

(2009) 09 KAR CK 0048
In the Karnataka High Court
Case No : S.T.R.P. No. 8 of 2006

Larsen and Toubro Limited

APPELLANT

Vs

The State of Karnataka

RESPONDENT

Date of Decision : 02-09-2009

Acts Referred:

Karnataka Sales Tax Act, 1957 — Section 5 B
Karnataka Sales Tax Rules, 1957 — Rule 6 (1) (c), 6 (4) (n) (iv)

Citation : (2010) ILR (Kar) 3154 : (2010) 34 VST 53

Hon'ble Judges : D.V. Shylendra Kumar, J;Aravind Kumar, J

Bench : Division Bench

Advocate : T. Suryanarayana, for the Appellant; A.M. Manjunath, Additional Government Advocate, for the Respondent

Final Decision : Allowed

Judgement

D.V. Shylendra Kumar, J.—Revision petition u/s 23(1) of the Karnataka Sales Tax Act, 1957 (hereinafter referred to as the Act, for short) by a dealer registered under the provisions of this Act and directed against the order passed by the Karnataka Appellate Tribunal, Bangalore order dated 30-6-2005 in STA Nos. 1263 and 1264/2001.

2. Under the impugned orders which had come to be passed by the Tribunal in exercise of its powers u/s 22 of the Act wherein the assessee's appeal against the suo motu revisional order dated 10-9-2001 passed by the Joint Commissioner of Commercial taxes in exercise of its power u/s 21(4) of the Act had come to be allowed in appeal in the sense that while the Tribunal had granted some relief to the appellant dealer in respect of the subject matter of appeal and in respect of the other part of the appeal which had not been allowed by the Tribunal as against the order of the Joint Commissioner, the present revision petition.

3. The revision petition has been admitted to examine the following questions of law as arising out of the order of the Tribunal:

Whether on the facts, in the circumstances and on the contentions taken, the Tribunal was right in:

(i) not allowing, while computing taxable turnover, deduction in respect of depreciation on plant and machinery owned and used by the Petitioner for executing the works contracts?

(ii) Not allowing deduction in respect of:

(a) Interest charged by clients;

(b) Postage, telephone and telex expenses; and

(c) Vehicle tax

(iii) holding that TOT would be leviable on materials supplied by clients for use in execution of the works contracts

(iv) not taking note of restrictive legal scope of the charging provision of Section 5B of the Act r/w. Rule 6(1)(c) of the Rules to examine whether levy of tax is permissible without allowing deduction of various expenses including those referred above?

4. We have heard Sri. Suryanarayana, learned Counsel appearing for the petitioner and Sri. Manjunath, learned Additional Government Advocate appearing for the respondent State.

5. The brief facts leading to the above petitions are that the petitioner-assessee/dealer is a construction company registered under the Companies Act. The petitioner in the course of its business activities undertakes various civil construction works at a competitive price quoted by it for the execution of the entire work which in the Sales Tax parlance is termed as a works contract and the consequence in so far as the Act is concerned, is when the dealer like petitioner executes a works contract, the value of the taxable goods involved in the execution of the works contract attracts tax liability under the provisions of the Act and the machinery for determination of the tax liability is set in motion and quantified, and the dealer called upon to pay the corresponding tax.

6. In the present case we are concerned with the tax liability of the petitioner determined by the authorities for the period 1991-92 i.e., from 1-4-1991 to 31-3-1992 and 1992-93 i.e., from 1-4-1992 to 31-3-1993.

7. The 12 months duration constitutes the fiscal unit for the purposes of assessment. Questions have arisen in the context of determination of the value of the goods involved in the execution of the works contract undertaken by the petitioner during these two periods and as to when the title in goods passes from the dealer to their client.

8. It is a transaction of sale of the goods attracting tax liability under the Act. The exercise of determination of the value of the goods involved in the execution of any works contract is not a simple exercise but is rather a complicated

exercise and the tax liability in respect of such value of goods involved in the works contract is to be found in terms of Section 5B of the Act which reads as under.

[5B. Levy of tax on transfer of property in goods (whether as goods or in some other form) involved in the execution of works contracts.- Notwithstanding anything contained in Sub-section (1) or [Sub-section (3) or Sub-section (3C) of Section 5, but subject to Sub-section (4), (5) or (6) of the said Section, every dealer shall pay for each year, a tax under this Act on his taxable turnover of transfer of property in goods (Whether as goods or in some other form) involved in the execution of works contract mentioned in column (2) of the Sixth Schedule at the rates specified in the corresponding entries in column (3) of the said Schedule.

9. The nature of works contract identified for the purpose of tax and the rate at which the goods involved in the execution of such works contract are to be subjected to tax is found in Schedule VI to the Act.

10. In so far as the activity of the petitioner is concerned, having regard to the nature of works contract that is being executed by them, the said activity is without any dispute one falling within entry VI of Schedule VI to the Act i.e., Civil Works like construction of buildings, bridges, roads etc and during the relevant period attracted tax at the rate of 8%.

11. The entire exercise being one of ascertaining the value of the goods passing from the contractor to his client on the execution of the works contract, the sum total of which constitute the taxable turnover of the dealer as the expression occurs not only in Section 5(b) but as defined u/s 2(u)(i) reading as under:

2. Definitions: (1) In this Act, unless the context otherwise requires,-

(u1) "Taxable turnover" means the turnover on which a dealer shall be liable to pay tax as determined after making such deductions from his total turnover and in such manner as may be prescribed, but shall not include the turnover of purchase or sale in the course of inter-State trade or commerce or in the course of export of the goods out of the territory of India or in the course of import of the goods into the territory of India;

and for the purpose of determining the taxable turnover the legislature having enabled, its delegate to prescribe the manner in which it can be arrived at and for such purposes is designed Rule 6 of the Karnataka Sales Tax Rules 1957.

12. In the present context as it is the undisputed case of the petitioner as well as the revenue that the relevant provision of the Rules is Sub-clause (iv) of Clause (n) of Sub-rule (4) of Rule 6 i.e. Rule 6(4)(n)(iv) for the main purpose of ascertaining the value of the goods is Sub-clause (4) and the explanation as it prevailed at the relevant time which in all operate in conjunction for achieving the desired purpose. We may conveniently extract only the relevant provisions of the rule as under:

Rule 6(1)(c)" and Rule 6(4)(n)(iv) and explanation I as found at page 284 (Rule 6), 285 (Sub-rule 4), 288 (Clause n), 289 (Sub-clause iv) and at 291 (explanation - I) of the 2004-05 (5th edition) of the KST Act edited by Sri Sathpal Puliani and published by Karnataka Law journal publications.

6. Determination of total and taxable turnover: -

(1) The total turnover of a dealer, for the purposes of the Act, shall be the aggregate of:

(a) xxxxxx

(b) xxxxxx

(c) the total amount paid or payable to the dealer as the consideration for transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract; and includes any amount paid as advance to the dealer as a part of such consideration;

6. Determination of total and taxable turnover: (1) The total turnover of a dealer, for the purposes of the Act, shall be the aggregate of:

(2) xxxxxx

(3) xxxxxx

(4) In determining the taxable turnover, the amount specified in Clauses (a) to (p) shall, subject to the conditions specified therein, be deducted from the total taxable turnover of a dealer as determined under Clauses (a) to (e) of Sub-rule (1).

(a) to (m) xxxxxxxx

(n) in the case of works contracts specified in serial numbers 6, 13, 14, 15, 16, 18, 19, 20, 21, 22, 23, 24, 25, 28, 29], 30, 31, 32, 33, 34, [37, 38, 39 and 41] of the Sixth Schedule;

(i) to (iii) xxxxxxxx

(iv) Such amounts towards labour charges and other like charges not involving any transfer of property in goods actually incurred in connection with the execution of works contract, or

Explanation-I:- For the purpose of Clauses (m) and (n) of Sub-rule (4), labour and other like charges include, charges for obtaining on hire or otherwise machinery and tools used for execution of Works Contract, charges for planning, designing and architects fees, cost of consumables used in the execution of the Works Contract, cost of establishment to the extent relatable to supply of labour and services and other similar expenses relatable to supply of labour and services.

13. In respect of the determination of the taxable turnover of the dealer for the

two accounting periods referred to above, while the process of determination of the tax liability was on, the appellant dealer had claimed the following deductions as deductions to be allowed even in terms of the Rule, from out of the value of the works contract to arrive at the value of the taxable goods involved in the works contract and passed on to the client for the accounting period 91-92:

The revised assessment order in respect of E.C.C Construction Group is as under:

Total contract receipts Rs. 26,06,10,562-00 Less: 1) Excess considered for the re-assessment order dated: 20-6-94 Rs. 17,27,65,026-02

2) Add: Labour charges Collected for quarrying, and extraction of stones from M/s NPC, kaiga, North Kanara Rs. 1,41,36,213-00

3) Items of expenditure relating to cost of consumable materials service charges tools and spares, tackles, consumable spares, being cost of estd., cost of relatable labour Rs. 4,09,58,676-00 Rs. 22,73,59,915-00 Taxable Turnover Rs. 3,32,50,647-00

Classification of Taxable Turnover:

Value of civil contract receipt liable at 8%	Rs. 2,30,10,072-00	8%	Rs. 18,40,806-00
Value of Iron and Steel used in the execution of works contract	Rs. 1,02,40,570-00	4%	Rs. 4,09,623-00
			Rs. 3,32,50,647-00
			Rs. 22,62,429-00

T.O.T u/s 6B on the following Turnovers: 1) Taxable turnover Rs. 2,30,10,072-00 2) Second sales of II schedule items Rs. 17,57,661-00 T.O.T at 1.75% Rs. 2,42,67,738-00 Rs. 4,33,435-00 _____ Total Taxes payable Rs. 26,95,864-00

Add: Taxes payable as assessed in the order u/s 12A dt. 26-6-94 in case of Bangalore Branch, B"lore works, Mysore works. Rs. 2,21,61,419-00 _____ Total Taxes payable Rs. 2,48,57,283- 00

for the accounting period 1-4-1992 to 31-3-1993:

The revised assessment relating to ECC Construction Group is finalised as under by considering the above facts and reasons:

Gross receipts Rs. 47,60,51,640-00	Add: Sales of Scrap Materials Rs. 25,49,481-00	Rs. 47,86,01,121-00
Less Exemptions Rs. 46,18,37,337-00		Rs. 1,67,63,784-00

Add: Excess expenditure over receipts Admitted to tax during 1992-93 Rs. 8,11,31,799-00 _____ Taxable Turnover Rs. 9,78,95,583-00

Classification of Taxable Turnover:

1) Works contract receipts Rs. 19,13,183-00 4% Rs. 76,527-00 relating to M/s KPC Limited, Raichur vide Govt. Notification, dt: 11-7-86 and 31-3-1987.

- 2) Works Contract receipts relating to KEB, Bangalore of Electronic works Rs. 1,55,031-00 10% Rs. 15,503-00
 - 3) Cost of Steel used in Contract works Rs. 5,63,39,798-00 4% Rs. 22,53,592-00
 - 4) Civil Contract receipts Rs. 3,60,88,207-00 8% Rs. 28,87,057-00 B/F Rs. 9,44,96,219-00 Rs. 52,32,679-00
 - 5) Works contract receipts of Structural works Rs. 8,49,883-00 7% Rs. 59,492-00
 - 6) Sale of Steel Scrap & Items Rs. 24,35,361-00 4% Rs. 97,414-00
 - 7) Sale of Unserviceable articles Rs. 1,14,120-00 7% Rs. 7,988-00
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- Rs. 9,78,95,583-00 Rs. 53,97,573-00

TOT on the following Turnover:

- 1) Cost of II dealer Rs. 1,50,03,122-00 goods other than declared goods involved in the execution of works contract
 - 2) Civil Contract receipt other than the value of declared goods out of the admitted taxable value Rs. 3,90,06,304-00
 - 3) Sale of un-serviceable Rs. 1,14,120-00 _____ articles Rs. 5,41,23,546-00 T.O.T 0 2.5% works out to Rs. 13,53,089-00
-
- Total Taxes Rs. 67,50,662-00 _____

Abstract of total taxes payable:

Taxes assessed in case of Bangalore Branch for Bangalore works, Mysore works as per the Final Assessment Order Rs. 2,59,70,160-00

Taxes now assessed in case of ECC-Works Contract Rs. 67,50,662-00
 _____ Total: Rs. 3,27,20,822-00

Less: Form-37 submitted for sale of Electronic computer peripherals for which Form-37 now filed at set off of 2% (assessed 0 6% vide page No. 52. Sl. No. 2 of this page of FAO on P.T.O of Rs. 10,10,695-00) Rs. 20,214-00
 _____ Total Taxes Payable. Rs. 3,27,00,608-00

The excess payment of taxes if any shall have to be carried forward to next year of 1993-94,

Revised Demand Notice shall issue accordingly.

14. Even the determination as above by the Assessing Officer has a history in the sense the Assessing Officer had not allowed all such deductions initially and the two assessments had made the subject matter of appeal before the Joint Commissioner invoking the provisions of Section 20 of the Act and the appeals had come to be allowed but by way of remand and it is on such remand the

Assessing Authority had passed orders indicating computation as extracted above and the assessee getting substantial relief.

15. It was now the turn of the Joint Commissioner to Exercise his suo motu revisional jurisdiction being of the opinion that the assessment orders as passed by the Assessing Authority on remand were not correct and that they were prejudicial to the interest of the revenue and therefore proposing exercise of jurisdiction u/s 21 of the Act to revise the two assessment orders of the Assessing Authority (later done as per the show-cause notice dated 10-1-2001), (produced as Annexures F1 and F2) as the revisional authority was of the view that the assessee was not entitled to claim deduction in respect of the following expenditure/claims even in terms of the provisions of Rule 6(4)(n)(iv) Explanation I, issued a show-cause notice to the dealer as to why such deductions as permitted by the Assessing Authority should not be excluded but to be added back to the value of the goods which in turn will have the effect of increasing the tax liability:

(b) The assessing authority has allowed exemption of tax u/s 6B on the sales tax paid, customs duty and bank charges etc., in all at Rs. 1,29,00,628-00 as indicated below.

- 1) Sales tax and customs duty paid Rs. 14,58,127.00
 - 2) Bank charges Rs. 3,66,517.00
 - 3) Depreciation on plant and machinery Rs. 96,39,825.00
 - 4) Interest charged by clients Rs. 7,17,929.00
 - 5) Postages and telephone, telex Rs. 5,38,986.00
 - 6) Vehicle tax Rs. 1,79,245.00
- Total Rs. 1,29,00,624.00

and in respect of the year 1992-93 the following extents proposed to be disallowed:

2. Following are the reasons for coming to the conclusion as noted in para (1) above:

(a) The assessing authority while concluding the asst. order in question has allowed exemption of tax on the following items:

- i) Sales tax, Turnover Tax and Entry tax paid Rs. 28,59,383.00
- ii) Depreciation on plant and machinery Rs. 1,71,83,168.00 _____ Total Rs. 2,00,42,551.00

16. Notwithstanding the dealer making a brave effort to avoid the Additional Tax liability in terms of the show-cause notice by filing objections etc., was not successful in doing so as the revisional authority was of the view that the

defence raised by the assessee in terms of the reply to the show-cause notice was not very satisfactory for varying the show-cause notice and the additions to be made to the value of the taxable goods and therefore confirmed the proposition and raised demand for payment of commensurate tax by the dealer. In terms of the order dated 10-9-2001.

17. Against these two orders of the revisional authority the appellant dealer preferred two appeals to the Tribunal u/s 22 of the Act.

18. Before the Tribunal the appellant dealer again met with partial success as the Tribunal thought it fit to set aside the order of the revisional Commissioner, in so far as it disallowed the expenses in the nature of sales tax, Customs duty paid on the machinery and the bank charges thereon but did not agree with the contention of the assessee dealer that the dealer can claim a deduction towards the depreciation also and did not deem it fit even to discuss the deductions in respect of interest charged by clients by advance, postage, telephone, telex expenses and vehicle tax. The above three items are relatable only to the period 1991-92 but did not vary the addition to the value of the goods as was done by the revisional authority. In so far as the levy of turn over tax, the stand of the assessee that the value of the material supplied which has gone into the execution of the works contract should be excluded in calculating the turnover of the dealer, did not find acceptance and the question framed by the Tribunal in this aspect as question No. 2 and reading as under:

2. Whether the RA was justified in levying TOT in respect of the value representing materials supplied by the Client for use in the execution of works contract?

was answered in the affirmative and against the petitioner dealer following the judgment of the Supreme Court in the case of Cooch-Bihar Contractors' Association and Others Vs. State of W.B. and Others, . It is in respect of such orders passed by the Tribunal in the two appeals before it for the two accounting periods the present revision petitions on the questions as extracted above for the examination of the same.

19. Appearing on behalf of the revision petitioner dealer, Sri. Suryanarayana, learned Counsel would submit that in so far as question No. 3 relating to the inclusion or exclusion of the value of the material supplied by the clients to the contractors is though a debatable issue between the revenue and the petitioner, keeping the question open would like to address arguments on the same as Sri. Manjunath, learned Government Advocate would submit by pointing out that so far as this question is concerned, it is now not only covered by the judgments referred to by the Tribunal as indicated above but is finally concluded by the judgment of the Supreme Court in the case of Karya Palak Engineer, C.P.W.D., Bikaner Vs. Rajasthan Taxation Board, Ajmer and Others, holding that such value of the goods supplied by the client to the contractor which goes into execution of the works contracts though for the very client is nevertheless to be included in

the taxable turnover of the contractor as what is supplied is in the form of goods as it is a sale in the first instance by the client to the contractor.

20. We have examined the facts of the present case and in the context the applicability of the ratio of the judgment of the Supreme Court in Karya Palak Engineer's case we are of the view that in the light of the legal position enunciated by the Supreme Court in this case there is no scope for entertaining further arguments on this aspect by this Court and therefore without going further into this question, the question is answered in the affirmative against the assessee dealer.

21. That leaves us with the remaining three questions which essentially revolve around the exercise of the determination of the value of the goods involved in the execution of the works contract by computing the total value of other components of the works contract and by deducting this total value from out of the value of the works contract. This exercise is necessarily one warranting the ascertainment of such other deductions to be made from the value of the works contract in terms of the statutory provisions and as indicated above in terms of Rule 6(4)(n)(iv) explanation.

22. Contentions urged by Sri. Suryanarayana for the revision petitioner are as under:

Sri T. Suryanarayana, learned Counsel by drawing reference to the statutory provisions would submit that the deductions claimed by the writ petitioner dealer and which have not been allowed even by the Tribunal are all deductions which are within the contemplation of the statutory provision in terms of the explanation I to Sub-clause (iv) Clause (n) of Sub-rule 4 of Rule 6. Submission is that the value of the depreciation on plant and machinery utilised by the petitioner for the purpose of execution of the works contract is a part of expenditure which the assessee would have otherwise incurred if the contractor should have hired such machinery from an outside source and for which the contractor has to necessarily pay the hire charges within the meaning of the explanation I relating to charge on obtaining on hire or otherwise machinery and dealers machinery used on works contract. Submission is that the depreciation amount claimed is on par with this hire charges expressly permitted in terms of explanation I and though is not necessarily an item which was subject matter of discussion before the Supreme Court in 2nd Denkerley's case in the sense the Supreme Court was not seized of the word "depreciation" in the context of examination of the scope for reducing the value of other components on works contract other than the value of the goods and in principle an expenditure of the like nature which is one covered by Clause (d) of the difference tax on deduction permitted and as indicated in Clauses (a) to (h) of the judgment of the Supreme Court in the case of Gannon Dunkerley and Co. and Others Vs. State of Rajasthan and Others, and the relevant clause is as follows:

(d) charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract.

and therefore would submit that it is a deductible item of expenditure both in terms of explanation I of Sub-clause (iv) of Clause (n) of Sub-rule 4 of Rule 6 and as per terms of the judgment of the Supreme Court and therefore the Tribunal is in error in taking the view that as it is not an expenditure incurred by the dealer in the sense no payment is made to an outside agency by the Contractor it is not to be allowed and for the very reason would submit that the Joint Commissioner is also in error in thinking that the judgment of the Supreme Court in 2nd Dunkerley's case did not enable allowing deduction of this nature. It is therefore submitted that both on the ratio of the judgment in 2nd Dunkerley's judgment and the express statutory provisions and even on a principle of interpretation such as what is taxable in an amount attributable to the execution of works out to be the value of the goods and not any other components and if it of a profit component of the goods alone to be included in terms of the discussion by the Supreme Court in 2nd Denkerley's case as figures at paragraphs 4, 5 and 6 of the conclusions as they occur at page 237 of the judgment which are to the following effect:

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 supply of labour and services, and (viii) profit earned by the contractor to the extent it is relatable to supply of labour and services.

23. Learned Counsel would submit that such expenditure incurred by the dealer though is quantified with reference to the depreciation as recognised under other enactment and as computed under other enactments is nevertheless a deductible

expenditure in terms of Clause (d) of the items of expenditure identified by the Supreme Court for such deduction and the assessee has restricted the claim under Clause (d) even on the value of the depreciation, only to the proportionate extent of the machinery having been deployed for the purpose of the execution of the works contract in the sense such portion of the period during which the machinery is deployed for the execution of the works contract vis-a-vis the entire year. So far as the disallowance of the expenditure such as vehicle tax is concerned, which was expressly disallowed by the revisional authority and not even adverted to by the Tribunal, submission is that these are all expenses clearly forming part of the cost of establishment and therefore not only in terms of explanation I which allowed such a deduction as:

...cost of establishment to the extent relatable to supply of labour and services and other similar expenses relatable to supply of labour and services.

but also in terms of the judgment of the Supreme Court in 2nd Denkerley's case and as is indicated in Clause (f) of the deductible charges permitted and as occurred at page 235 of the judgment and therefore the Revisional Commissioner was in error in not permitting the deduction.

24. It is further submitted by Sri. Suryanarayana by pointing out to the legislative history of Rule 6 of the Rules that explanation I as it stands as of now, and at the relevant time, was one in terms of amendment carried out by the notification No. FD 83 CSL 95 dated 5-8-1995 giving it retrospective effect from 1-4-1986 and the said amendment having been brought about only in the wake of the judgment of the Supreme Court in the case of 2ndDunkerley case and if one should read the explanation as it prevailed at the relevant time applicable to the two periods with which we are concerned, it is virtually verbatim reproduction of the contents of the situation (a) to (h) discussed by the Supreme Court as at page 235 and therefore any meaning that can be attributed to explanation I can only be and should necessarily be in consonance with the understanding of the Supreme Court in terms of Clause (a) to (h) of the permissible deduction as discussed in Gannon Dunkerley and Co. and Others Vs. State of Rajasthan and Others, and as it occurs at page 235 and would therefore submit that the dealer definitely would be entitled to claim such deduction, that the Revisional Commissioner was in error in disallowing the same and the Tribunal has committed a further error by its inaction on this aspect by not even adverting to the contentions urged on behalf of the assessee on this aspect. It is therefore submitted that the three other questions amongst the 4 questions determined for answering should also be answered in favour of the appellant dealer and in the negative.

25. On the other hand, appearing on behalf of the State, Sri. Manjunath, learned AGA submits that the Commissioner was fully justified in revising the order passed by the Assessing Authority; that such a correction was warranted even in terms of the judgment of the Supreme Court in the decision of 2nd Gannon Dunkerley's case (supra); that a deduction for a claim in the nature of

depreciation was never in contemplation of the discussion before the Supreme Court in the 2nd Gannon Dunkerley's case (supra); that have been indicated as plausible deductions which can be claimed from out of the value of the contract for arriving at the value of the goods passing on the execution of the work under the contract are all expressly discussed in paragraph 8 of the judgment:

With regard to the determination of the value of the goods which are involved in the execution of a works contract the submission of the learned Counsel appearing for the State is that a more convenient mode for such determination is to take the value of the works contract as a whole and deduct therefrom the cost of labour and services rendered by the contractor during the course of execution of the works contract. The submission of the learned Counsel is that this mode would prevent evasion of tax. The learned Counsel for the contractors have submitted that in that event the following deductions should be made from the value of the entire contract in order to arrive at the value of the goods involved in the execution of a works contract:

- (i) labour charges for execution of the works;
- (ii) amounts paid to a sub-contractor for labour and services;
- (iii) charges for planning, designing and architect's fees;
- (iv) charges for obtaining on hire the machinery and tools used in the execution of the works contract;
- (v) cost of consumables such as water, electricity, fuel, etc.
- (vi) transportation charges for transport of goods to the place of works;
- (vii) overhead expenses of the head office and branch office including rents, salary, electricity, telephone charges, etc., and interest charges to banks and financial institutions;
- (viii) profits expected on such contract;

and none of the deductions enumerated as plausible deductions as above i.e., from Item at Sl. Nos. 1 to 8 in any way providing for a deduction in respect of a claim towards depreciation even on the basis of the judgment of the Supreme Court. Submits that the assessee is not entitled for claiming a deduction attributable to the depreciation, even in respect of proportionate depreciation of the plant and machinery employed by the assessee in the course of the execution of the works contract and even when only the proportionate quantum of depreciation is claimed by way of deduction.

26. Learned AGA would also submit that even Rule 6(4)(n) r/w Explanation I, does not enable the assessee to put forth a claim of this nature for the simple reason that the word "depreciation" is not to be found anywhere in the sub-rule r/w Explanation I. Learned AGA would therefore, submit that neither on the basis of the judgment of Supreme Court in 2nd Dunkerley's case (supra) nor on the

basis of the statutory provision, the assessee is entitled to claim a deduction in the nature of depreciation while computing the value of the goods passing to the buyer in the course of the execution of a works contract and any such deduction being statutorily regulated and there being no scope for claiming a further deduction on any other nature, there is no way of the assessing officer allowing such a deduction and therefore, the Commissioner has rightly revised the order of the Assessing Authority and equally rightly the Tribunal has declined to interfere with the action of the Revisional Authority.

27. It is in the background of such submissions we are required to examine the questions.

28. It is now history that the Constitutional 46th amendment by which the "Article" providing for defining the words and phrases used in the Constitution viz., Article 366 came to be amended by way of insertion of Clause (29A) and this was in the wake of the various judgments of the High Court and the Supreme Court indicating the scope of levy of sales tax in Entry 54 of List II in Schedule VII to the Constitution of India. The 1st Dunkerley's case (*supra*) viz., originating from the Madras High Court in the case of Gannon Dunkerley and Co. (Madras) Ltd., v. State of Madras [1954] 5 STC 216 Mad : AIR 1954 Mad. 1130 affirmed by the Supreme Court in the judgment of *The State of Madras Vs. Gannon Dunkerley and Co., (Madras) Ltd.*, and as applied by the various High Courts, while interpreting the sales tax enactment's of the respective States, was a subject matter for considerable heart burn for State Governments, who have been eyeing for basketting a better yield from levy of sales tax, drawing on their power from Entry 54 of List II Schedule VII to the Constitution of India. The other developments of many assesseees/dealers escaping the net of taxation by resorting to many avoidable transactions also had attracted the attention of the State Legislatures and it is as a result of collective thinking on the part of State Governments and the Union Government that ultimately the definition of "tax" on the sale or purchase of goods came to be amended. The definition of tax on the sale or purchase of goods was an inclusive one, which was inserted as Sub-article (29A) in Article 366 by the 46th Constitutional amendment to enable State Governments to levy tax in respect of the value of the goods involved even in respect of transactions of the following nature:

[(366: 29A): tax on the sale or purchase of goods" includes -

- (a) a tax on the transfer, otherwise than in pursuance of a contract, of property in any goods for cash, deferred payment or other valuable consideration;
- (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;
- (c) a tax on the delivery of goods on hire-purchase or any system of payment by installments;
- (d) a tax on the transfer of the right to use any goods for any purpose (whether

or not for a specified period) for cash, deferred payment or other valuable consideration;

(e) a tax on the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration;

(f) a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration,

and such transfer, delivery or supply of any goods shall be deemed to be a sale of those goods by the person making the transfer, delivery or supply and a purchase of those goods by the person to whom such transfer, delivery or supply is made;]

29. Though such a definition was found in Sub-article (29A), it was obviously corresponding to and linked to Entry 54 of the List II. This amendment by itself was not of much significance, unless the State Legislatures gave expression to this, in their respective sales tax enactment and that is the history of finding Section 5B of the Act in the statute, with which we are directly concerned in this case.

30. Section 5B itself was introduced in The Karnataka Sales Tax Act, 1957, by way of an amendment in terms of Karnataka Act No. 27/1985, given effect to from 1.4.1986. For the purpose of ascertaining the taxable turnover from out of the value of the contract and in terms of the very Section 5(B) r/w the phrase taxable turnover, Rule 6 of the Karnataka Sales Tax Rules, 1957, provided for the manner of arriving at the same after making the deductions permitted in terms of the Rules. Rule 6 reads as follows:

Rule 6: Determination of total and taxable turnover - [(1) The total turnover of a dealer, for the purposes of the Act, shall be the aggregate of-

[(a) the total amount paid or payable by the dealer as the consideration for the purchase of any of the goods in respect of which tax is leviable at the point of purchase under one or more of the provisions specified hereunder, where such purchase has taken place inside the State -

(i) Clause (b) of Sub-section (3) of Section 5;

(ii) Sub-section (4) of Section 5;

(iii) Section 6;]

(iv) xxxxxxxx;]

(b) the total amount paid or payable to the dealer as the consideration for the sale, supply or distribution of any goods other than those coming under Clause (a), where such sale, supply or distribution has taken place inside the State;

[xxxxxxx]

(c) the total amount paid or payable to the dealer as the consideration for transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract; and includes any amount paid as advance to the dealer as a part of such consideration;

(d) the total amount paid or payable to the dealer as the consideration for transfer of the right to use any goods for any purpose (whether or not for specified period);

(e) the total amount payable to the dealer as the consideration in respect of goods delivered on hire purchase or any system of payment by installments;] [

(f) the aggregate of the sale prices received and receivable by the dealer in respect of sales of any goods in the course of inter-State trade or commerce as determined in accordance with the provisions of the Central Sales Tax Act, 1956 (Central Act 74 of 1956), as also in respect of sales of any goods in the course of export out of the territory of India and also in respect of sales of goods in the course of import into the territory of India.]

[(2) xxxxxx

(3) xxxxxx]

(4) [x x x x x] In determining the taxable turnover, the amount specified in Clauses [(a) to (p)] shall, subject to the conditions specified therein, be deducted from the total taxable turnover of a dealer [as determined under Clauses [(a) to (e) of Sub-rule (1)].

xxxxxxx xxxxxxxx xxxxxxxx xxxxxxxxxxxxxxxxxxxx xxxxxxxx xxxxxxxx
xxxxxxx (n) in the case of works contracts specified in serial numbers 6, 13, 14, 15, 16 2[18, 19, 20, 21, 22, 23, 3[24, 25, 4[28,] 29,] 30, 31, 32, 33, 34, [xxx] 6(37m 38, 39 and 41] of the sixth schedule;

7[(i) all amounts received or receivable in respect if any goods other than the goods taxable under Sub-section (1A) or (1B) of Section 5 which are purchased from registered dealers liable to pay tax under the Act.]

1[(i) all amounts received or receivable in respect of goods specified in second, third and fourth schedules which are purchased from registered dealers liable to pay tax under the Act].

(ii) [all amounts received or receivable in respect of goods] which are specifically exempted from tax under any of the provisions of the Act;

(iii) all amounts paid to sub-contractors as the consideration for execution of works contract whether wholly or partly:

Provided that, no such deduction shall be allowed unless the dealer claiming deduction produces proof that the sub-contractor is a registered dealer liable to

contractor for the benefit of its client is not the value of the goods itself, as in the execution of a works contract several other input components are present and unless the precise value of the goods passing on the execution of the works contract is ascertained and levy of tax is confined to that value alone, the possibility of the charging section itself failing for the unwork ability of the procedural provisions, which in this case is Rule 6 of the Rules and in turn also rendering the charging section unconstitutional is a potential possibility looming large as a basic concept.

34. It is in the background of these further developments, we are examining the merits of the submissions made by Sri. T. Suryanarayana, learned Counsel for the appellant - assessee. On such an examination, while we find and as submitted by the learned AGA the word "depreciation" is conspicuously absent either in Rule 6 particularly, Explanation 1 to Sub-rule (4) of Rule 6 or even in the judgment of the Supreme Court in the 2nd Gannon Dunkerley's case as it occurs on this aspect at page 233 and 235, we are nevertheless inclined to examine the submissions made by Sri. Suryanarayana, learned Counsel for the appellant-assessee, for the reason that the entire exercise for the purpose of levy of tax u/s 5(B) of the Act is only to ascertain the precise value of the goods in respect of which title passes from the contractor to the client on the execution of the work. The charge cannot be on anything over and above the value of the goods, not even by a pie ! Even assuming that Rule 6 when read in its entirety does not contain the word "depreciation", but nevertheless should necessarily take the hue from the permitted deductions as indicated by the Supreme Court in Clause (d) occurring at page 235 of the judgment which reads as "charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract" and examining the scope of Explanation I to Sub-rule (4) of Rule 6 of the Rules construed in this background and answer the question. We say so, for the reason that it is the goods of the assessee for the purpose of execution of the works contract, which the assessee otherwise, could have hired the machinery and tools, instead of utilizing its own machinery and tools and in the process of execution of the work, the machinery and tools are worn down and depreciates in value and as the end price i.e., the value of the contract is fixed or determined by the contract factoring this wear and tear to the machinery and tools as a consequence of using them for the execution of the works contract, the value of the proportionate wear and tear of the machinery which is otherwise identified as depreciation has to be necessarily permitted as a deduction on the premise that it is equivalent to the hire charges as is otherwise provided in Clause (d) and for such purpose one has to understand the same even in terms of the language of Explanation I as quoted above and particularly, to be one within the scope of "other similar expenses relatable to supply of labour and services."

35. We find the submission of Sri. Suryanarayana, learned Counsel for the appellant attractive enough for acceptance, for the reason that Section 5B of the Act is only as a sequel to Sub-clause (b) of Sub-article (29A) of Article 366 which

reads as "a tax on the transfer of the property in goods (whether as goods or in some other form) involved in the execution of a works contract; ".

36. While a levy of tax of such nature, as indicated in Clause (b) is nevertheless a tax on sale or purchase of goods, though the goods may not be identifiable for such purpose on the execution of the works contract. A combination of Article 366 Clause (29A)(b) r/w Section 5B of the Act, having enabled such a levy to be sustainable but within the limits of Entry 54 of List II, the provisions of Section 5B remains sustainable and does not become unconstitutional. This is achieved only if the charge is confined to the property in goods involved in the execution of the works contract and nothing more than that. It is for this reason, than for any other thing, such fulfillment has been factored in determining the value of the work other than the value of the property in goods has to be necessarily excluded and to the hilt. So long as the claim for deduction towards proportionate depreciation is a claim even akin to and within the scope of the charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract, notwithstanding the fact the word "depreciation" itself does not figure either in the deductions mentioned in the course of the judgment of the Supreme Court in 2nd Gannon Dunkerley's case and or within Rule 6 of the Rules.

37. It is for this reason that we cannot accept the submission of the learned Addl. Govt. Advocate that the rule not having expressly enabled the dealer to claim a deduction of this nature, the assessing officer was not right in permitting a deduction of this nature and the revisional authority was right in allowing the deduction. We have to bear in mind that the exercise in terms of Rule 6 is only for the purpose of understanding the scope of Section 5B of the Act and for effectuating the charge u/s 5B and that charge can never exceed the limits of Entry 54 of List II. Until and unless all other components in the value of the works contract other than the value of the property in goods passing from the contractor to the client on the execution of works contract are all excluded, the transaction does not fit into the definition of Sub-article (29A) of Article 366 and if it is not so, automatically the ratio of the judgment and the law as declared in the 1st Gannon Dunkerley's case, springs into action and renders Section 5B of the Act unconstitutional ! On the accepted Rules of interpretation, Rule 6 which is expressly provided for effectuating the charge u/s 5B has to be necessarily understood and interpreted within the scope of Section 5B of the Act and only for the purpose of effectuating it as per the Section but not to so interpret it to render it ultra vires the Section. If we should understand the Explanation to Sub-rule (4) of Rule 6 as contended by the learned AGA, while no doubt such a contention is a very live possibility and in any other situation perhaps the submission could have been accepted, but the submission cannot be accepted for the purpose of Section 5B of the Act, as an understanding of this nature would render Section 5B of the Act itself unconstitutional.

38. It is for this reason that we eschew such a limited meaning to the

Explanation and accept the meaning to the explanation as canvassed by Sri. Suryanarayana, learned Counsel for the petitioner. Therefore, we are of the definite view that both the Commissioner and the Tribunal were in error in disallowing the claim made by the dealer, towards proportionate depreciation of the machinery and tools to the extent they have been exclusively used for the execution of the works contract and owned by the dealer.

39. While the extent of usage of machinery and tools in the execution of any contract is dependent on facts and has to be worked out in each case and on ascertainment of all aspects of the matter, it is submitted by Sri. Suryanarayana, learned Counsel for the petitioner that in the instant case such exercise had been undertaken and accepted by the assessing officer.

40. Therefore, we will have to necessarily proceed on such finding of fact and as the revisional authority - Joint Commissioner and further the appellate authority - Tribunal reversed this view of the assessing officer on their understanding of the Judgment of the Supreme Court in Gannon Dunkerley's case [supra] read with the statutory provisions of Rule 6 of the rules and as we have indicated above such an understanding having the possibility of rendering the section itself unconstitutional and it being a settled principle of interpretation that any statutory provision should be so understood so as to render it constitutional if that is one way of understanding a statutory provision and if there is no way of understanding the statutory provision in that manner then the section becoming unconstitutional and that eventuality to be avoided and there being a possibility to understand the explanation - [I] to Sub-rule [4] of Rule 6 of the rules as discussed above, we accept this option for interpreting the scope of the explanation in the light of the law declared by the Supreme Court in Gannon Dunkerley's case [supra] and accordingly answer question No. 1 in the negative, in favour of the petitioner and against the revenue.

41. In so far as deductions in the nature of interest charged by client towards postage, telephone and telex expenses incurred by the dealer as also the vehicle tax said to have been paid in respect of the vehicles exclusively used by the contractor in the execution of the works contract and during the period for which the vehicle had been used, such charges undoubtedly come within the scope of cost of the establishment of the contractor to the extent it is relatable to supply of labour and services. On this aspect of the matter, while the revisional authority disallowed the same. In the appeal of the dealer, the Tribunal has not even discussed about it, but has simply allowed the finding of the Commissioner to pass.

42. Be that as it may, we will have to examine this question also with reference to the principles laid down in Gannon Dunkerley's case [supra] and it is precisely for this reason Sri. Manjunath, learned Additional Government Advocate has submitted that while the assessee - contractor, in Gannon Dunkerley's case [supra] had claimed deductions of the nature such as overhead expenses as occurring at Sl. Nos. [vii] and [viii] in sub-paragraph occurring at page 233 of

the said Judgment and would therefore submit that the supreme court also having not allowed such deductions to pass or to be permitted, the claim towards deduction in respect of interest charge, postage etc., being like or identical charges, cannot be permitted and the Commissioner has rightly revised the assessment order to disallow the deduction in respect of such charges.

43. Submission that non-examination by the Tribunal is of no consequence as once the Commissioner has taken the correct view, it is only to be taken and affirmed by the Tribunal and therefore no interference is warranted etc., is not a submission that can be accepted for the reason that the Supreme Court had occasion to discuss the claim under item Nos. [vii] & [viii]. We may indicate that the deduction claimed towards such charges even otherwise come within the scope of Clause [f] which is cost of establishment of the contractor to the extent it is relatable to supply of labour and services and also Clauses [g] and [h] and at any rate are all expenses in the nature of expenses as covered under Clauses [f], [g] and [h] occurring at page 235 of Gannon Dunkerley's case [supra]. If so, it has to be inevitably allowed as deductible expenditure for arriving at the value of the goods as otherwise there may be possibility of levying tax u/s 5B of the Act on an amount over and above the actual value of the goods which should be avoided under all circumstances to retain the section within the limitations as prescribed by the constitutional provisions.

44. It is therefore we are of the view that the assessee is entitled to claim deductions in respect of such nature of charges and accordingly we answer question No. 2 in the negative and against the revenue.

45. We are of the view that the assessing authority was right in permitting such deductions. In the light of the view taken, the answers to questions 1 & 2 as mentioned above being answered in favour of the assessee, the question No. 4 automatically answers in favour of the assessee and against the revenue.

46. In the result, the petition is allowed. The Judgment of the Tribunal is set aside to the extent indicated above. The parties to bear their own costs.

47. We place on record our great appreciation of the erudite manner in which Sri. Suryanarayana, learned Counsel for the petitioner has presented the case of the petitioner before us and has illuminated the dim corners of the entangled provisions of the sales tax enactments in the background of the constitutional provisions and the case law.

48. We are grateful to the learned Counsel for the petitioner and the learned additional government advocate for the respondent - revenue for their very effective assistance rendered us, in resolving the ticklish questions that arose for examination and we place on record our appreciation of the quality of presentation.