IN THE HIGH COURT OF JUDICATURE AT MADRAS

Dated : 05.12.2016

Coram

THE HONOURABLE MR. JUSTICE RAJIV SHAKDHER

W.P.No.38178 of 2016

and WMP No.32711 of 2016

M/s.FL Smidth Private Limited
rep. by its Director,
"FLSmidth House",
34, Egatoor, Kelambakkam,
Rajiv Gandhi Salai,
Chennai, Tamil Nadu-603 103. .. Petitioner

vs.

1. The Commissioner of Central Excise,
Puducherry Commissionerate,
No.1 Goubert Avenue,
Puducherry-605 001.

2. The Commissioner of Service Tax,
No.2054, Newry Towers,
12th Main Road, II Avenue,
Anna Nagar, Chennai-600 040. .. Respondents

Prayer : Writ Petitioner filed under Article 226 of the Constitution of India praying to issue a writ of certiorari to call for the records of the First respondent in the impugned order in Original No. 62/ 2016 (C)(ST) dated 31.08.2016, quash the same as it is violative of the law laid down by the Larger Bench of the Supreme Court in the case of Kone Elevators India Pvt. Ltd. Vs. State of Tamil Nadu (2014) 34 STR 641 and travelling beyond the scope of Section 65(105) (zzzza); Section 66; Section 66B; Section 66E(h); Section 67 of the Finance Act 1994 as amended read with Rule 2A of the Service Tax (Determination of Value) Rules 2006 as if seeks to levy service tax on value of goods supplied, as far as the petitioner is concerned.

For Petitioner : Mr.V.S.Manoj
For Respondents : Mr.K.Ravi, Standing Counsel for respondents

ORDER

1. This is a writ petition filed to assail the order dated 31.08.2016 passed by respondent No.1. With the consent of the counsel for parties, the writ petition is taken up for final hearing.

2. The principal ground, on which, the order is impugned by the petitioner is that respondent No.1, while passing the impugned order, took into account extraneous material, inasmuch as he adverted to a decision of the Supreme Court passed in State of Andhra Pradesh V. M/s.Kone Elevators (India) Limited, 2005 (181) ELT 156 (in short "Kone-I"), which had been overruled by a Larger Bench of the Supreme Court in the case of Kone Elevator India Pvt. Ltd., V. State of Tamil Nadu, 2014 (34) S.T.R. 641 (SC) (in short "Kone-II").

3. My predecessor, while issuing notice in the writ petition, on 03.11.2016, had, after a detailed discussion, granted time to the respondents counsel to take instructions in the matter, and, advance arguments on the next date of hearing.

4. Briefly, the case set up by the petitioner is that it is in the business of design, engineering and supply of equipment for cement industry, as also in the business of design, engineering and supply of erection of mineral handling systems for mining, power and steel industries.

4.1. It is submitted that while entering into such like contracts with its customers, often material is supplied, which is, used in the execution of the works contract.

4.2. The petitioner's case, is that, often goods used in the execution of the works contract are delivered directly to the site of the customer, and, since, the sale is an inter-state sale, E-1 declarations are submitted to it by the concerned vendor.

4.3. The petitioner submits that insofar as its customers are concerned, commercial invoices are raised, wherein, the sale price of the goods delivered and used in the works contract is reflected.

4.4. It is, thus, stated that sales effected in respect of the goods supplied and used in the works contract are recorded and relevant CST returns are filed in that behalf.

4.5. It is also the case of the petitioner that both the sale price of the goods supplied and the margin added by the petitioner are known to the customer, and therefore, are reflected in the invoices furnished to the customer.

4.6. In other words, it is the petitioner's case that there is neither an under nor an excess valuation of the goods supplied to the customer or, qua the value of the services, as alleged at all.

5. The record shows that the respondents were not convinced by the stand taken by the petitioner, and accordingly, issued a show cause notice dated 22.10.2013 via the Additional Director of Central Excise Intelligence.

5.1. Via the aforementioned notice, the petitioner was called upon to show cause as to why service tax to the tune of Rs.155,93,77,607/- along with interest and penalties should not be levied on it.

5.2. The petitioner, as it appears from the record, furnished its reply to the show cause notice. The respondents, however, proceeded to adjudicate upon the show cause notice and after giving personal hearing in the matter, passed the impugned order.

5.3. In the reply, filed, to aforementioned show cause notice, the petitioner sought to demonstrate the following, which is summarised in paragraph 17 of the writ petition :

> "...... (i) Rs.36,35,90,578/- represents pure sale of goods which is completely outside the purview of service tax. Documentary evidences were placed to establish that the value pertains to supply of goods which is not liable to service. This has not at all been considered.
>
> (ii) Rs.6,58,90,923/- represents the value of goods which are exported and any attempt to levy service tax is contrary to the law. The petitioner also placed the details of bill of lading to establish the value of export. This has not at all been considered.
>
> (iii) Rs.61,41,44,180/- represents the supply portion in a contract and there is no provision to levy service tax on the value of goods supplied.
>
> (iv) Rs.49,89,90,042/- pertains to comprehensive contract which clearly provides for value of goods, charges towards commissioning and installation and civil works.
>
> (v) The petitioner relied upon Rule 2A of the Service Tax (Determination of Value) Rules, 2006 which provides for deduction of value of goods supplied during the contract.
>
> (vi) The petitioner also specifically addressed the allegations in the Show Cause Notice to the effect that there is a huge margin in respect of

transit sales. In fact, the petitioner established that the margins assumed are erroneous and in any case, the authority cannot sit on judgment over a commercially negotiated sale price of goods and adopt the purchase value of the goods for the purpose of identifying a higher quantum of value of service for the purpose of levy of service tax, ignoring the transacted price. ...."

6. The Adjudicating Authority/respondent No.1, as it appears, disregarded the contentions raised by the petitioner, and consequently, came to the conclusion, which, in sum, is that the contracts executed by the petitioner were comprehensive works contract for design, engineering, supply, erection, commissioning and installation on Lump Sum Turn Key basis, which were artificially split up into separate components such as contract for supply of equipments, and, for erection and commissioning, as also for execution of civil and structural works.

6.1. Furthermore, the Adjudicating Authority/respondent No.1 recorded that the value of supply of goods had been inflated, so as to reduce the value of taxable services provided under the contract, and thereby, bring about a situation, where, lesser quantum of service tax was paid.

6.2. To be noted, a summary of the reasoning adopted by the Adjudicating Authority/respondent No.1 is set out in paragraphs 61 and 62 of the impugned order. The discussion, with regard to other issues raised by the petitioner, is set out in the subsequent paragraphs, commencing from paragraph 65.

6.3. However, in arriving at the aforesaid conclusion, the Adjudicating Authority/respondent No.1, made the following observations in paragraphs 41 and 42 of the impugned order :

".... 41. I further find that there are various case laws which deal on the issue whether a particular work qualifies as a 'works contract' or as 'sale of goods'. The Hon'ble Supreme Court in State of Andhra pradesh Vs. M/s.Kone Elevators (India) Limited, as reported in 2005 (181) ELT 156, brought out the distinction between a contract of sale and a works contract. As it observed,

"It can be treated as well settled that there is no standard formula by which one can distinguish a "contract for sale" from a "works contract". The question is largely one of fact depending upon the terms of the contract including the nature of the obligations to be discharged thereunder and the surrounding circumstances. If the intention is to transfer for a price a chattel in which the transferee had no previous property, then the contract is a contract for sale. Ultimately, the true effect of an accretion made pursuant to a contract has to be judged not by artificial rules but from the intention of the parties to the contract. In a "contract of sale", the main object is the transfer of property and delivery of possession of the property, whereas the main object in a "contract for work" is not the transfer of the property but it is one for work and labour (emphasis supplied). Another test often to be applied to is : when and how the property of the dealer in such a transaction passes to the customer : is it by transfer at the time of delivery of the finished article as a chattel or by accession during the procession of work on fusion to the movable property of the customer? If it is the former, it is a "sale"; if it is the latter, it is a "works-contract". Therefore, in judging whether the contract is for a "sale" or for "work and labour", the essence of the contract or the reality of the transaction as a whole has to be taken into consideration. The pre-dominant object of the contract, the circumstances of the case and the custom of the trade provides a guide in deciding whether transaction is a "sale" or a "works contract". Essentially, the question is of interpretation of the "contract".

In aforesaid case, Supreme Court has held that 'custom of trade' and 'substance over form' are important.

42. On the applying the ratio followed by the Hon'ble Apex Court in the above case to the case in hand, I find that the work undertaken by the noticee unit is without any dispute, involved both supply of equipments and provision of service thereon like erection, testing, commissioning, installation etc. using such goods supplied to the contractee. The custom of the trade in respect of Lump Sum Turn Key (EPC) projects is to treat the entire activity of supply of equipments and installation and erection and commissioning of such equipments as a singular inseparable activity and the substance of the contract awarded is erection and commissioning of the plant as a whole and is not merely restrict to supply of equipments alone. Technically it may be contended that the property in goods passes on to the

contractee once sale invoices are raised by the noticee on their customers. However, in actual, considering the turnkey responsibility of the Contractor, the risk and title of the goods to be incorporated in the works remained with the contractor till successful commissioning and handing over of the entire system. It is pertinent to note that the entire contract in these case were awarded to the noticee unit on lump sum turn-key (LSTK) basis only, thereby the supply of equipments and the services of erection, commissioning and installation of such equipments are inextricably linked to each other, thereby giving the entire work the character of a 'works contract'. As held by the Hon'ble Apex Court in the above referred case, the intention of the contractee in awarding the work decides whether the contract is for 'sale of goods' or it is a 'works contract' involving both supply of goods and services. In this connection, the documents 'Invitation for Bid' issued by the contractee is an obvious source to find out the intention behind such transactions for which contract was ultimately awarded. The bid was for giving contract on lump sum turn-key basis for erection of the plant as a whole and is not restricted to mere supply of equipments. The person awarded with the contract is obliged to supply the equipments, erect the same in the premises of the contractee and their contractual obligation continues till the plant is erected. Thus, in this case, both the supply of goods and provision of services go hand-in-hand for execution of the comprehensive contract of erection, commissioning or installation of the plant altogether. Thus raising of mere sale invoices on the supply of equipments alone will not take away the basic character of such composite contracts being works contracts and make it separate contracts for supply of goods and provision of services. Therefore, I have no hesitation to hold that classification of a work undertaken under a particular contract is to be decided on the basis of the comprehensive nature of work undertaken and the purpose of the contract and accordingly, the comprehensive contract for execution of Turn-Key Project and all composite work involving both service and supply for erection and commissioning of the plant as a whole, are to be classified as 'Works Contract Service' in terms of Section 65(105)(zzzza) of the Finance Act, 1994 and as a service under Section 65B(44) of the Finance Act, 1994 read with Section 66E(h) ibid. and accordingly, I hold that the noticee have artificially vivisected such composite works to classify the service portion alone as 'Erection, Commissioning or Installation Services' which is not in line with the relevant statutory provisions."

7. Furthermore, the Adjudicating Authority/respondent No.1, based on the reasoning contained in the impugned order, went on to confirm the demand raised in the sum of Rs.155,10,33,144/-.

7.1. In addition, payment qua interest at the appropriate rates on the service tax amount was also confirmed.

7.2. This apart, penalty in the sum of Rs.10,000/- under Section 77(2) of the Finance Act, 1994, (in short '1994 Act') was also imposed on the petitioner.

7.3. Furthermore, penalty in the sum of Rs.126,65,32,838/- was imposed under Section 78 read with 78B of the 1994 Act.

7.4. The only concession, if one may call it a concession, which was given to the petitioner, was that, the penalty would get reduced to 25% of the service tax, if the service tax and interest, as ordered to be paid, by virtue of the impugned order, was paid within thirty (30) days of the date of communication of the order.

8. It is, because of this, that the petitioner, has filed the instant writ petition.

9. Mr.V.S.Manoj, who appears for the petitioner, submitted that the impugned order had been passed, based the application of principles enunciated in a judgement, which was no longer relevant to the case. It was submitted that the Adjudicating Authority/respondent No.1, has pivoted his view on the decision of the Supreme Court in Kone-I, which was overruled in Kone-II.

9.1. On merits, counsel for the petitioner submitted that respondent No.1 had come to an erroneous conclusion that the contracts were comprehensive works contract, which had been artificially split or, that the value of the goods supplied had been inflated to bring about a contrived reduction in the value of taxable services.

10. On the other hand, Mr.K.Ravi, who appears for respondents, relied upon the assertions made both in the show cause notice as well as in the impugned order to demonstrate that it was the petitioner's own case that the contract was a comprehensive works contract, and therefore, no interference was called for in the impugned order.

10.1. Mr.Ravi, when, queried as to whether reliance on the overruled judgment of the Supreme Court could have had an impact on the conclusions that the Adjudicating Authority/ respondent No.1 reached; said, that, if, that part of the order is severed, the impugned order could still be sustained.

10.2. In any event, it was the submission of the learned counsel for the Adjudicating Authority/respondent No.1 that since, an alternative remedy was available to the petitioner, the writ would not lie.

11. I have heard the learned counsel for the parties.

12. A perusal of the record and submissions shows that at the heart of the case is the two diametrically opposite stands taken by the parties. While the petitioner's say is that the transactions are separate and not composite in nature, it is the contention of the respondents that the transactions are composite in nature and that they have been artificially "split".

12.1. Whether or not, the impugned transactions are composite in nature, as alleged by the respondents is a mixed question of fact and law.

12.2. Having said so, concededly, the impugned order refers to a judgment, i.e., Kone-I and the principles articulated therein, which has been overruled by a Larger Bench of the Supreme Court in Kone-II.

12.3. As to what extent the Adjudicating Authority/respondent No.1 was influenced by the ratio of the judgement in Kone-I cannot be known. The judgement in Kone-I has had a bearing on the manner in which subject contracts have been viewed.

13. Therefore, having regard to the aforesaid circumstances, I am inclined to set aside the impugned order. It is ordered accordingly.

13.1. Furthermore, the petitioner is directed to appear before the Adjudicating Authority/respondent No.1 on 19.12.2016 at 11.00 a.m. In case, for some reason, the aforementioned date is not convenient to the Adjudicating Authority/respondent No.1, the Adjudicating Authority/respondent No.1 will be at liberty to fix another date, which would be proximate to the date fixed by the Court.

13.2. Upon hearing the petitioner, the Adjudicating Authority/respondent No.1 will pass a fresh order, after affording due opportunity to the petitioner. Needless to say, the copy of the order will be supplied to the petitioner.

13.3. I may also make it clear the fact that the impugned order has been set aside by this Court, will not be taken as a reflection on the merits of the matter.

14. Consequently, the writ petition is disposed of, in the aforementioned terms. There will be no order as to costs. Resultantly, connected miscellaneous petition is closed.

Sd/-
Assistant Registrar

//True Copy//

Sub Assistant Registrar

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To

1. The Commissioner of Central Excise,
   Puducherry Commissionerate,
   No.1 Goubert Avenue,
   Puducherry-605 001.

2. The Commissioner of Service Tax,
   No.2054, Newry Towers,
   12th Main Road, II Avenue,
   Anna Nagar, Chennai-600 040.

+1cc to Mr. K.Ravi, Advocate Sr.No.72190(06/01/2017)
+1 cc to Mr.K. Vaitheeswaran, Advocate Sr.71835(10.1.17)

mu(CO)
md(19/12/2016)

W.P.No.38178 of 2016