said provision, advance tax cannot be levied.

19. In view of what is stated above, these appeals are allowed. The judgment of the learned single Judge is set aside and it is declared that section 19A of the Karnataka Sales Tax Act is unconstitutional and void.

20. The parties are directed to bear their costs in these appeals.

21. Appeals allowed.