

HIGH COURT OF JAMMU AND KASHMIR AT JAMMU

1. OWP No.419/2014, CMA No.539/2014

c/w

2. OWP No.525/2014, CMA No.685/2014

Date of Decision: 29.05.2015

1. M/s. Pardeep Electricals & Builders Pvt. Ltd. and anr.
Vs.
Union of India and ors.

2. M/s. Pardeep Electricals & Builders Pvt. Ltd. and anr.
Vs.
Union of India and ors.

Coram:

Hon'ble Mr. Justice Bansi Lal Bhat-Judge

Hon'ble Mr. Justice Janak Raj Kotwal-Judge

Appearing counsel:

For Petitioner (s) : Mr.D.C.Raina, Sr. Advocate with
Mr. Anil Verma, Advocate.

For respondent(s) : Mrs.Sindhu Sharma, ASGI for R-1, 4 to 13.
Mr. M.A.Bhat, Advocate for R-2 and 3.

i) Whether approved for reporting
in Press/Media : **YES/NO**

ii) Whether approved for reporting
in Digest/Journal : **YES/NO**

1. OWP No.419/2014 has been filed by petitioner No.1 – M/s. Pardeep Electricals and Builders Private Limited through its Managing Director, Pardeep Jain – petitioner No.2 for quashing clarification No.1 of 2014 dated 14th January, 2014 issued by Commissioner, Commercial Taxes Department of Excise and Taxation, Jammu-respondent No.2 herein on the ground that the same offends the statutory and legal rights of petitioners in so far it provides for charging of service tax on the gross value of the contract items. It is contended that in terms of the impugned clarification, petitioners are required to

pay the service tax inclusive of the tax already included at the time of submitting of the tenders which is impermissible in view of the clear mandate of Rule 19 of Jammu and Kashmir General Sales Tax Rules. The following reliefs are claimed in the petition:-

- i) *“Issue writ in the nature of Certiorari quashing the impugned clarification No.1 of 2014 dated 14.01.2014, whereby clarification has been made by including the tax in whole price of services not covered under Rule 19 of J&K General Sales Tax Rules 1962.*
- ii) *Issue writ in the nature of Mandamus commanding the respondent No.8 to reimburse the excess tax deducted from whole amount instead of taxable amount along with the interest @ 18% till final realization of the amount.*
- iii) *Issue writ in the nature of Prohibition restraining the respondent no.8 for further deducting the tax over the whole amount instead of tax able amount of which the payment/outstanding is due.”*

2. In OWP No.525/2014 filed by the same petitioners against the same respondents, petitioners seek quashment of the Notification No.1/2014 dated 14.01.2014 issued by respondent No.2 which is also the subject matter of challenge in OWP No.419/2014.

Following reliefs are claimed in the petition:-

- i) *“Issue writ in the nature of Certiorari quashing the impugned Notification No.1 of 2014 dated 14.01.2014 being contrary to Rule 19 of the G.S.T. Rule.*
- ii) *By issuance of writ of Mandamus command the respondent No.2 and other functionaries to make deduction only in accordance with Rule 19 of the*

GST Act on the amount exclusive of Service Tax/Labour Welfare Cess and consequently direct respondent No.8 to reimburse the excess tax deducted from whole amount instead of taxable amount along with the interest @ 18% till final realization of the amount.

iii) Issue writ in the nature of Prohibition restraining the respondent no.8 for further deducting the tax over the whole amount instead of taxable amount of which the payment/outstanding is due.”

3. The only difference between subject matters of the two petitions is that in OWP No.419/2014, the work executed related to Tender Notice dated 04.04.2011 whereas in OWP No.525/2014, the work executed related to Tender Notice dated 17.07.2010. The contract in OWP No.419/2014 related to execution of Prov. of KLP (PHASE-III) INCL. ALLIED SERVICES FOR LSRC AT LEH whereas the contract in OWP No.525/2014 related to work PROVN OF OTM ACCN FOR-14 CORPS-ENGR-SIGNAL-REGT-(PH-II) at LEH. Since both petitions raise common issues between the same parties, the petitions were clubbed together for hearing.
4. The common thread running through the web of both writ petitions concerns the legality and correctness of impugned clarification No.1 of 2014 dated 14th January, 2014 issued by respondent No.2. The case set up by petitioners in both the petitions is that the petitioners are required to pay the service tax inclusive of the tax already included at the time of submitting of the tenders which is not permissible in view of clear mandate of

Rule 19 of the Jammu and Kashmir General Sales Tax Rules, 1962 (hereinafter to be referred to as “Rules of 1962”). It is claimed that the petitioner No.1 responded to the Tender notices dated 04.04.2011 and 17.07.2010 respectively. Petitioner No.1 was found to be the lowest tenderer and accordingly the works were allotted in its favour. Petitioner No.1 executed the works allotted to it. However, at the time of releasing of payments, respondent No.8 deducted tax over the gross amount instead of deducting tax on taxable turnover. Thus, it is claimed, respondent No.8 has been deducting tax over tax, i.e. cascading.

5. According to petitioners, the definition of “goods” under provisions of Section 2 (h) of the Jammu and Kashmir General Sales Tax Act, 1962 includes a service tax. It is submitted that Rule 19 of Rules of 1962 is clear with respect to determination of taxable turnover for which the tax has not been charged on the sale of goods separately but included in the sale price and the tax included therein is determinable on the basis of provision engrafted in the aforesaid Rule. It is further submitted that even otherwise condition No.15 of the contract agreement providing for levy of service/sales tax clearly spells out that the service tax shall be deductible on the gross payment to the contractor. It is further submitted that similar issues have been raised

earlier. Reference is made to clarification No.8 of 2006 dated 14.08.2006, clarification No.1 of 2009 dated 09.04.2009, clarification No.27 of 2000 dated 08.02.2002, clarification No.11 of 2005 dated 20.05.2005 and clarification No.6 of 2008 dated 11.02.2008 in this regard. Deduction of tax by respondent No.8 over the gross amount instead of over the taxable turnover is said to have caused financial loss to petitioner to the tune of Rs.27,03,305/- in OWP No.419/2014 and of Rs.24,30,996/- in OWP No.525/2014.

6. Respondent Nos.2 and 3, in response to Notices issued, filed their objections, common to both the petitions, contesting the petitions on the ground that in terms of the impugned clarification No.1 of 2014 dated 14.01.2014 issued by respondent No.2, confusion in regard to levy of sales tax on services rendered in the shape of works contract has been harmonized. It is pleaded that respondent No.8 – Garrison Engineer Leh had approached respondent No.2 seeking clarification on the issue whether sales tax had to be charged on the gross amount on the contract or after deducting the tax element in contracts where the agreement is inclusive of taxes. Respondent No.2, having jurisdiction to clear the doubts in terms of provisions of Section 25-C of the Jammu and Kashmir General Sales Tax Act of 1962

(hereinafter to be referred to as “Act of 1962”), clarified that incidence of service tax shall be on the aggregate of the amount of services and goods consumed in the contract as per provisions of the Act of 1962. It was clarified that for purposes of service tax, value of every service had to be determined with reference to aggregate value of such service whether in the shape of works contract, banking service, insurance service etc. Thus, it was further clarified that inclusion of tax in whole price of services provided was not covered under Rule 19 of the Rules of 1962. The deduction of cost of labour from amount payable to contractor had been withdrawn after explanation-1 (a) to Section 2 (h) was deleted vide amendment Act No.7 of 2009 dated 20th March, 2009. It is further pleaded that respondent No.2 felt the need to harmonize clarification No.6 of 2008 and clarification No.16 of 2010. He found that there was some confusion with regard to taxability on the individual contract of supply, installation, commissioning, repairing and fitting out improvement. Relook was given to aforesaid clarifications in the light of law laid down by the Hon’ble Apex Court in case titled **“State of Andhra Pradesh Vs. Kone Elevators (India) Ltd.”**. Thus, impugned clarification No.1 of 2014 came to be issued clarifying that contract for supplying and installation shall amount to works contract irrespective of the fact

whether predominant part is supply or installation in terms of the Act of 1962. According to respondents, the whole indivisible transaction/contract had to be subjected to service tax and surcharge if the contract envisaged inter-dependence of supply and installation for fulfillment of the contractual obligation. The impugned clarification is thus defended on the ground of being strictly in consonance with the provisions of law. It is pleaded that sales tax is required to be deducted on gross amount of the contract and the impugned clarification harmonizes the tax structures as regards works contract and to remove the confusion created by earlier clarifications. It is pleaded that respondent No.8 was obliged under law to deduct the sales tax on gross amount of the contract. It is further pleaded that it is for the concerned assessing authority to see whether the contract is inclusive of tax or not. It is further pleaded that the levy of sales tax is not subservient to the contract agreement entered into between the parties or conditions stipulated therein. It is for the concerned Assessing Authority to look into the various aspects of the taxable turnover of a dealer at the time of assessment. Act of respondent No.8 in deducting the sales tax from the gross amount of the contracts awarded to petitioners is pleaded to be not violative of

provisions of the Act of 1962 and Rules framed thereunder.

7. The issues arising for determination may be stated as follows:

- I) Whether the impugned clarification was beyond competence of respondent No.2;
- II) Whether respondent No.2 was legally justified in holding that the service tax was leviable on the gross value of the contract irrespective of inclusiveness of the tax factor in the approved rate of a given item.

8. As regards Issue No. 1, a bare look at the provisions engrafted in Section 25-C of the Act of 1962 lays it bare that the Commissioner is empowered to determine issues and issue clarifications in regard to various issues including issues relating to nature of any transaction and whether any tax is payable in respect of any particular sale or purchase. That being so, commissioner cannot be said to be lacking jurisdiction in issuing the impugned clarification. The objection is, accordingly, overruled.

9. Now coming to Issue No. 2, it is not in controversy that the payment for execution of works in terms of agreements was released in favour of petitioner after deducting tax over the gross amount. It is contended on behalf of respondents that under provisions of the Act of 1962 and Rules framed thereunder, sales tax is leviable on the gross amount of the contract. The sales tax leviable on the services rendered by the contractor in the shape of works contract has to be deducted at source

from the gross amount of the contract. Thus, sales tax is included in the gross amount of the contract. The levy of sales tax under the Act of 1962 is not subservient to the contract agreement *inter se* the parties. The Assessing Authorities are under a legal obligation to look into every aspect of taxable turnover of a dealer at the time of assessment. To appreciate this argument, it would be appropriate to refer to the definition of “goods” under Section 2(h) of the Act of 1962 which is reproduced herein below;

(h) “Goods” means all kinds of moveable property (not being actionable claim, newspapers, stock, shares, and securities) and includes;

i) xxxx

i-a) services provided in the shape of works contract, whether divisible or indivisible, involving the transfer of property or not, services in the form of lodging facilities provided by the hotels, services provided by Telecom/Cellular phone agencies by way of transfer of right to use any goods or otherwise, services provided by private nursing homes, beauty saloons, photographers and advertisers rendered by way of or as part of any contract or in any other manner whatsoever involving skill and labour or any other services as may be notified by the Government from time to time.”

10. It is manifestly clear that the definition of “goods” includes services provided in the shape of works contract, whether divisible or indivisible, involving the transfer of property or not. There is no ambiguity in it that the types of services enumerated in the provision are covered under the definition of goods. A transaction, whether involving transfer of property or not, shall be deemed to be a sale by the person making the same. Services provided in execution of works contract are

goods and, thus, the services provided constitute sale of goods which is exigible to tax under the relevant tax schedule. It is, therefore, amply clear that it is the services provided in the shape of works contract together with the goods, skill, labour, and consumables etc. which constitute goods. The person who executes the works contract is deemed to sell “these goods” attracting the tax provision. As regards determination of taxable turnover, it would be appropriate to extract Rule 19 of the Rules of 1962 herein below:-

“19. Determination of taxable turnover- (a) the taxable turnover shall be determined after allowing the deduction of the following amounts from the turnover:-

- (i) The discount actually allowed in the customary course of business or in accordance with the agreement with the purchaser; provided that such discount has been deducted from the price in the sale bill/voucher and the purchaser, has paid the price less by that discount.**
- (ii) Sale price of the goods returned by the purchaser as verified from the account books of the dealer.**
- (iii) Sale price of goods which are not liable to tax under Section 4 or are exempt under Section 5 of the Act.**
- (iv) The amount of sale price of goods sold in the course of inter-State trade or commerce as defined by Section 3 of the Central Sales Tax Act, 1956.**
- (v) The amount of sale price of goods sold in the course of export as defined by Section 5 of the Central Sales Tax Act, 1956.**
- (vi) Tax payable, if included in the turnover.**
 - [(aa) Provisions allowing the deductions contained in sub-rule (a) will apply mutatis-mutandis for determination of taxable turnover in respect of purchases liable to tax under Section 4 B of the Act.]**
 - (b) In respect of a sale on hire purchase system the amount of hire receivable or the amount actually received whichever is higher, shall be included in the taxable turnover provided that the amount of hire, if included in taxable turnover of one year on accrual basis**

shall not be again included in the taxable turnover of the year in which it is actually received.

- (c) In respect of a sale other than the sale specified in sub-rule (b) full sale price shall be included in the turnover of the year in which the sale is made notwithstanding that the sale price is receivable or is received in installments and some installments are not received during the year.*

Explanation – Taxable turnover means the aggregate of taxable turnover of all the places of business of a dealer having more than one such place.

- (d) If a dealer has not charged the tax on sale of goods separately but included it in the sale price the tax included therein shall be determined on the basis of the following formula]:*

$$\frac{\text{Rate of tax} \times \text{Aggregate of sale price}}{100 + \text{Rate of tax.}}$$

- (e) Subject to the foregoing sub-rules, the taxable turnover in respect of the goods used in a work contract shall be estimated at an amount equal to the cost of such goods as enhanced by a profit margin of 20% provided that the dealer does not maintain correct and complete accounts from which the cost of labour as deductible from the amount payable to the dealer for currying out the contract under Explanation 1 of clause (n) of Section 2 of the Act can be deducted.]”*

11. A bare look at the provision engrafted in Section 19 of the Rules of 1962 brings it to fore that certain deductions are to be allowed while determining taxable turnover. Clause (d) of the aforesaid provision lays down the formula for determination of taxable turnover where the dealer has not charged the tax on sale of goods separately but included it in the sale price. The tax included therein has to be determined in accordance with the following formula;

$$\frac{\text{Rate of tax} \times \text{Aggregate of sale price}}{100 + \text{Rate of tax.}}$$

For elucidation of the application of above formula, an example can be taken. Where the rate of tax inclusive of service tax (10.5 %) + labour welfare tax (1%) totaling 11.5% is applicable and the aggregate sale price is taken as Rs.100/-, the deduction of tax under the formula laid down in Section 19(d) of the Rules of 1962 would be computed as under:-

$$\frac{11.5 \times 100}{100+11.5} = \text{Rs.10.31/-}$$

Therefore, taxable turnover would be Rs.100 - Rs.10.31 = Rs.89.69/-.

12. In the case in hand, respondents, under the garb of impugned clarification, determined service tax over the gross amount, i.e. Rs.100/- which comes to Rs.11.50/- instead of determining the same on the basis of above formula which comes to Rs.10.31/-thus, charging excess tax of Rs.1.19/- over the aggregate value of sale price of Rs.100/-. This amount of Rs.1.19/- represents the element of tax over tax, i.e. cascading.
13. Learned counsel for petitioners vehemently argues that even otherwise, condition 15 of the contract agreement provides for levy of service/sales tax on the gross payment to the contractor. Condition 15 of the contract Agreement is extracted as under:-

“15.0 LEVY OF SERVICE/SALES TAX

Finance Deptt. Of J&K Govt. has levied tax on services in the shape of works contract rendered by the contractor at the rate of 10% plus surcharge of 5% w.e.f. 01.04.2010 vide SRO No.153 dt. 31st March, 2010. Therefore, this service tax at the rate of 10% on gross payment to contractor and 5% surcharge on the amount of service tax

will be recovered by the department from the contractor at source. Service tax of 10% plus surcharge of 5% is deemed to be included in the lump sum amount/contract sum amount quoted by the tenderer.

15.1 LABOUR WELFARE CESS TAX

Labour welfare cess shall be levied at the rate of 1% (one percent) on gross payment to contractor. Labour welfare cess deemed to be included in the lump sum/contract sum quoted by the contractor.”

14. The stipulation in the aforesaid condition is loud and clear that the service tax plus surcharge and labour welfare cess is deemed to be included in the contract sum quoted by the tenderer/contractor. It is, therefore, manifestly clear that the contract sum quoted by the tenderer includes the component of service/sales tax plus surcharge leviable on services in the shape of works contract and labour welfare cess. Given the nature of condition, there is no difficulty in arriving at the conclusion that the tax leviable on services rendered by the contractor through works contract are included in the sale price and have not been charged on sale of goods separately. The taxable turnover is, thus, to be determined in accordance with the formula engrafted in Clause (d) of Section 19 of the Act of 1962.
15. To determine whether the services provided by petitioners constituted a part of the contract included in sale of goods, be it seen that the definition of “goods” in Section 2(h)(I-a) includes, *inter alia*, services provided in the shape of works contract, whether divisible or indivisible involving the transfer of property or not. The million dollar question, in each case of the instant type,

would be whether the contract is a “contract for sale of goods” or a “works contract”. This assumes significance in view of the fact that in case of the former, the entire sales consideration would be taxable under Sales Tax Act or VAT Act whereas in the later case, the part of consideration payable on account of labour and service element would be excluded from the total consideration received and sales tax or value added tax would be chargeable only on the balance amount. A Five Judge Bench of the Hon’ble Apex Court, in **“M/s. Kone Elevator India Pvt. Ltd. Vs. State of Tamil Nadu and ors.”** in WP (Civil) No.298/2005 decided on 06.05.2014 dealt with the controversy whether manufacture, supply and installation of LIFTS is to be treated as “sale” or “works contract”. The majority view was that the decision rendered in **“State of AP Vs. Kone Elevators (India) Ltd.”** reported in (2005) 3 SCC 389 did not correctly lay down the law. It held:-

63. Considered on the touchstone of the aforesaid two Constitution Bench decisions, we are of the convinced opinion that the principles stated in Larsen and Toubro (supra) as reproduced by us hereinabove, do correctly enunciate the legal position. Therefore, “the dominant nature test” or “overwhelming component test” or “the degree of labour and service test” are really not applicable. If the contract is a composite one which falls under the definition of works contracts as engrafted under clause (29A)(b) of Article 366 of the Constitution, the incidental part as regards labour and service pales into total insignificance for the purpose of determining the nature of the contract.

64. Coming back to Kone Elevators (supra), it is perceivable that the three-Judge Bench has referred to the statutory provisions of the 1957 Act and thereafter referred to the decision in Hindustan Shipyard Ltd. (supra), and has further taken note of the customers’ obligation to do the civil construction and the time schedule for delivery and thereafter proceeded to state

about the major component facet and how the skill and labour employed for converting the main components into the end product was only incidental and arrived at the conclusion that it was a contract for sale. The principal logic applied, i.e., the incidental facet of labour and service, according to us, is not correct. It may be noted here that in all the cases that have been brought before us, there is a composite contract for the purchase and installation of the lift. The price quoted is a composite one for both. As has been held by the High Court of Bombay in *Otis Elevator (supra)*, various technical aspects go into the installation of the lift. There has to be a safety device. In certain States, it is controlled by the legislative enactment and the rules. In certain States, it is not, but the fact remains that a lift is installed on certain norms and parameters keeping in view numerous factors. The installation requires considerable skill and experience. The labour and service element is obvious. What has been taken note of in *Kone Elevators (supra)* is that the company had brochures for various types of lifts and one is required to place order, regard being had to the building, and also make certain preparatory work. But it is not in dispute that the preparatory work has to be done taking into consideration as to how the lift is going to be attached to the building. The nature of the contracts clearly exposit that they are contracts for supply and installation of the lift where labour and service element is involved. Individually manufactured goods such as lift car, motors, ropes, rails, etc. are the components of the lift which are eventually installed at the site for the lift to operate in the building. In constitutional terms, it is transfer either in goods or some other form. In fact, after the goods are assembled and installed with skill and labour at the site, it becomes a permanent fixture of the building. Involvement of the skill has been elaborately dealt with by the High Court of Bombay in *Otis Elevator (supra)* and the factual position is undisputable and irrespective of whether installation is regulated by statutory law or not, the result would be the same. We may hasten to add that this position is stated in respect of a composite contract which requires the contractor to install a lift in a building. It is necessary to state here that if there are two contracts, namely, purchase of the components of the lift from a dealer, it would be a contract for sale and similarly, if separate contract is entered into for installation, that would be a contract for labour and service. But, a pregnant one, once there is a composite contract for supply and installation, it has to be treated as a works contract, for it is not a sale of goods/chattel simpliciter. It is not chattel sold as chattel or, for that matter, a chattel being attached to another chattel. Therefore, it would not be appropriate to term it as a contract for sale on the bedrock that the components are brought to the site, i.e., building, and prepared for delivery. The conclusion, as has been reached in *Kone Elevators (supra)*, is based on the bedrock of incidental service for delivery. It would not be legally correct to make such a distinction in respect of lift, for the contract itself profoundly speaks of obligation to supply goods and materials as well as installation of the lift which obviously conveys performance of labour and service. Hence, the fundamental characteristics of works

contract are satisfied. Thus analysed, we conclude and hold that the decision rendered in Kone Elevators (supra) does not correctly lay down the law and it is, accordingly, overruled.”

16. It is not in controversy in the cases in hand that the contracts allotted to the petitioner were composite contracts for supply and installation which satisfied the fundamental characteristic of a works contract. Applying the dictum of Hon’ble Apex Court, the impugned clarification holding that inclusion of tax in whole price of service provided is not covered under Rule 19 of the Rules of 1962 cannot be supported. There is no dispute with the proposition that contract for supply of goods and materials as well as installation amounts to works contract and the constitutional Bench Judgment of the Hon’ble Apex Court upholds such view. However, the impugned clarification, though reiterating the same principle, departs from the issue as to whether service tax has to be charged on the gross amount of the contract or after deducting the tax element in contracts where the agreement is inclusive of taxes. It is, fallacious to hold that Rule 19 of the Rules of 1962 does not cover inclusion of tax in sale price. Such an interpretation would render Clause (d) of Rule 19 of the aforesaid Rules redundant which provides the formula for computation of tax included in the sale price. The impugned clarification cannot be sustained in view of

the authoritative pronouncement of the Constitutional Bench of the Hon'ble Apex Court and has to be quashed.

17. In view of the findings arrived at hereinabove, these Writ Petitions are allowed and following reliefs are granted by issuing:-

- i) *writ in the nature of Certiorari quashing the impugned clarification No.1 of 2014 dated 14.01.2014, whereby clarification has been made by including the tax in whole price of services not covered under Rule 19 of J&K General Sales Tax Rules 1962.*
- ii) *writ in the nature of Mandamus commanding the respondent No.8 to reimburse the excess tax deducted from whole amount instead of taxable amount;*
- iii) *writ in the nature of Prohibition restraining the respondent no.8 for further deducting the tax over the whole amount instead of taxable amount of which the payment/outstanding is due.*

18. Disposed of along with all connected CMAs.

(Janak Raj Kotwal)
Judge

(Bansi Lal Bhat)
Judge

Jammu

29.05.2015
Varun Bedi

This judgment is pronounced by me under Rule 138 (4) of the Jammu and Kashmir High Court Rules, 1999.

(Janak Raj Kotwal)
Judge

Jammu

29.05.2015