**(2016) 03 KAR CK 0340**

**In the Karnataka High Court**

**Case No :** W.P. Nos. 107787-107791/2015 and W.P. Nos. 107839-107845/2015 (T-RES)

SEW Infrastructures Ltd. APPELLANT

Vs

The State of Karnataka and Others RESPONDENT

**Date of Decision :** 24-03-2016

**Acts Referred:**

Andhra Pradesh Value Added Tax Act, 2005 — Section 4(7)
Constitution of India, 1950 — Article 366(29A)(b)
Karnataka Value Added Tax Act, 2003 — Section 3(1), Section 36, Section 4, Section 4(7), Section 72(2)

**Citation :** (2016) 03 KAR CK 0340

**Hon'ble Judges :** B.S. Patil, J.

**Bench :** Single Bench

**Advocate :** M. Thirumalesh, H.R. Kambiyavar and Amrutha S. Babladi, Advocates, for the Appellant; M. Kumar, AGA, for the Respondent

**Final Decision :** Allowed

# Judgement

B.S. Patil, J.—1. In these writ petitions, petitioner - Company is challenging the order dated 12.06.2015 passed by the Joint Commissioner of Commercial Taxes (Admin.) DVO., Davangere Division - respondent No. 3 herein. By the said order, exercising his powers under Section 63-A, 72(2) and 36 of the Karnataka Value Added Tax Act, 2003 (for short, ''the KVAT Act''), he has set aside the reassessment order dated 28.06.2014 passed by the Deputy Commissioner of Commercial Taxes (Audit & Recovery), Ballari for the tax periods from April, 2011 to March, 2012 and has confirmed the proposals made vide office notice dated 25.11.2014 and recomputed the net tax payable with penalty and interest for the aforementioned tax period in a total sum of Rs. 5,91,90,155/- after deducting the amount already paid. Petitioner has also challenged constitutional validity of the first proviso to Rule 3(2) (i-1) of the Karnataka Value Added Tax Rules, 2005 (for short, ''the KVAT Rules''). A declaration is sought to the effect that consideration paid by the main contractor to the sub-contractors formed part of the subcontractors turnover liable to tax in the hands of sub-contractors and does not form part of the contractors turnover and therefore, levy of tax contrary to the above principle was beyond the powers conferred under Section 3(1) of the KVAT Act.

2. Petitioner is a company incorporated under the provisions of the Companies Act, 1956. It is a dealer registered under the KVAT Act. Petitioner is engaged in execution of infrastructure projects involving work contracts which are got executed through sub-contractors.

3. The Deputy Commissioner of Commercial Taxes (Audit & Recovery), Ballari - respondent No. 4 herein carried out verification of books of accounts and issued proposition notice to pass reassessment order with regard to various issues including disallowance of deduction regarding payments made to two sub-contractors by name M/s. Venkata Sai Constructions Private Limited, Mysuru and M/s. R.K. Infra & Engineering (India) Private Limited. It was alleged that as proof regarding payment of tax by the said sub-contractors had not been filed, deduction claimed had to be disallowed. Petitioner furnished copies of the sub-contract agreements and copy of reassessment order passed in the case of M/s. Venkata Sai Constructions Private Limited by the Assistant Commissioner of Commercial Taxes (Audit)-2, Mysuru, for the tax periods April, 2011 to March, 2012 and the returns filed by the other sub-contractor for the said tax periods. Reliance was placed by the petitioner on the judgment in the case of state OF ANDHRA PRADESH & OTHERS v. LARSEN & TOURBO LIMITED AND OTHERS - , (2008) 17 VAT AND SERVICE TAX CASES 1 (SC). The Deputy Commissioner passed reassessment order after verifying the returns filed by the sub-contractors and allowed deduction of payments made to the sub-contractors to an extent of Rs. 32,89,60,004/- in the case of M/s. Venkata Sai Constructions Private Limited and Rs. 1,71,68,764 in the case of M/s. R.K. Infra & Engineering (India) Private Limited.

4. When the Joint Commissioner of Commercial Taxes took up the matter for revision and issued notice proposing to review the reassessment order passed by the Deputy Commissioner of Commercial Taxes, Ballari, stating that deductions allowed towards sub-contractors had not been assessed to tax nor they had filed returns declaring turnovers to the extent of payments made by the petitioner in favour of sub-contractors, petitioner submitted his reply. The Joint Commissioner of Commercial Taxes rejected the reply submitted by the petitioner and has passed the order under Section 63-A of KVAT Act on 12.06.2015 disallowing the deduction in respect of sub-contract payments to the extent of Rs. 30,83,06,284/- and Rs. 1,71,68,764/-. This order is produced at Annexure-D. Consequential demand notice issued by respondent No. 4 is also enclosed to the order.

5. Challenging this action of the Joint Commissioner of Commercial Taxes, learned counsel for the petitioner has essentially contended that the Joint Commissioner of Commercial taxes has ignored the ratio laid down by the Apex

 

Court in the case of state of andhra pradesh & others v. LARSEN & TOURBO LIMITED AND OTHERS - , (2008) 17 VAT AND SERVICE TAX CASES 1 (SC) and has proceeded solely on the basis of the proviso to Rule 3(2)(i-1) of KVAT Rules. He has taken me through the decision of the Apex Court and the relevant provisions of KVAT Act and KVAT Rules. He has placed reliance on the judgment of a Division Bench of Andhra Pradesh High Court in the case of gannon dunkerley & co. v. GOVERNMENT OF ANDHRA PRADESH - , 1997 VOL.105 SALES TAX cases 227 urging that a similar rule framed by the State of Andhra which was pari materia with Rule 3(2)(i-1) of KVAT Rules has been declared as unconstitutional.

6. Learned Additional Government Advocate has contended that a statutory appeal has been provided to the Tribunal against the order passed by the Joint Commissioner of Commercial Taxes and therefore, writ petition is not maintainable. He has urged that petitioner ought to have produced relevant documents showing that sub-contractors had included the amount received by them from the contractor while submitting their returns. He has urged that challenge to Rule 3(2)(i-1) of KVAT Rules is misconceived inasmuch as the said rule has been incorporated to achieve the object of ascertaining what has been exempted from tax at the hands of a contractor. He has also urged that writ of certiorari cannot be issued unless there is apparent illegality or error of jurisdiction in the order impugned. In this regard, he has placed reliance on the judgment of the Apex Court in the case of P. KASILINGAM v. P.S.G. COLLEGE OF TECHNOLOGY - , (1981) 1 SCC 405.

7. Having heard the learned counsel for both parties and on careful perusal of the entire materials on record, I find that the principle of law to the effect that consideration paid by the main contractor to the sub-contractors forms part of subcontractors turnover liable to tax in the hands of subcontractors and does not form part of main contractors turnover has been laid down in the judgment of the Apex Court in the case of state of andhra pradesh & others v. Larsen & TOURBO LIMITED AND OTHERS - , (2008) 17 VAT AND SERVICE TAX CASES 1 (SC). In the said case, dealing with Andhra Pradesh VAT Act, 2005 while examining the provisions contained under Section 4(7) of the said Act, the Apex Court has stated that in terms of the said provision, ''every dealer executing works contract shall pay tax on the value of goods at the time of incorporation of such goods in the works executed at the rates applicable to the goods under the Act and point to be noted was that as per the said Section taxable event was transfer of property in goods involved in the execution of works contract and the said transfer of property in such goods takes place when the goods were incorporated in the works and value of the said goods which constitutes the measure for levy of tax at the incorporation of goods in the works''. In laying down the said proposition, the Apex Court has referred to the judgment in the case of builders association of india v. union of INDIA - , (1989) 73 STC 370 (SC) quoting the following passage found at page 400 of the said judgment -

 

"Ordinarily unless there is a contract to the contrary in the case of works contract the property in the goods used in the construction of a building passes to the owner of the land on which the building is constructed, when the goods or materials used are incorporated in the building."

The Apex Court by referring to the judgment in the case of BUILDERS ASSOCIATION OF INDIA v. UNION OF INDIA - , (1989) 73 STC 370 (SC) has further observed as under:

"If one keeps in mind the above quoted observation of this Court in the case of Builders Association of India (1989) 73 STC 370 the position becomes clear, namely, that even if there is no privity of contract between the contractee and the sub-contractor, that would not do away the principle of transfer of property by the sub-contractor by employing the same on the property belonging to the contractee. This reasoning is based on the principle of accretion of property in goods. Thus, in our view, in such a case the work executed by a sub-contractor, results in a single transaction and not multiple transactions. This reasoning is also borne out by section 4(7) which refers to value of goods at the time of incorporation in the works executed. In our view, if the argument of the Department is to be accepted, it would result in plurality of deemed sales which would be contrary to article 366(29A)(b) of the Constitution as held by the impugned judgment of the High Court..........................................................

Therefore, in our view, the principle to be adopted in all such cases is that the property in the goods would pass to the owner/contractee on its incorporation in the works executed. This principle finds place in sub-section (7)(a) of Section 4 of the said 2005 Act."

8. A perusal of the judgment of the Apex Court would reveal that apart from interpreting the provisions contained under Section 4(7) of Andhra Pradesh VAT Act, 2005, the Apex Court has dealt with the general principle pertaining to point of time when the property in goods would pass to the contractee in connection with works contract. By referring to the judgment in the case of builders association of india v. union of india - , (1989) 73 stc 370 (SC), it has held that even if there was no privity of contract between the contractee and the sub-contractor, there will be a deemed transfer of property by the sub-contractor to the contractee by virtue of principle of accretion of property in goods, in which event work executed by sub-contractor results in a single transaction. It is this ratio laid down by the Apex Court which the Deputy Commissioner took into consideration while giving deduction of turnover towards the amount paid to the sub-contractor by the petitioner - Company.

9. The Joint Commissioner of Commercial Taxes has not referred to the decision of the Apex Court at all. He has simply laid the entire emphasis on Rule 3(2)(i-1) of KVAT Rules. Rule 3(2) of KVAT Rules deals with determination of taxable turnover of a dealer by allowing certain deductions from the total turnover. One

 

of the deductions provided for is mentioned in sub-clause (i-1) of clause (2) of Rule 3 i.e., ''all amounts paid or payable to sub-contractors as consideration for execution of works contract whether wholly or partly''. Proviso to this Rule states that no such deduction shall be allowed unless the dealer claiming deduction produces document in proof that the sub-contractor was a registered dealer liable to pay tax under the Act and that the turnover of such amounts was included in the return filed by such sub-contractor.

10. The Joint Commissioner of Commercial Taxes, in the impugned order, has held that the Assessing Authority / Deputy Commissioner of Commercial Taxes had never verified whether the sub-contractor had actually declared the turnover in the returns before allowing deduction. In his opinion, for the purpose of complying with the rule, at the time of audit proceedings, the Assessing Authority ought to have obtained such returns from the concerned LVO to ascertain the truth before allowing deductions from taxable turnover; as the dealer had failed to furnish copies of returns of turnover for the relevant tax period from April, 2011 to March, 2012, despite issue of notice by the revisional authority in respect of sub-contractor M/s. Venkat Sai Constructions Private Limited, the returns of turnover filed by it were obtained from efs system and on scrutiny, it revealed that sub-contractor M/s. Venkat Sai Constructions Private Limited, Mysuru, had not declared turnover in any of the returns filed from April, 2011 to March, 2012, thus, there was clear non-compliance of the rule by the sub-contractor and therefore, the Assessing Authority was incorrect in allowing deduction of turnover of Rs. 32,89,60,004/- towards sub-contractor''s turnover of M/s. Venkata Sai Construction Private Limited, Mysuru.

11. It has to be noticed here that in the rejoinder filed, petitioner has stated that the sub-contractor M/s. Venkata Sai Constructions Private Limited had indeed filed revised returns before the Assistant Commissioner of Commercial Taxes (Audit)-2, Mysuru on 12.12.2012 disclosing the receipts from the petitioner and the tax payable enclosing copy of the same as Annexure-G to the rejoinder. The declaration furnished by the said sub-contractor to the petitioner dated 21.08.2015 declaring receipt of Rs. 30,18,33,510/- in the year 2011-12 has been also enclosed as Annexure-H. The rectification order dated 06.01.2016 passed in the case of the said sub-contractor by the Assistant Commissioner of Commercial Taxes, (audit)-2, Mysuru for the tax periods falling in the financial year April, 2011 to March, 2012 is also produced at Annexure-J, wherein the total contract receipts received by the sub-contractor from the petitioner amounting to Rs. 30,19,30,693 has been mentioned and the taxable turnover has been determined accordingly.

12. The reason for disallowing deduction by the Joint Commissioner of Commercial Taxes is want of documentary proof from the sub-contractor. In the light of several documents which the petitioner has now produced and keeping in mind the object of the Rules which is indeed aimed at ensuring that sub-contractor declares the amount received by him from the contractor in his

 

turnover and payment of tax does not escape, in my view the Joint Commissioner of Commercial Taxes has to re-examine the matter. When the law declared by the Apex Court makes it clear that in case of a dealer executing works contract, the property in goods used in the construction of a building passes to the owner of the land on which the building is constructed when the goods or materials used are incorporated in the building and that the said principle is based on the principle of accretion of property in goods, apparently, there cannot be two deemed sales, one from the main contractor to the contractee and the other from the sub-contractor to the main contractor. This principle of law has to be borne in mind and thereafter, compliance with Rule 3(2)(i-1) of KVAT Rules which is aimed at securing full information regarding the returns submitted and the documents furnished by the sub-contractor in his turnover has to be insisted upon.

13. The Joint Commissioner has ignored the principle of law enunciated in the judgment of the Apex Court in the case of STATE OF ANDHRA PRADESH & OTHERS v. LARSEN & TOURBO LIMITED AND OTHERS - , (2008) 17 VAT AND SERVICE TAX CASES 1 (SC) and has merely focused his attention on Rule 3(2) of KVAT Rules. Now that petitioner has produced several documents to show that the sub-contractor has indeed included the amount received by him from the petitioner in his returns filed and that the same has been reflected in the assessment orders later on passed, copy of which has been also produced, without going into the constitutional validity of Rule 3(2)(i-1) of KVAT Rules, the matter is remanded to the Joint Commissioner of Commercial Taxes for fresh consideration in accordance with law keeping in mind the principle of law enunciated in the case of state of andhra pradesh & others v. LARSEN & TOURBO LIMITED AND OTHERS - , (2008) 17 VAT AND SERVICE TAX CASES 1 (SC) and also in the case of builders ASSOCIATION OF INDIA v. UNION OF INDIA - , (1989) 73 STC 370 (SC) and the purpose and object behind Rule 3 (2) (i-1) of KVAT Rules, and thereafter pass a fresh order by providing a fair and reasonable opportunity of being heard to the petitioner.

14. In the light of the view expressed above, I do not consider it necessary to examine the effect of the judgment in the case of gannon dunkerley & co. v. government of ANDHRA PRADESH - , 1997 VOL.105 SALES TAX cases 227 because in my view challenge to constitutionality of Rule 3(2)(i-1) of KVAT Rules need not be considered at this stage.

Writ petitions are accordingly allowed in part.

 