The Hit and Miss of Gujarat High Court in Munjaal Manishbhai Bhatt – 1/3rd Deduction for Transfer of Land

- Contributed by CA Sri Harsha

[This article was first published in taxmann.com and available at [2022] 139 taxmann.com 139 (Article)]

Introduction:

Gujarat High Court strikes again, this time holding that providing an adhoc and standard method to value of undivided share of land involved in provision of construction services as invalid and has Para 2 of Notification No 1/2017 – CT (R) to be read down.

Before going into the detailed study of ruling for understanding the hit and miss of the Court in Munjaal Manishbhai Bhatt[1], it is necessary to understand the issue involved, the major arguments by petitioner and revenue and the analysis of High Court. Let us proceed to examine the same. Our analysis on the judgment and way forward is given at the conclusion of this article.

Issue Involved:

The petitioner has entered an agreement with Navratna Organisers & Developers Private Limited (4th respondent) for the purchase of plot of land admeasuring 1021 square meters. The said agreement also encompassed construction of bungalow on the said plot of land by 4th respondent. Separate and distinct considerations were agreed upon between the parties to the agreement for sale of land and construction of bungalow on the land. The agreement stated that the petitioner is liable to pay all taxes including GST and the petitioner believed that GST is required to be paid only on the construction services qua bungalow, because that would only constitute supply under GST laws.

However, the 4th respondent relying upon the Entry 3(if) of Notification No 11/2017 – CT (R) read with Para 2 informed the petitioner that he would be liable to pay tax at the rate of 18% on the entire consideration payable for land as well as construction of bungalow after deducting 1/3rd of value towards land as stipulated in Para 2 and accordingly raised invoice on the petitioner. The petitioner challenged the above Entry 3(if) read with Para 2 of Notification No 11/2017 – CT (R) [for brevity 'NN 11/2017')], since the same does not provide for complete exclusion of consideration towards land and provides only for 1/3rd deduction, instead.

In another set of petitions, the petitioner were developers who have sold/intending to sell developed parcels of land The advance ruling applications were filed seeking a ruling on the question whether there was any tax liability under the GST Act on supply of developed land. The advance ruling authority held that the deduction of land was admissible only to the extent of 1/3rd of total consideration on basis of NN 11/2017. The said ruling was also affirmed by Appellate Authority for Advance Ruling. Hence, the petitioner has challenged the validity of the impugned notification.

Major Arguments by Petitioners:

The petitioner states that there were two separate agreements for transfer of land and for construction of bungalow and pointed out that the booking agreement was entered after the land was fully developer and that no further activity was required to be done by the land owner/developer in respect of the land

[1] [2022] 138 taxmann.com 117 (Gujarat)

after entering of the booking agreement with petitioner. Since there were two separate agreements which are clearly severable and the sale of land being made for a separate consideration, the entire amount of consideration relating to land is outside the scope and purview of GST Act and not 1/3rd which is provided by the NN 11/2017. The petitioner relied upon the minutes of 14th GST Council meeting to demonstrate that the before of issuance of said notification, it was deliberated that the same should be confined only in respect of sale of flats/apartments and not in respect of transactions where land was separately sold and separate value of land was specifically so available. However, the notification was issued in wide terms so as to even include the sale of plots of land along with construction of bungalows which is argued to be arbitrary and contrary to the object sought to be achieved by deeming fiction.

The petitioner further argued that it was post decision of Supreme Court in 1st Larsen and Toubro[2] that sale in course of execution of works contract would commence only from the stage when the contract is entered into during the course of construction and observed that sale of fully constructed property would also not attract levy of tax and accordingly it was the reason that the sale of land and fully constructed building has been excluded from the purview of GST Act. Since, what is taxable under the GST Act is supply of goods or services, they argued that it is only when the recipient enters into a contract with supplier, the supply can commence and since in the instant case, the land has already been developed by the developer and thereafter if the contract for construction of bungalow is entered with prospective buyer, then the supply of goods or services is only to the extent of construction undertaken pursuant to contract with such a prospective buyer. For something done by the developer prior to execution of contract with prospective buyer, such activity is not a supply at all as defined under Section 7 and thus there should not be no charge of tax on such activity.

The petitioner further argued that the Supreme Court held in 2nd Gannon Dunkerley's case[3], that tax is imposed on the actual taxable value of works contract and the Government could prescribe fixed percentage only for cases where the actual value was not ascertainable and in cases where fixed percentage is prescribed the same should not appreciably differ from the actual value. The petitioner argued that the impugned notification prescribing fixed percentage deduction of 1/3rd without giving option for deducting the actual value of land as well as without taking into consideration the different variants of contracts as also the size of the land vis-à-vis the consideration is contrary to the rationale delivered by the Supreme Court in 2nd Gannon Dunkerley's case (supra).

The petitioner argued that the Delhi High Court in Suresh Kumar Bansal[4] clearly held that there need to be a specific statutory provision excluding the value of land from the taxable value of the works contract and mere abatement by way of notification is not sufficient and post that judgment, the Government by way of retrospective amendment to Service Tax (Determination of Value) Rules provided for specific deduction for consideration charged for land and provided that only in event of such actual value not being available that the alternative methods of fixed percentage deduction were to be adopted. However, the petitioner argued that impugned notification providing only a specific method for deducting the value of land is to be held ultra-vires.

The petitioner urged that the deeming fiction is ex-facie discriminatory in as much as person like the petitioner who are getting the bungalow constructed on 10-20% of the land get the same deduction as a buyer of a flat unit in a multi-storeyed building who merely gets an undivided share in the land and major portion of the agreement value is towards cost of construction. Further, the petitioner argued

[2] 2014 (1) SCC 708
[3] (1993) 1 SCC 364
[4] [2016] taxmann.com 55 (Delhi)

that, as a result of impugned entry, there is a high taxability in cases such as that of the petitioner, where construction is to be done by the same person who is seller of land vis-à-vis cases where the sale of land and construction is by separate individuals and it was pointed out that in **the present case the seller and developer are different person.**

In another set of petitions, where the developed land was sold and the appellate authority for advance ruling held that, even in such cases, the deduction of 1/3rd of total amount would be applicable, the petitioners argued that once a particular consideration was agreed for sale of land between two parties, it was not open for the tax authorities to rewrite the terms of agreement. Further, they have stated that if the impugned notification is not to be struck down as ultra-vires, the same is required to be read down as inapplicable where separate value of land was ascertainable.

Major Arguments by Revenue:

The revenue argued that in case of transaction that involves construction of building, civil structure or part thereof, including a complex or building intended for sale to a buyer, wholly or partly, wherein the completion certificate with respect to such constructions has not been received, such transactions shall be treated as services under Para 5(b) of Schedule II and in the facts, the petitioner has entered into a booking agreement with the developer (4th respondent) whereby the petitioner agreed to purchase the residential plot together with a bungalow/apartment thereon in the scheme called as the 'Kalhaar Blues and Greens' subject to various terms and conditions, which indicate that none of these components of transaction can be separated and are integral part of the transaction. The Revenue argued that the petitioner has no right to construct the plot, no right to change the plan/layout of all the plans provided by the developer, no right to get the construction done by any other person other than the developer, no right to divide the plot area from the scheme, no right to deal with the plot are and other such conditions, limitations, prohibitions and restrictions, except without the consent of the developer and the concerned local authority and all these indicate that the sale of land and construction of bungalow forms part of single transaction and cannot be treated as separate transactions dehors the fact that separate contracts have been entered, for the reason they may not reflect true value of land.

The Revenue placed reliance on the Supreme Court judgment in the case of Narne Construction Private Limited[5], which was in the context of Consumer Protection Act to drive that the sale of developed plot is not sale of land only, it is a different transaction that mere sale of land and accordingly argued that sale of developed land in the instant case is different from the mere sale of land as envisaged in Schedule III. The Revenue argued that the component of land as provided in the booking apartment is not only land, it is a developed land as being part of the plotting scheme and developer shall have to get the plans approved by concerned local development authority and develop the common facilities like roads, water lines, drainage, greens and various other amenities and thus land component is not only land but also consist of such development being part of the plotting scheme and value of such development cannot be ascertained as the same are to be enjoyed with all the occupants of the scheme.

Analysis by High Court:

The High Court after listening to both the parties have framed a question for consideration as to whether the impugned notification providing for 1/3rd deduction with respect to land or undivided share of land in cases of construction contracts involving element of land is ultra-vires the provisions of GST laws and/or violative Article 14 of Constitution of India?

[5] [2013] 30 taxmann.com 42 (SC)

After tracing the history of taxation of building construction contracts through various judgments of Supreme Court stated that the very base of the levy was not changed under GST law. While earlier VAT and service tax were imposed on tripartite agreements, such taxes were sought to be consolidated under GST laws with a specific exclusion of land element. The High Court stated that 'supply' under Section 7 of CT Act includes supply of goods or services or both made or agreed for a consideration and thus the factum of supply should be initiated only once the agreement is entered between the supplier and recipient and such agreement is for consideration and this is in consonance with the observation of Supreme Court in case of 1st Larsen and Toubro (supra) that there cannot be a sale in respect of construction undertaken prior to the agreement with the buyer. The Court stated that thus the legislative intent is to impose tax on construction activity by a supplier at the behest of or pursuant to contract with recipient and there is no intention to impose tax on supply of land in any form and it is for this reason that it is provided in Schedule III that supply of land will be neither supply of goods nor supply of services.

The Court stated that if looked from this perspective, the arguments of Revenue that there is difference between sale of land and sale of developed land should be set aside. The expression used in Schedule III is, sale of land and then it can be in any form, developed or undeveloped.

The Court stated the Revenue's stand that exclusion of sale of land will not be available since the land is a developed piece of land is difficult to accept such argument, as at the point of time when the buyer entered into the picture, the land was already developed and thus, even without going to Schedule III, the only service which is supplied by supplier to the recipient is the construction undertaken for buyer and it is such supply alone can be taxed and the fact the land is not a plain parcel of land but a developed land cannot be a ground for imposing tax on sale of such land. Further, the Court held that the Revenue's argument is not supported by the notification, since the subject notification does not state that if the land is developed, the service provider cannot take the benefit of Para 2. Since Para 2 provides for deduction for transfer of land, it would also cover the developed land. The next and only question that is left to be determined is whether such artificial deeming fiction of 1/3rd deduction is ultra-vires of provisions of GST laws and Constitution.

The Court stated that in the facts of the case the booking agreement showed specific consideration was agreed for sale of land and for construction of bungalow. **The Court stated that there is no averment in the affidavit filed by Revenue that such bifurcation is not acceptable.** In such a case, the Court stated that if there is a specific value for land and Revenue does not have any objection for such bi-furcation, can the notification provide for fixed deduction as against the actual value of land available in the agreement?

The Court stated it should be answered in negative because, when the valuation provisions provide for valuation with actual price paid or payable for the service and where such actual price is available, then tax has to be imposed on such actual value. Deeming fiction can be applied only where actual value is not ascertainable and accordingly held that mandatory application of deeming fiction of 1/3rd of total agreement value towards land even though the actual value of land is ascertainable is clearly contrary to the provisions and ultra-vires the statutory provisions.

The Court further held that one of the most glaring feature of the impugned deeming fiction is its arbitrariness in as much as the same is uniformly applied irrespective of the size of plot of land and construction therein and there is no distinction which is made even between a flat and bungalow and while a flat would have number of floors and the transfer would only be undivided share in land, the same deduction which is available on supply of flats is made available on supply of bungalows without

any regard to the vast different factual aspects. The Court also rejected the Revenue's argument that there is a possibility to include the value of construction contract into the value of land and to avoid the GST on the construction contract by stating that there are various ways in the valuation mechanism through which Revenue can reject valuation in such cases and that cannot be the sole reason for adopting the fixed deduction. The Court also stated that when there was a methodology prevalent under the service tax law ([as a consequence to the judgment of Delhi High Court in Suresh Kumar Bansal] to provide for deduction of land, ignoring the same and providing a standard deduction in GST laws is not right in law. The Court also ruled out that the present controversy is not pertaining to Para 5(b) of Schedule II because the issue is with the valuation and not with chargeability.

The Court further held that reliance placed by Revenue on Narne Construction Private Limited (supra) is misplaced, since the judgment was in the context of Consumer Protection Act and the same is inapplicable while interpreting a statute. **The Court stated that in a given case there may be tax liability if the development of land is undertaken pursuant to contract with buyer and however, if the land is already developed and thereafter agreement is entered with the buyer for sale of such developed land, then it would not involve any service.**

The Court concluded by stating that while maintaining the mandatory deduction of 1/3rd value of land is not sustainable in cases where the value of land is clearly ascertainable or where the value of construction service can be derived with aid of valuation rules, such deduction can be permitted at the option of taxable person particularly in cases where the value of land or undivided share of land is not ascertainable. Accordingly, the Court held that the Para 2 has to be read down to the effect that the deeming fiction of 1/3rd will not be mandatory in nature and it will only be available at the option of taxable person in cases where the actual value of land or undivided share in land is not ascertainable.

Our Analysis:

Whether the judgment missed out a crucial fact that Revenue argued that the contract is an integrated one and cannot be split?

The Revenue in their arguments has stated that the contract is integrated one and cannot be split dehors the fact that the consideration is separately agreed, for the reason that the petitioner (buyer) does not have any right to get the bungalow constructed by anyone except from the developer. Hence, the Revenue stated that such a split as argued by the Petitioner is not possible. However, when the Court was analysing, it has stated that the Revenue in its affidavit has no-where stated that bifurcation is not acceptable. Despite the Revenue has made its arguments in such a direction, the Court appears not to consider such arguments since they do not form part of the affidavit. The Revenue's submissions that the components of transaction cannot be separated and are integral part of the transaction are evident from Para 46 of the judgment. If this would have been considered, whether the High Court would have come to the same conclusion as it has reached is doubtful.

Whether the facts in the current judgment were understood by the High Court in a different manner than the actual transaction?

The High Court in Para 4.1 when narrating the facts stated that the land is being sold by the developer and construction of bungalow is also being done by the same developer. However, in Para 22, the Court stated that in the present case, the seller and developer are different persons. Whether the judgment rendered keeping in view that the seller and developer as one and same or different was not clear. It is

important to note that the taxation would be completely different, if the developer and seller are different than in a case, where the seller and developer is same.

In a situation, where the seller of land is different from the developer, then there is no requirement for the developer to include the value of land in his consideration to claim a deduction of 1/3rd or actual value of land. If the seller of the land and developer are same, then only the question of deduction of 1/3rd or actual value would come into play. If the entire judgment is taken holistically, it appears that the facts narrated in Para 4.1 appears to be more resembling with the actual transaction rather than what was mentioned in Para 22.

Whether there is any mandate or deeming fiction under the GST law that though the contract for sale of land and construction agreement are entered separately, should they be seen as a single contract?

The facts of the case in one set of petitions is that the sale of land and construction agreement were entered separately and consideration is fixed separately. Since there are separate agreements, the petitioner stated that they cannot be asked to pay tax on the total agreement value after taking a deduction of 1/3rd towards land, when the entire value of land can be excluded from the levy. They have argued that there can be tax only on the construction contract and not on the value of land.

The question that arises is, whether there is an obligation for the developer under the GST laws to club the agreements for land and agreements for construction as a single agreement? The Court appears not to have done this discussion, based only on the reasoning that Revenue did not object that such a bifurcation is not possible. However, we feel that the Court should have analysed this aspect also before reaching the current conclusion.

The agreement between the petitioner and developer is for purchase of land and for construction of bungalow. Para 4.1 of the judgment clearly specifies this, that developer has sold and also entered an agreement for construction of bungalow. Hence, when it comes to construction of bungalow, the nature of work would be the works contract as defined under Section 2(119), because this is a contract for building or construction of an immovable property, wherein a transfer of property in goods (whether as goods or in some other form) is involved in the execution of such contract. Hence, the contract between the petitioner and developer would be undoubtedly a works contract. Para 6(a) of Schedule II calls out a works contract, which is a composite supply as supply of services.

Hence, by the deeming fiction prescribed under Para 6(a) of Schedule II, the works contract is deemed to be supply of services. This is done precisely to remove, whether a contract involving goods and services, should be called as a contract of supply of goods or supply of services and by deeming that such a composite supply as supply of services, the disputes pertaining to classification as goods or services is put at rest. In other words, after introduction of GST laws, when the contract is relating to construction and other similar items pertaining to immovable property, the supplier cannot take an argument that he has entered two different agreements, one for supply of goods and two, for supply of services and cannot pay tax on the rate of tax applicable for supply of goods and rate of tax applicable for supply of services. The entire contract (despite of the fact that there are numerous contracts with separate consideration) would be treated as supply of services and the rate of tax that would be applicable for such services should be applied.

Accordingly, in the instant case, though the petitioner has entered two agreements, one for supply of land and the other for supply of services, since the same is for construction of an immovable property,

the same will be classified as works contract services and no matter how many agreements were entered, the taxation cannot be applied qua single contract. It has to be applied for the entire contract.

Further, if we go to the history of applicability of service tax on the construction of flats, there was an explanation inserted to Section 65(105)(zzzh) (which is similar to the current Para 5(b) of Schedule II) to deem that there exists any service if consideration is received from customer prior to completion certificate. The said explanation was inserted to come over the practices adopted by developers of certain states, where they have practice of entering two agreements, one for sale of semi-finished flat (on which stamp duty was paid) and the other for construction agreement.

The current judgment tries to revive the said position (which existed prior to insertion of above explanation) to allow the developer to enter two agreements and exclude the value of land based on the such agreements. This is in a way ignoring the whole concept of composite supply of works contract being called as supply of services. Had the High Court analysed this aspect, the outcome would be different.

Whether the High Court struck down the methodology of 1/3rd deduction towards land for all the situations or did it limit to certain instances?

The High Court stated that where it is not possible to determine the actual value of land, then the 1/3rd deduction can be made applied. In all other cases, where the actual value of land is discernible, the deduction of 1/3rd is mandatory. Now, the question that arises is, who decides, whether the actual value of land is available or not. Further, what would be the actual value of land? In other words, would this judgment applicable only to such developers who enter two separate agreements, one for land and the other for construction and if yes (assuming that such a methodology is permissible under GST laws), whether the amount mentioned in the agreement for transfer of land, can be claimed as deduction taking it to be a true value. These are all the questions which need to be evaluated before placing reliance on the judgment. Hence, the judgment in a way tried to read down the Para 2 instead of striking it as ultra-vires.

What changes did the Suresh Kumar Bansal's judgement of Delhi High Court brought in the service tax law which the Gujarat High Court suggested that it should be under the GST laws?

The Delhi High Court in Suresh Kumar Bansal's judgment held that, since the act or rules do not provide machinery provision for arriving the service component in a composite contract, the notification prescribing abatement of 75% cannot in any way substitute the machinery provisions which should have been by way of act or rules. Accordingly, held that notification prescribing abatement in absence of any statutory machinery is invalid.

In order to overcome the above, the Rule 2A of Service Tax (Determination of Value) Rules, 2006 has been amended to include a method for deriving the actual value of service in a composite contract (which includes goods and undivided share of land) and only in cases where the valuation cannot be done in above manner, then the valuation to be done based on the standard deduction.

The Gujarat High Court stated that though the above mechanism is in place during service tax law, the Government providing a standard deduction of 1/3rd for transfer of land, without giving an option for deduction of actual value of land under GST laws, has to be read down.

An observation from Supreme Court's judgment in case of Mohit Minerals Private Limited[6] is worth referring here:

94 The respondents have urged that the determination of the value of supply has to be specified only through rules, and not by notification. However, this would be an unduly restrictive interpretation. Parliament has provided the basic framework and delegated legislation provides necessary supplements to create a workable mechanism. Rule 31 of the CGST Rules 2017 specifically provides for a residual power to determine valuation in specific cases, using reasonable means that are consistent with the principles of Section 15 of the CGST Act. This is where the value of the supply of goods cannot be determined in accordance with Rules 27 to 30 of the CGST Rules 2017. Thus, the impugned notification 8/2017 cannot be struck down for excessive delegation when it prescribes 10 per cent of the CIF value as the mechanism for imposing tax on a reverse charge basis.

Had similar analogy being applied by Gujarat High Court, the outcome in the current judgment would have been different.

What would be the impact of the above judgment on AARs and AAARs relying on Supreme Court's judgment in Narne Construction Private Limited (supra) for holding that plot sales are subjected to GST?

The High Court stated that the judgment of Supreme Court in Narne Construction Private Limited (supra) delivered in the context of the Consumer Protection Act cannot be applied for interpretation of taxing statute. Hence, in a way the High Court stated that the said judgment would not be applicable for interpreting the GST statutes. Majority of the AARs and AAARs rely on the judgment of Supreme Court in Narne Construction Private Limited (supra) to hold that there is a supply of service in case of sale of plots attracting tax under the GST laws. Since, the subject judgment has stated that the judgment of Supreme Court is not applicable, this is a kind of respite.

What would be the impact of the above judgment for sale of plots?

In another set of petitions, the petitioner was engaged in development and sale of developed lands. The High Court further stated that there is no difference qua taxation in case of developed land and undeveloped land as far as Para 5 of Schedule III is concerned. The Revenue's argument that developed land would involve a kind of service element when compared to the mere sale of land is brushed away. The High Court stated that land in any form can be interpreted as covered under Entry 5 of Schedule III.

If the High Court's interpretation has to be taken to logical conclusion, then all sale of plots (developed parcel of lands) should be neither a supply of goods nor supply of services, since the subject sale of developed lands also fall under the ambit of Entry 5 of Schedule III. If such a conclusion is taken, then the High Court should have held that there is no requirement to pay tax on petitioners who are engaged in supply of developed lands. However, the Court in concluding remarks ordered the tax authorities to take the actual value of land in cases of sale of developed lands and arrive at the balance value of construction and charge tax only on such construction value as stipulated in agreement.

From the above conclusion, it may be the fact in the portioner's situation that even for the sale of developed lands, there were two agreements entered, one for supply of land and the other for development activities. If that is the fact, then the High Court concluding remarks will be meaningful.

[6] [2022] 138 taxmann.com 331 (SC)

However, if the facts are that, where the petitioner has paid stamp duty on the entire amounts collected from customers for sale of developed parcels of land, then the judgment would require a re-consideration, since it would be contradictory to the conclusion arrived by the High Court in the earlier part.

Hence, in case of developers who are paying stamp duty on entire consideration received for sale of plots, then they are still untouched by the concluding remarks and the main portion of the judgment which deals with developed land also finds place in Para 5 of Schedule III would be helpful. For developers who pay stamp duty only on certain portion of consideration received for sale of plots, then the judgment would be applicable for claiming the deduction of actual value of land and balance would be subjected to tax, if there are separate agreements (assuming that such an arrangement is possible under GST laws).