

WHETHER THE SALE OF FLATS YET TO BE CONSTRUCTED BY A DEVELOPER IS TAXABLE UNDER STATE VAT ACTS?

Recently, the Larger Bench of J. R.M. Lodha, J. Chelameswar and J. Madan B. Lokur of the Hon'ble Supreme Court of India in the case of **Larsen And Toubro Limited And Anr. V. State Of Karnataka And Anr. [Civil Appeal No. 8672 of 2013]** decided on **26.09.2013** as under:

"The value of the goods which can constitute the measure of the levy of the tax has to be the value of the goods at the time of incorporation of goods in the works even though property in goods passes later. Taxing the sale of goods element in a works contract is permissible even after incorporation of goods provided tax is directed to the value of goods at the time of incorporation and does not purport to tax the transfer of immovable property."

Relevant Provision:

The following definition of "works contract" in Karnataka Sales Tax Act, 1957, was under consideration: "works contract" includes any agreement for carrying out for cash, deferred payment or other valuable consideration, the building, construction, manufacture, processing, fabrication, erection, installation, fitting out, improvement, modification, repair or commissioning of any moveable or immovable property."

Scenario in Other States:

Almost identical definitions of "works contracts" are present in VAT legislations of Delhi, Haryana, Uttar Pradesh, Rajasthan, and Maharashtra to name a few.

Question

Whether it is permissible for State (State Governments) to levy tax on sale of goods and materials in agreements for sale of flats yet to be constructed by a developer?

Summary of Ratio

Hon'ble Supreme Court upheld the ratio earlier laid down by it in Raheja Development Corporation v. State of Karnataka [(2005) 5 SCC 162]. Under Article 366(29A)(b) of the Constitution of India, States have the power to levy sales tax on the value of material used in execution of works contract. A transfer of property in goods under Article 366(29A)(b) is deemed to be a sale of goods involved in the execution of a works contract.

For sustaining the levy of tax on the goods deemed to have been sold in execution of a works contract, three conditions are required to be fulfilled:

- (i) There must be a works contract;
- (ii) The goods should have been involved in the execution of a works contract;
- (iii) Property in these goods must be transferred to a third party either as goods or in some other form.

Article 366(29A)(b) contemplates a situation where the goods may not be transferred in the form of goods but may be transferred in some other form, which may even be in the form of immovable property. It is permissible for States to levy sales tax on goods/materials used in the execution of works contract, even if the dominant intention of is not to transfer property in goods, or even if the ultimate transaction is for transfer of an immovable property.

The value of goods which can constitute the measure of the levy of the tax has to be the value of the goods at the time of incorporation of goods in the works, even though property in goods passes at a later stage. Where a composite contract comprises elements of both 'works contract' and 'transfer of immovable property', it is not denuded of its character as a works contract.

Construction activity undertaken by a developer would be a works contract from the stage the developer enters into a contract with the buyer. If the agreement is entered into after the unit is already constructed then there would be no works contract. However, if the agreement is entered into before the unit is constructed, such agreement would be a works contract. If there is a termination and a particular unit is not resold/ or is retained by the developer, there would be no works contract to that extent.