$~16

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ W.P.(C) 3048/2008

ERA INFRA ENGINEERING LTD. ..... Petitioner

Through: Mr. Manoj K. Singh, Advocate alongwith Mr. Vijaya Singh, Advocate.

versus

UOI & ORS. ..... Respondents

Through: None.

**CORAM:**
**HON'BLE MR. JUSTICE S. RAVINDRA BHAT**
**HON'BLE MS. JUSTICE DEEPA SHARMA**

**O R D E R**

% **17.10.2016**

The issue for consideration is whether the explanation to Item No. 7 in Notification no. 1 of 2006, issued by the respondent i.e. the sales tax department is enforceable in law in so far as it directs the inclusion of the value of free supplies used by a contractor in construction activity.

Construction activity was included as a taxable service with its introduction of Section 65 (105) (zzq). Section 66 of the Finance Act, 1994 (the enactment having imposed the service tax levying in the first instance) alludes to rules and notifications issued from time to time as providing mechanism for the enforcement of the levy, its collection etc. In furtherance of its statutory mandate, the respondents issued the Notification no.1 of 2006. The petitioner/the Construction Contractor complains that explanation to item no. 7, in the table annexed to the said notification, requires that total amount of taxable turnover would include "the value of goods and materials supplied or provided or used by the service provider of construction service for providing that service" which in the opinion of the respondents also includes the value of free goods supplied by the service recipients. The petitioner argues that where as the principle that there can be no objection to the inclusion of the gross amount charged which would also include the value of the materials supplied by the service provider himself, if it so procures, the inclusion of such value where recipient procures it for the purpose of hiring the contractor, would be unjustified given the narrow nature of the service tax levy.

The respondents in their counter affidavit refute the petitioner's contention. They fall back upon the definition of taxable service-in the present instance Section 65 (105) (zzq) introduced to the Finance Act. The respondents further explained that the construction contract could be of two types i.e. a) pure labour contract of construction or, b) the contract of construction including use of material partly or fully. It is stated that the contractor or the service provider is entitled to take credit for the excise duty paid on input capital goods and service tax paid on input services used for providing the construction service. The service tax is leviable on the gross amount charged by the service provider. It is further explained as under:-

> *"6. Excise duty and service tax paid taken as credit can be utilised against the service tax liability on the construction service. In case where the service provider is not able to maintain records for such goods and*

> *services, he has been given an option to avail an abatement of 67% from the gross amount charged vide notification No.1/2006-Service Tax dated 01.03.06 and pay service tax on 33% of the gross amount charged. Service provider availing abatement scheme can not take CENVAT credit. Thus, it may be seen that effectively service tax is payable on the value of the component of construction activity less the value of inputs.*
>
> *7. As per Section 65(105)(zzq) the taxable service is defined as any service provided by any person to any other person in relation to commercial or industrial construction service. In the case of Advertising Club Vs. Central Board of Excise and customs 2001 (131) ELT 35 (Mad) it was held that tax is levied on 'service' provided to a client by advertising agency in relation to advertisement and is not a tax on advertisement. So also the tax in the case at hand is on the services provided in relation to commercial or industrial construction i.e. the act of construction and the levy is, thus not a tax on constructed property."*

The petitioners rely upon the Division Bench ruling of this court in ***Intercontinental Consultants & Technorats (P.) Ltd vs. Union of India,*** *(2013) 19 GSTR 462 (DEL)* and a larger bench ruling of the Customs Excise and Service Tax Appellate Tribunal (CESTAT) reported as ***Bhayana Builders (P) Ltd. vs. Commissioner of Service Tax, Delhi*** *(2014) 69 VST 18 (CESTAT-New Delhi)*. This court has in ***Intercontinental Consultants*** (supra), held as invalid the provisions of Rule 5(1) of the Service Tax Rules 2006 as then passed. The conclusions of the court were that the concept of taxable service in the context of taxable turnover would include the value of goods supplied. The only consideration that is received is subject to service tax levy and not something which is being attributed on the basis of fiction which is otherwise unwarranted in law. The conclusions of this court in ***Intercontinental Consultants*** (supra) were as follows:-

> *17. Section 66 levies service tax at a particular rate on the value of taxable services. Section 67 (1) makes the provisions of the section subject to the provisions of Chapter V, which includes Section 66. This is a clear mandate that the value of taxable services for charging service tax has to be in consonance with Section 66 which levies a tax only on the taxable service and nothing else. There is thus in built mechanism to ensure that only the taxable service shall be evaluated under the provisions of 67. Clause (i) of sub-section (1) of Section 67 provides that the value of the taxable service shall be the gross amount charged by the service provider "for such service". Reading Section 66 and Section 67 (1) (i) together and harmoniously, it seems clear to us that in the valuation of the taxable service, nothing more and nothing less than the consideration paid as quid pro quo for the service can be brought to charge. Sub-section (4) of Section 67 which enables the determination of the value of the taxable service "in such manner as may be prescribed" is expressly made subject to the provisions of sub-section (1). The thread which runs through Sections 66, 67 and Section 94, which empowers the Central Government to make rules for carrying out the provisions of Chapter V of the Act is manifest, in the sense that only the service actually provided by the service provider can be valued and assessed to service tax. We are, therefore, undoubtedly of the opinion that Rule 5 (1) of the Rules runs counter and is repugnant to Sections 66 and 67 of the Act and to that extent it is ultra vires. It purports to tax not what is due from the service provider under the charging Section, but it seeks to extract something more from him by including in the valuation of the taxable service the other expenditure and costs which are incurred by the service provider "in the course of providing taxable service".*

*What is brought to charge under the relevant Sections is only the consideration for the taxable service. By including the expenditure and costs, Rule 5(1) goes far beyond the charging provisions and cannot be upheld. It is no answer to say that under sub-section (4) of Section 94 of the Act, every rule framed by the Central Government shall be laid before each House of Parliament and that the House has the power to modify the rule. As pointed out by the Supreme Court in Hukam Chand v. Union of India, AIR 1972 SC 2427: -*

*"The fact that the rules framed under the Act have to be laid before each House of Parliament would not confer validity on a rule if it is made not in conformity with Section 40 of the Act."*

*Thus Section 94 (4) does not add any greater force to the Rules than what they ordinarily have as species of subordinate legislation."*

In ***Bhayana Builder*** (supra), the Tribunal was seized of the question which this court is called upon to consider in the present case i.e. whether the value of goods supplied by the principle to a contractor under the agreement, the value of free goods can be included in service tax turnover. The CESTAT noticed in Intercontinental Consultants and thereof in its ratio held as follows:-

*(vi) In Intercontinental Consultants and Technocrats Pvt. Ltd. v. Union of India [2013] 59 VST 487 (Delhi); [2013] 29 STR 9 (Delhi), the Delhi High Court was essentially considering a challenge of the validity of rule 5 of the Service Tax (Determination of Value) Rules, 2006. This provision was challenged to the extent it includes reimbursement of expenses in the value of taxable services for the purpose of levy of service tax. Apart from the challenge to its constitutionality, the provision was challenged on the ground that it is ultra vires the*

*provisions of sections 66 and 67 of the Act. The High Court held that section 66 of the Act levies tax only on the taxable services; that this is an inbuilt mechanism to ensure that only the taxable service shall be evaluated under the provisions of section 67; that on construing the provisions of sections 66 and 67(1) (i) together and harmoniously, it is clear that the value of taxable service shall be the gross amount charged by the service provider; and nothing more and nothing less than the consideration paid as a quid pro quo for the service can be brought to charge. The High Court further held that the common thread that runs through sections 66 and 67 and 94 (the rule-making power), manifests that only the service actually provided by the service provider can be valued and assessed to tax. The High Court concluded that the provisions of rule 5(1) of the Valuation Rules are repugnant to sections 66 and 67 of the Act since the provision purport to tax not, what is due from the service provider under the charging section, but seeks to extract something more from him by including in the valuation of the taxable service other expenditure and costs which are incurred by the service provider in the course of providing taxable service.*

*(vii) In the light of the clear legislative text, the unambiguous provisions of sections 66 and 67 of the Act and in the light of the judgment in Intercontinental Consultants and Technocrats Pvt. Ltd. [2013] 59 VST 487 (Delhi); [2013] 19 GSTR 462 (SC); [2013] 29 STR 9 (Delhi), the conclusion is compelling and inviolable that the value "free supplies" by a construction services recipient, for incorporation in the constructions would not constitute a non-monetary consideration to the service provider nor form part of the gross amount charged for the services provided. Whether the Legislature may enact that the value of "free supplies" should be included in the value of the service provided for levy of tax; and within its legislative competence, is an aspect that is speculative for the nonce and outside the purview of either the substantive*

*appeals or the issue referred to us. In this view of the matter it is not necessary to consider the contention on behalf of the assessees that an interpretation that section 67 of the Act enables or mandates inclusion of the value of goods and materials incorporated into construction services (whether provided by the service provider or as a free supplies by the service recipient) would render the legislative provision unconstitutional, since value of the goods incorporated being sale of goods would be liable to sales tax, an area within the legislative competence of State, the value of goods sold would thus be beyond the legislative competence of Parliament for levy of tax on such sale; consequently could not also constitute the value of taxable services. Learned counsel placed reliance on the judgment in Gannon Dunkerley & Co. v. State of Rajasthan [1993] 88 STC 204 (SC); [1993] 1 SCC 364 and State of Andhra Pradesh v. Larsen & Toubro Ltd. [2008] 17 VST 1 (SC); [2008] 9 SCC 191, to buttress this contention.*

*(viii) Since section 67 of the Act, as currently structured does not, in our view require inclusion of free supplies in the gross value charged, for computation of the value of taxable services; and as this is the only issue presented (on section 67 of the Act); we find no justification for a wider analysis of a speculative theatre, of potential conflict."*

xxx xxx xxx

*In conclusion we answer the reference as follows:-*

*(a) The value of goods and materials supplied free of cost by a service recipient to the provider of the taxable construction service, being neither monetary or non-monetary consideration paid by or flowing from the service recipient, accruing to the benefit of service provider, would be outside the taxable value or the gross amount charged, within the meaning of the later expression in Section 67 of the Finance Act, 1994."*

This court is of the opinion that the explanation to Item No. 7 of the Notification – which is been impugned in this case is worded in a neutral manner; it directs the inclusion of the gross value of the goods to the extent that goods are bought by the contractor, there can be no quarrel in its application. However, the problem in this case is that the petitioner claims that the goods were in fact supplied free of cost for the construction activity undertaken by its principle or the service recipient. In the light of the ***Intercontinental Consultants*** (supra) and ***Bhayana Builders*** *(supra)*, the petitioner's grievance is well founded. It is accordingly held that in cases where goods are supplied free of cost by the service recipient to the construction contractor of the service provider, the value of such goods shall be excluded from the gross amount in terms of explanation to Item No. 7 of the Notification 1 of 2006.

The writ petition is accordingly allowed.

**S. RAVINDRA BHAT, J**

**DEEPA SHARMA, J**

**OCTOBER 17, 2016**
*sapna*