Circular

Sub: TAMIL NADU VALUE ADDED TAX ACT 2006 – Works contracts – Levy of tax on developers - Upheld by the Hon’ble Supreme Court of India Circular instructions issued – Reg

Ref: Orders of the Hon’ble Supreme Court of India in the case of L&T and another Vs. State of Karnataka & another (Civil Appeal No.8674 of 2013 arising out of SLP (C) No.17741 of 2007 Dt26.9.2013.


*****

‘Works contract’ is defined under Sec. 2(43) of TNVAT Act and transfer of goods involved in the execution of works contract is liable to tax u/s 5 of TNVAT Act. Dealers in works contract having no inter-State purchase may opt for compounding payment of tax u/S 6 of the Act, without collecting the tax.

2. Construction of buildings falls under civil works contract, liable generally u/s 5 of TNVAT Act and at 2% compounding levy u/s 6 of the Act. Many building contractors are paying tax either u/s 5 or 6 of the Act. However, recently a tendency has arisen among the contractors/developers to avoid this payment of tax on the ground that the construction is undertaken by them either independently or jointly with the land owners and
the sale of flats takes place only after the construction and therefore such a sale is sale of immovable property and not liable to sales tax. Many building contractors have not registered themselves under TNVAT Act and are not paying tax under this pretext.

3. Similar disputes raised against levy of tax in Karnataka was settled in favour of the revenue by the two-judge Bench of the Supreme Court in the case of K.Raheja Development Corporation v. State of Karnataka (2005) 5 SCC 162. However, on further disputes raised in various appeals before the Supreme Court, the law laid down in the case of Raheja Development Corporation was challenged and therefore, the dispute was referred to a larger three-judge Bench of the Supreme Court to decide whether the law laid down in the Raheja Development Corporation is a good law.

4. The three-judge Bench of the Supreme Court after considering the various provisions of the Constitution relating to the power to levy of sales tax on the deemed sale of works contract and previous judgments on the same issue has upheld the legal validity of the law laid down in the case of Raheja Development Corporation, observing as follows, in the latest judgment in the case of Larsen Toubro Limited & Another v. State of Karnataka & Another dated 26/09/2013:

“64. Whether contract involved a dominant intention to transfer the property in goods, in our view, is not at all material. It is not necessary to ascertain what is the dominant intention of the contract. Even if the dominant intention of the contract is not to transfer the property in goods and rather it is the rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if it otherwise has elements of works contract.”
"93. The question is: Whether taxing sale of goods in an agreement for sale of flat which is to be constructed by the developer/promoter is permissible under the Constitution? When the agreement between the promoter/developer and the flat purchaser is to construct a flat and eventually sell the flat with the fraction of land, it is obvious that such transaction involves the activity of construction inasmuch as it is only when the flat is constructed then it can be conveyed. We, therefore, think that there is no reason why such activity of construction is not covered by the term “works contract”. After all, the term “works contract” is nothing but a contract in which one of the parties is obliged to undertake or to execute works. Such activity of construction has all the characteristics or elements of works contract. The ultimate transaction between the parties may be sale of flat but it cannot be said that the characteristics of works contract are not involved in that transaction. When the transaction involves the activity of construction, the factors such as, the flat purchaser has no control over the type and standard of the material to be used in the construction of building or he does not get any right to monitor or supervise the construction activity or he has no say in the designing or lay-out of the building, in our view, are not of much significance and in any case these factors do not detract the contract being works contract insofar as construction part is concerned."

5. The Supreme Court has summarized the legal position evolved by it in the above case of Larsen & Toubro as follows:

(i) For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, three conditions must be fulfilled: (one) there must be a works contract, (two) the goods should have been involved in the execution of a works contract and
(three) the property in those goods must be transferred to a third party either as goods or in some other form.

(ii) For the purposes of Article 366(29-A)(b), in a building contract or any contract to do construction, if the developer has received or is entitled to receive valuable consideration, the above three things are fully met. It is so because in the performance of a contract for construction of building, the goods (chattels) like cement, concrete, steel, bricks etc. are intended to be incorporated in the structure and even though they lost their identity as goods but this factor does not prevent them from being goods.

(iii) Where a contract comprises of both a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract. The term "works contract" in Article 366 (29-A)(b) takes within its fold all genre of works contract and is not restricted to one specie of contract to provide for labour and services alone. Nothing in Article 366(29-A)(b) limits the term "works contract".

(iv) Building contracts are species of the works contract.

(v) A contract may involve both a contract of work and labour and a contract for sale. In such composite contract, the distinction between contract for sale of goods and contract for work (or service) is virtually diminished.

(vi) The dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen have lost their significance where transactions are of the nature contemplated in Article 366(29-A). Even if the dominant intention of the contract is not to transfer the property
in goods and rather it is rendering of service or the ultimate transaction is transfer of immovable property, then also it is open to the States to levy sales tax on the materials used in such contract if such contract otherwise has elements of works contract. The enforceability test is also not determinative.

(vii) A transfer of property in goods under clause 29-A(b) of Article 366 is deemed to be a sale of the goods involved in the execution of a works contract by the person making the transfer and the purchase of those goods by the person to whom such transfer is made.

(viii) Even in a single and indivisible works contract, by virtue of the legal fiction introduced by Article 366(29-A)(b), there is a deemed sale of goods which are involved in the execution of the works contract. Such a deemed sale has all the incidents of the sale of goods involved in the execution of a works contract where the contract is divisible into one for the sale of goods and the other for supply of labour and services. In other words, the single and indivisible contract, now by Forty-sixth Amendment has been brought on par with a contract containing two separate agreements and States have now power to levy sales tax on the value of the material in the execution of works contract.

(ix) The expression “tax on the sale or purchase of goods” in Entry 54 in List II of Seventh Schedule when read with the definition clause 29-A of Article 366 includes a tax on the transfer of property in goods whether as goods or in the form other than goods involved in the execution of works contract.

(x) Article 366(29-A)(b) serves to bring transactions where essential ingredients of ‘sale’ defined in the Sale of Goods Act, 1930
are absent within the ambit of sale or purchase for the purposes of levy of sales tax. In other words, transfer of movable property in a works contract is deemed to be sale even though it may not be sale within the meaning of the Sale of Goods Act.

(xi) Taxing the sale of goods element in a works contract under Article 366(29-A)(b) read with Entry 54 List II is permissible even after incorporation of goods provided tax is directed to the value of goods and does not purport to tax the transfer of immovable property. The value of the goods which can constitute the measure for the levy of the tax has to be the value of the goods at the time of incorporation of the goods in works even though property passes as between the developer and the flat purchaser after incorporation of goods."

6. In view of the above clear legal position taken by the Supreme Court, there should not be any ambiguity in assessing all civil works contract transactions, particularly, construction and sale of flats. Hereinafter, except the construction made for self, all other construction activities would attract tax liability.

7. In the meanwhile, the recent amendments made in Tamil Nadu Registration Act, making compulsory registration of construction agreements paying 1% Stamp Duty and 1% Registration fee w.e.f 1/10/2013 has enabled this department to capture all the details of such transactions, so that works contract tax can be levied on them. Detailed Circular issued in this regard by the Inspector of Registration is enclosed for information.

8. Now, all building constructions can be brought to the net of taxation without any omission with the details of construction agreements gathered from the Registration office of the area
concerned and supported by the legal authority of the recent Supreme Court judgment in the case of Larsen & Toubro.

In this regard, the following instructions are issued to all Territorial and Enforcement Wing officials:-

i) If any assessment/reassessment proceeding involving the above dispute are pending, in such cases, this Supreme Court judgment should be applied and orders should be passed immediately.

ii) This circular should be brought to the notice of Departmental Representatives, Additional State Representatives and State Representatives before the appellate forum concerned to enable them to defend the department’s case in any appeal is pending involving this kind of dispute.

iii) As per circular No.16345/C2/2013 dated 28.10.2013 of the Inspector General of Registration, Chennai, registration of construction agreements are made compulsory paying 1% Stamp Duty and 1% Registration fee w.e.f 1/10/2013. The Joint Commissioner (CT) Enforcement are instructed to capture all the details of construction agreements registered in the previous month from the Sub/District Registrar’s office falling under their jurisdiction before 5th of every month and such details should be shared with their counter-part Territorial Joint Commissioners.
vi) All the Territorial Joint Commissioners (CT) and (Enforcement) are instructed to obtain details of approvals granted to developers for construction of flats/buildings/commercial complex from CMDA /DTCP /Local Planning Authority and verify whether those developers have paid tax as per provisions of the Act.

The above circular should be acknowledged at once.

Sd/-K.Manivasan
Commissioner of Commercial Taxes

To
All Joint Commissioner(CT)(Territorial, Enforcement, ISIC & MoU Cell)

Copy to:
All Deputy Commissioner(CT),(Territorial, Enforcement, MoU Cell)

Copy to:
1. All the Additional Commissioners in the O/o the Commissioner of Commercial Taxes, Chennai-5.
3. All Joint Commissioner (CT), Deputy Commissioners (CT) & Assistant Commissioners (CT) in the O/o the Commissioner of Commercial Taxes, Chennai-5.
4. The Joint Commissioner (Computer Systems), Chennai-6 for uploading in the intranet and internet websites,
5. The Director, Commercial Taxes Staff Training Institute, Chennai-6.

/forwarded by Order/

Superintendent