

# NUT CRACKERS

## Questions & Answers



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### Indirect Taxes

**Q.1** A contract has been awarded to contractor. In contract documents the value of the goods is specified as well as the value of services is specified. The argument of the contractor is that the VAT is leviable on value of goods shown by him in contract documents. However department is insisting to arrive at value of goods on its own either by applying principles laid down in Gannon Dunkerly & Co. (88 STC 204) or by abatement method. Whether Department is justified in adopting above course, ignoring the valuation done in contract documents ?

**Ans.** The issue pertains to arriving at value of goods in a contract on which sale tax can be levied by State Sales Tax Authorities. The issue would have been more complicated prior to guidelines on the subject by Supreme

Court. However now the issue is well settled by judgment of Supreme Court in case of *M/s.Imagic Creative Pvt. Ltd. (12 VST 371 (SC))*.

The facts in this case are that the dealer M/s.Imagic Creative carried on business of advertising services of various nature. It used to receive purchase order specifying various elements of transaction with separate consideration. Accordingly the dealer M/s.Imagic Creative also used to mention the said elements of the transaction separately in the invoice with separate consideration. In fact for the sake of clarity Supreme Court itself has reproduced in the judgment the sample copies of such purchase order and invoice of the dealer. The same are reproduced below.

#### “Estimate

P & PR Unit M/s. ISRO HEADQUARTERS Antariksh Bhavan, New BEL Road, Bangalore		Estimate No. 014F Date: 26.04.2003 Job No.: 051/APR/03 Enquiry No.	
Co-ordinated by: Mr. C.S. Ramachandran			
<b>Particulars GSAT 2 POSTER</b>	<b>Qty.</b>	<b>Rate Rs. p.</b>	<b>Amount Rs. p.</b>
1. Conceptualising, design and production of computer artwork of size A3, – front	1 No.	1500 00	1500 00
– back	1 No.	1500 00	1500 00
2. B/w Line drawings in back page artwork of size A5	4 Nos.	100 00	400 00
3. Digital inkjet output on photoglossy paper for layout of size A3 (1.5 sq. ft.) @ Rs. 100 per. sq. ft – front	1No.	150 00	150 00
– back	1 No.	150 00	150 00

4. Four colour separated positives size: A3 @ Rs. 250 per colour x 4 Nos. = 1,000 – front	1 Set	1000 00	1000 00
– back	1 Set	1000 00	1000 00
5% service tax on item 1			150 00
5% KST on item			15 00
31.5% resale tax on item 4			30 00
Rupees five thousand eight hundred ninety five only.		Total	5895 00

## Invoice

Consignee M/S MORRIS TOOLING PVT. LTD. Doddaballapur, Bangalore		Invoice No. 707	Dated 31.1.2004
Co-ordinated by: Mr. M. Muniswamy DEC/03		Delivery Note/Date 531/23.01.04	Job No. 1175/
		Purchase Order No. MTP/PUO/2004/00002	Dated 21.1.2004
<b>Sl. No.</b>	<b>Description of goods</b>	<b>Quantity</b>	<b>Rate Rs. p.</b>
	HSK TOOL HOLDER		
1.	Designing and system charges		9000 00
2.	Four colour separated positives for cover size: A3	1 set	1728 00
3.	Two colour separated positives size: A4	21 Sets	468 00
4.	Four colour offset printing on 300 GSM matt art card for cover two colour offset printing on 170 GSM matt art paper for inner pages with centre pinning	500 Nos.	31850 00
	8% service tax on item 1		720 00
	1.5% resale tax on item 2-4		651 00
		Total	53777 00

Rupees fifty three thousand seven hundred seventy seven only.”

It is seen that the different elements in the transaction are specified separately. The service tax is levied on the elements which are of service nature and sales tax is levied on the respective sale elements. In the assessment the tax was levied on the amounts pertaining to sale elements. However in the determination proceedings in relation to same transaction the determining authority held that the entire sum of the invoice is to be considered for levy of sales tax. It was held that ultimately the amounts charged are towards supply of printed material developed

by the dealer. The above view of the determining authority was upheld by Karnataka High Court. Therefore matter came before Supreme Court. It is in this respect the Supreme Court has given this important judgment.

Before Supreme Court on behalf of dealer it was pleaded that since on the service element service tax is levied the sales tax cannot be levied on the same where as on behalf of revenue it was pleaded that the transaction is one composite transaction containing not only

the value of the goods but also services. The buyer is buying the said goods which is enhanced in its value by service portion. Therefore revenue tried to justify the levy of sales tax on entire value.

Supreme Court analyzed the position in light of various judgments cited by both the parties. Supreme Court also considered the 46<sup>th</sup> Amendment made to Constitution for bringing Works Contracts in Sales Tax net. Supreme Court held that due to above amendment a legal fiction is created so as to make the supply of goods involved in a works contract subject to sales tax. However Supreme Court observed that a transaction of the description of above given nature is not contemplated by above amendment. In fact Hon. Supreme Court observed as under:

“31. We have noticed hereinbefore that a legal fiction is created by reason of the said provision. Such a legal fiction, as is well known, should be applied only to the extent for which it was enacted. It, although must be given its full effect but the same would not mean that it should be applied beyond a point which was not contemplated by the Legislature or which would lead to an anomaly or absurdity.

32. The court, while interpreting a statute, must bear in mind that the Legislature was supposed to know law and the legislation enacted is a reasonable one. The court must also bear in mind that where the application of a Parliamentary and a legislative Act comes up for consideration; endeavours shall be made to see that provisions of both the Acts are made applicable.

33. Payments of service tax as also the VAT are mutually exclusive. Therefore, they should be held to be applicable having regard to the respective parameters of service tax and the sales tax as envisaged in a composite contract as contradistinguished from an indivisible contract. It may consist of different elements providing for attracting different nature of levy. It is, therefore, difficult to hold that in a case of this nature, sales tax would be payable on the value of the entire contract; irrespective of the element of service provided. The approach of the assessing authority, to us, thus, appears to be correct.”

Thus the effect of above judgment is that if the respective elements are determined separately by the contracting parties then the

authorities cannot consider the same in entirety. The sales tax authorities can levy tax only on the value which pertains to goods and cannot levy on service portion shown separately. The above ratio of the judgment can very well be applied in relation to works contract transactions. The contracting parties can specify the element of services separately and the value of goods separately. In light of the observations in para 33 of the judgment reproduced above the taxes will be payable on such respective values under respective Act, i.e. Sales Tax and Service Tax. The Sales Tax authorities will not be entitled to club the said amounts so as to arrive at the value by adopting the methods mentioned in the query. In other words in light of above judgment the valuation done by the contracting party has to be accepted by the Sales Tax Department.

#### **Q.2 Profession Tax – Extent of liability**

***As per Constitutional Provisions the State Governments are entitled to levy Profession Tax but subject to limitation that it should not exceed more than Rs.2500 per person. In a case where the same entity has more than one branches in one state, whether the State Government can levy Profession Tax on each such branch at Rs.2500 considering each such branch as a separate person. Whether it will amount to beyond the monetary limit put by the Constitution.***

**Ans.** In normal understanding the Head Office and branches of single entity are considered to be one person. However, in relation to Profession Tax the Supreme Court has decided the issue differently. Reference can be made to the judgment in case of *Karnataka Bank Ltd. vs. State of A.P. and others CH. Yegnaiah & Sons. vs. Profession Tax Officer and another (12 VST 459)(SC)*.

The issue in this case was about levy of Profession Tax. The A.P. Profession Tax Act sought to levy Profession Tax on each branch of the same person (entity). This was resisted on the ground that as per Constitution there is limit of Rs.2500 per person for levy of Profession Tax by States. It was argued that this limit is per person in State and hence including all branches, the Profession Tax on one person cannot exceed more than Rs.2500. The argument was that, levy of Profession Tax @ 2500 on its each branch is far in excess of State wise limit of Rs.2500 per person. In short, the argument was that tax is leviable on it at maximum Rs.2500. Therefore, the

specific provision under A.P. Profession Tax Act viz. definition of 'person' which sought to define each branch as person was challenged as unconstitutional. The short gist of Supreme Court judgment is as under:

Supreme Court observed that the definition of the word "person" in the Explanation to section 2(j) of the Andhra Pradesh Tax on Professions, Trades, Callings and Employments Act, 1987, and also Explanation No. I of the First Schedule to the Act is not intended to tax a person at a rate higher than Rs. 2,500 per annum, per person, but to treat even a branch of a firm, company, corporation or other corporate body, any society, club or association as a separate person, and therefore, a separate assessee within the meaning of section 2(b) of the Act and the Andhra Pradesh State Legislature has undoubtedly the competency to adopt such a devise of taxation. The Andhra Pradesh State Legislature did not violate the mandate of article 276(2) of the Constitution of India in so defining the word "person". It is further observed that the definition of "person" in General Clauses Act, would not restrict the power of the State Legislature to define a "person" and adopt a meaning different from or in excess of the ordinary acceptation of the word as is defined in the General Clauses Act.

On the aspect of constitution validity Supreme Court observed that there is always a presumption in favour of constitutionality, and a law will not be declared unconstitutional unless the case is so clear as to be free from doubt; "to doubt the constitutionality of a law is to resolve it in favour of its validity." Where the validity of a statute is questioned and there are two interpretations, one of which would make the law valid and the other void, the former must be preferred and the validity of law upheld, observed Supreme Court. It is further observed that in pronouncing on the constitutional validity of a statute, the court is not concerned with the wisdom or un-wisdom, the justice or injustice of the law. If that which is passed into law is within the scope of the power conferred on a Legislature and violates no restrictions on that power, the law must be upheld whatever a court may think of it, held Supreme Court.

In respect of argument on unconstitutionality in light of Article 14, Supreme Court held that no legislation can be declared to be illegal, much less unconstitutional on the ground of

being unreasonable or harsh on the anvil of article 14 of the Constitution, except, of course, when it fails to clear the test of arbitrariness and discrimination which would render it violative of article 14 of the Constitution.

In respect of tax levy provisions, Supreme Court held that the State Legislature undoubtedly is competent to make a law relating to taxes for the benefit of the State or other local authorities therein in respect of professions, trades, callings or employments. It is traceable to entry 60 of List II of the Seventh Schedule but that power of the Legislature to make such a law to levy and collect the profession tax is made subject to the restrictions as provided for under article 276(2) of the Constitution. The purpose of article 276 is not to amend the State's power to tax profession founded on entry 60 but is to provide that such tax is not invalid on the ground that it relates to a tax on income.

It is well-settled that a tax on profession is not necessarily connected with income. A tax on income can be imposed if a person carries on a profession, trade, calling, etc. Such a tax on profession is irrespective of the question of income. There is no other restriction imposed upon a State Legislature in making law relating to tax on profession, trade, calling and employment. There can be no doubt whatsoever that a State Legislature cannot make any law to levy and collect profession tax at the rate of more than Rs. 2,500 per person, per annum, in view of the restriction in article 276(2) of the Constitution.

The Legislature is competent in its wisdom to define "person" separately for the purposes of each of the enactment and different from the one in the General Clauses Act and create an artificial unit. The definition of "person" in the General Clauses Act would not operate as any fetter or restriction upon the powers of the State Legislature to define "person" and adopt a meaning different from that defined in the General Clauses Act.

Supreme Court thus upheld the levy on different branches of same person at Rs.2500 each.

Therefore, if State Government treats every branch of a entity as different person for Profession Tax purpose it will be within the Constitution limit and thus on each branch Profession Tax upto Rs.2500 can be levied.

