KSCAA NEWS BULLETIN

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Ignite Inspire Knowledge Initiate
pravartana

Theme 2015-16

Executive Committee 2015-16

Inauguration of Workshop on Co-operative Audit at Tumkur held on 4th July 2015

KSCAA 1st Women CAs' Conference Inaugurated by Dr. N. Manjula, IAS, held on 11th July 2015

President's Communique

Dear Professional Colleagues,

I thank all of you for electing me as President to this august Association KSCAA for the term 2015-16. I consider it honour & privileged but at the same time duty bound to serve the professional fraternity. I have a dynamic & enthusiastic team with me & with the support of them I promise to fulfill my duty as President. I request your support & blessings to achieve and set new goals for the Association. I also wish to thank my predecessor CA. Raveendra Kore who guided & supported me during my tenure as Vice - President.

I wish to place on record & thank all the Past Presidents, Senior Members, MC Members of Bangalore & Other Branches of SIRC of ICAI and well wishers who always supported & guided us year by year in all activities of the Association. We need suggestions & feedback so as to improve upon ourselves. Times are rapidly changing, so are the expectations from the Profession. I am aware of the task ahead of me. If requires best efforts to excell & accomplish the vision. This is possible with more of your Co-operation, Let us plan and work & achieve success while maintaining the esteem of our Profession.

The theme of the year

The theme of the year "Pravartana" is an act of promoting knowledge through initiating novel ideas of learning, igniting professional minds to think beyond boundaries and inspiring people to succeed in their professional life.

Be the change you want to see in this world. Change is inevitable and Change is the only permanent thing in life. Changing times throws up new opportunities. Let us initiate, ignite and inspire everybody to be part of our goal of knowledge dissemination to reap the benefits of this change.

In service of the Profession,

CA. Dileep Kumar T M
President

From the Outgoing President

ರಾಷ್ಟ್ರ ನಿರ್ಮಾಣದ ಪಾಲುದಾರರಾಗಿರುವ ನಾವುಗಳು, ರಾಷ್ಟ್ರದ ಬೆನ್ನೆಲುಬಾಗಿರುವ ಹಾಗೂ ಆತ್ಮಹತ್ಯೆಯ ದಾರಿ ಹಿಡಿದಿರುವ ಅನ್ನದಾತರಿಗೆ ಆತ್ಮಸ್ಥೈರ್ಯ ತುಂಬುವ ಕಾರ್ಯಗಳನ್ನು ಮಾಡೋಣ ಎನ್ನುತ್ತ . . . .

Dear Professional Friends,

It is truly hard to believe how quickly a year has passed and that I am writing this message as I prepare for transition to immediate past president. It was certainly a busy year, which is probably why it passed in the blink of an eye.

Our Association has had many successes over the years, and 2014-15 was no different. This month we have successfully completed two more programmes. Mofussil programme held at Tumkur on Co-operative Audit was well received by attendees. Programme was well orchestrated by Tumkur District Chartered Accountants Association and deserves big hats off. I am proud in mentioning, KSCAA has organised its first ever Women CAs Conference at Bengaluru and outstanding number of delegates attended making it an unprecedented success.

Critical to our success was the Executive Committee of the Association. We reaped the harvest of men and women who were willing to serve and were elected to the Committee who met regularly to make the decisions that allow our Association to run so effectively. I want to take this opportunity to thank all Executive Committee Members who so willingly chaired committees, attended meetings and completed all of those other tasks to meet the mandate of our Association and at the same time be a very active part of our activities.

It takes a collective effort to make an association like ours viable, and I think it is only fair that special thanks also go out to all the office bearers on our Executive Committee, including our Secretary CA. Raghavendra Puranik, Joint Secretary CA. Raghavendra T N, Treasurer CA. Nagappa Nesur and Vice President CA. Dileep Kumar T M who is taking baton as President now. I believe that the future of Association is in the strong leadership hands of some of the most dedicated professionals. I thank all of you for your assistance, guidance, and friendship.

I thank office staff of KSCAA Ms. Gayathri and Mr. Dilip for making this a very successful year.

I thank you all – the members of KSCAA – for allowing me to serve you as President over the last year. It has been an honor, a joy, and an experience that I will always cherish. I have met many new, interesting professional colleagues, made many new friends, and enjoyed it to the fullest. I look forward to seeing you at upcoming Association events in the fall.

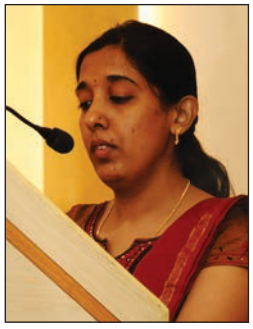
Thanks to all,

CA. Raveendra S. Kore
Immediate Past President

Workshop on Co-operative Audit at Tumkur held on 4th July 2015

Bagalkot District
Chartered Accountants Association
Members celebrated CA Day
at Neeralakeri Orphanage, Bagalkot

KSCAA 1st Women CAs' Conference held on 11th July 2015



KSCAA
News Bulletin
July 2015
Vol. 2 Issue 11
No. of Pages : 20

CONTENTS

Valuation of Inventories 6
CA. S. Krishnaswamy

Service Tax Valuation 9
– FOC Materials
CA. Madhukar N Hiregange &
CA. Mahadev R.

Is Landowner liable to pay VAT 11
under the Commercial Tax Laws?
CA. Srikanth Acharaya &
CA. Annapurna Kabra

Did the Supreme Court apply the 13
wrong legal standard in
Kone Elevators?
Vikram A. Huilgol

KSCAA Membership 16
Application Form

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Website: www.kscaa.co.in

Theme of the year 2015-16

Theme of the year "Pravartana" is an act of promoting knowledge through initiating novel ideas of learning, igniting professional minds to think beyond boundaries and inspiring people to succeed in their professional life.

To improve is to change, Progress is impossible without change; Hence Change is the part of life. Monotonous activities in our life create stagnation. Continuous improvement keeps us going and gives strength to face any challenges.

"Pravartana" is a cohesive process of enforcing new challenges in to our life which encourages the creativity of identifying new ways to reach professional goals. We wish to bring a change in our surrounding, by creating atmosphere which encourages learning new things in newer ways. We want to initiate a new dimension to Knowledge dissemination which is inspired by mentors, ignites the professionals to become part of change.

KARNATAKA STATE CHARTERED ACCOUNTANTS ASSOCIATION ®

VISION

- KSCAA shall be the trusted and value based knowledge organisation providing leadership and timely influence to support the functional breadth and technical depth of every member of CA profession;
- KSCAA shall be the nucleus of activity, amity and unity among members aimed at enhancing the CA profession's social relevance, attractiveness and pre-eminence;
- KSCAA shall in the public interest, be a proactive catalyst, offering a reliable and respected source of public statement and comments to induce effective laws and good governance;
- KSCAA shall be the source of empowerment for leadership and excellence; disseminating knowledge to members, public and students; building a framework for new opportunities and partnerships that enhance life in the community and beyond; encouraging highest ethical standards and professional integrity, in realization of India global leadership vision.

MISSION

- The KSCAA serves the interests of the members of CA profession by providing new generation skills, amity, unity, networking and leadership to strengthen the professional capabilities, integrity, objectivity, social relevance, standards and pre-eminence of India's Chartered Accountants nationally and internationally through; becoming gateway of knowledge for Chartered Accountants, students and public; helping members add value to their customers/employers by enhancing their professional excellence and services; offering a reliable and respected source of public policy advice and comments to bring about more effective laws and policies and transparent administration and governance.

MOTTO: KNOWLEDGE IS STRENGTH

VALUATION OF INVENTORIES

CA. S. Krishnaswamy

In the last article I dealt with "Construction Contracts" and the standard issued by the Income Tax Department comparing it with AS 7 and due to be brought into force as newly Christened IND AS 115, convergent with IFRS 15. The Central Council as on its agenda discussion on the proposed adoption of IND AS 115 to be brought in to force from April next year.

Now in this article I deal with 'Valuation of Inventories'

1. Section 145 of the Income tax Act gave the power to from year 1996-97 to the Central Government to notify ICDS to be followed by any class of taxpayers or in respect of any class of income. (S 145(2))
2. CBDT released revised 12 drafts (after electing public opinion) of ICDS. Finance Act 2014 substituted the words "Accounting Standards" to " Income Computation and disclosure Standards" w.e.f 01.04.2015.

1.1 Valuation of inventories be

"Inventories should be valued at cost or net realisable value whichever is less"

3.2 The standard defines "inventories"

2 (1) (a) "Inventories" are asset:

(i) Held for sale in the ordinary course of business;

(ii) In the process of production for such sale;

(iii) In the form of materials or supplies to be consumed in the production process or in the rendering of services.

3.3 The realisable value is also defined

2 (1)(b) " Net realisable value" is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

3.4 Cost of Inventories

Cost of inventories shall comprise of all costs of purchase, costs of services, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

3.5 Cost of Conversion

Conversion means bringing the inventories to their present location and condition. Also see para 10 Other costs shall be included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

4. S 145A of the Income Tax Act makes a specific reference to this aspect-

Section 145A

Notwithstanding anything to the contrary contained in section 145,-

a) The valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall be-

(i) In accordance with the method of accounting regularly employed by the assessee; and

(ii) Further adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) **actually paid or incurred** by the assessee to bring the goods to the place of its location and condition as on date of valuation.

The section has been the subject matter of judicial interpretation in the matter of inclusion of excise duty in the cost of Inventory:

4.1 S. 145A : Assessment – Method of accounting – Accounts - Valuation of closing stock – Excise duty

Excise duty on sugar manufactured but not sold is not to be included in the value of closing stock. In respect of excisable goods manufactured and lying in stock excise duty liability would be crystallized **on date of clearance of goods and not on date if manufacture** and therefore, till the date of clearance of excisable goods, assessee cannot be said to have incurred excise duty liability. (A.Y. 2001-02).

CIT v. Loknete Balasaheb Desai S.S.K. Ltd. (2011) 200 Taxman 238 / 59 DTR 169 / 243 CTR 181 / 339 ITR 288 (Bom.) (High Court)

4.2 S. 145A : Assessment – Method of accounting – Valuation – Valuation of Stock

For the purpose of valuation of closing stock, section 145A of the Act provides that only taxes duties, cess or fees actually paid by the assessee to bring the goods to place of its location would form part of the value stock. Accordingly, there is no justification on the part of the Assessing Officer to add excise duty to the price of the raw material, etc. while computing the value of goods in closing stock, as the goods had not left the premises of the assessee.

ACIT v. D & H Secheron Electrodes P. Ltd. (2008) 5 DTR 279 / 173 Taxman 188 (MP) (High Court)

4.3 S. 145A : Assessment – Method of accounting – Valuation – Valuation of Stock – Addition to opening stock

Section 145A begins with a non obstante clause and therefore to give effect to sec. 145A, if there is a change in the opening stock as on March 31, 1999, there must necessarily be a corresponding adjustment made in the opening stock as on April 1, 1998. (A.Y. 1999-2000) CIT v. Mahavir Aluminium Ltd. (2008) 297 ITR 77 / 214 CTR 45 / 168 Taxman 27 (Delhi) (High court)

4.4 S. 145A : Assessment – Method of accounting – Valuation of closing stock – Raw material – Excise duty [S.145]

Where by applying provisions of section 145A, Assessing Officer computed excise duty proportionate to closing stock of raw material, without considering similar adjustment in value of opening stock of raw material, Commissioner (Appeals) was justified in directing Assessing Officer to recomputed adjustment under section 145A making necessary adjustment to closing stock of finished goods, opening stock of raw material and MODVAT credit.

ITO v. Mehra Electric Co. (2005) 148 Taxman 37 (Mag.) (Kol.) (Trib.)

4.5 In CIT v Lakshmi Sugar Mills Co. Ltd. [2014] 369 ITR 666 (Delhi):

At Page 671 the court observed explaining S145A: "The expression '**incurred by the assessee'** in the section 145A(b) is followed by the words 'to bring the goods to its location and condition as on the date of valuation'. Thus, the expression 'incurred by the assessee' relates to the liability determined as tax, duty, cess or fee payable in bringing the goods to the place of its location and the condition of the goods. The explanation to section 145A(b) makes it further clear that the income chargeable under the head 'Profits and gains of business' shall be adjusted by the amount paid as tax, duty, cess or fee. Therefore, the expression 'incurred' in section 145A(b) must be construed to mean the liability actually incurred by the assessee.

Where the excisable goods are lying in the stock on the last day of the accounting year, whether the manufacturer has incurred liability to pay the excise duty on the manufactured goods is the question.

The apex court in the case of Collector of Central Excise v. Polyset Corporation reported in [2000] 115 ELT 41 (SC) has held that the dutiability of excisable goods is determined with reference to the date of manufacture and the rate of excise duty payable has to be determined with reference to the date of clearance of the goods. Therefore, though the date of manufacture is the relevant date for dutiability, the relevant date for the duty liability is the date on which the goods are cleared, in the other words, in respect of excisable goods manufactured and lying in the stock, the **excise duty liability would get crystallised on the date of clearance of goods** and not on the date of manufacture. Therefore, till the date of clearance of the excisable goods the excise duty payable on the said goods does not get crystallised and, consequently, the assessee cannot be said to have incurred the excise duty liability. In respect of the excisable goods lying the stock, no liability is determined as payable and, consequently, there would be no question of incurring excise duty liability.

In the present case, it is not in dispute that the manufactured sugar was lying in stock and the same were not cleared from the factory. Therefore, in the facts of the present case, the Income Tax Appeallate Tribunal was justified in holding that in respect of unsold sugar lying in the stock, central excise liability was not incurred and, consequently, the addition of excise duty made by the Assessing officer to the value of the excisable goods was liable to be deleted.

4.6 The ICDS para 22 specifies that "The value of the inventory as on the beginning of the previous year shall be

(i) The cost of inventory available, if any, on the day of the commencement of the business when the business has commenced during the previous year, and

(ii) The value of the inventory as on the close of the immediately preceding previous year, in any other case.

This nullifies the impact of judicial decisions which provided that opening stock should be valued on the same basis as closing stock, in cases where there is a change in policy for inventory valuation during the year.

5 Guidance Note

The ICAI has also issued a guidance note on the valuation in which it opines that excise duty must be included.

Guidance Note on Accounting Treatment for Excise Duty, issued by the Institute of Chartered Accountants of India:

"18. Since the liability for excise duty arises when the manufacture of the goods is completed, it is necessary to create a provision for liability of unpaid excise duty on stocks lying in the factory or bonded warehouse."

6 AS2 does not provide for any method of valuation in case of service providers, But ICDR provides on Para 6 for valuation of inventories for a service provider.

7 The other difference between AS2 and ICDR :

AS2: As per para 16 of the Standard: "The Cost of inventories, other than those dealt with paragraph 14, should be assigned using the first-in, first-out (FIFO), or weighted average cost formula. The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to the present location and condition.

A variety of cost formulas is used to determine the cost of inventories other than those for which specific identification of individual costs is appropriate. The formula used in determining the cost of an item of inventory needs to be selected with a view to providing the fairest possible approximation to the cost incurred in bringing the item to its present location and condition. The FIFO formula assumes that the items of inventory which were purchased or produced first are consumed or sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the enterprise.

ICDR: "Cost of inventories is to be determined using the first-in-first-out (FIFO) method or the weighted average cost method. When these methods are not practicable, the retail trade method is to be adopted".

8 AS2: "Method of valuation of inventory can be changed if it results in a more appropriate presentation of accounts".

ICDR: "Method of valuation of inventory once adopted cannot be changed, unless there is a reasonable cause for doing so".

9 AS2: "Does not provide the value of inventories to be adopted at the time of dissolution of a partnership firm, association of persons (AOP) or body of individuals (BOI)".

ICDR: "Provides that the value of inventories shall be the net realisable value on the date of dissolution".

10 Disclosure:

(i) Disclosure in the Reliance Annual Report of 2014-15 on Inventories:

Items of inventories are measured at lower of cost and net realisable value after providing for obsolescence, if any, except in the case of by-products which are valued at net realisable value. Cost of inventories comprises of cost of purchase, cost of conversion and other costs including manufacturing overheads incurred in bringing them to their respective present location and condition.

(ii) Disclosure as per Standard

The financial statements should disclose:

a) The accounting policies adopted in measuring inventories, including the cost formula used; and

b) The total carrying amount of inventories and its classification appropriate to the enterprise.

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Congratulations

CA. K. Ravi,
Past President of KSCAA
has been elected as the **Vice President** of
Federation of Karnataka Chambers of Commerce and Industry (FKCCI)
for the year 2015-16.

He is the first practicing Chartered Accountant to have been elected to this prestigious position.

KSCAA WELCOMES NEW MEMBERS - JULY 2015

	Name	*Place*
1	Bharath M	Bengaluru
2	Ashish Rungta	Bengaluru
3	Nagendra	Bengaluru
4	Pradeep Jhon	Bengaluru

Congratulations

Ms. Lavanya
D/o. CA. Murugesh HBM &
Ms. Arpitha
D/o. CA. Mohan Kumar HP
qualified as **CA in May 2015 Exam.**

Service Tax Valuation – FOC Materials

CA. Madhukar N Hiregange & CA. Mahadev R.

The concept of adding the value of free goods or services supplied by customer used in manufacture of excisable goods is not new in Central Excise. The principle that VAT and service tax are mutually exclusive adds to the confusion. [Imagic Creative – 2008(9) STR 337 (SC)] Section 67 emphasizing on the gross value of service has also undergone change in this Finance Act- 2015.

Valuation of services under service tax law has always been subject matter of interpretation and disputes. In this article, we examine the issue of free issue materials under service tax law especially under works contract for construction where supply of materials such as steel and cement by customers is quite common.

We need to understand the valuation options, legal provisions with respect to valuation of services and interpretation of such provisions with supporting judicial decisions.

Legal provisions

Section 67 of the Finance Act 1994 which deals with valuation services states that the value of taxable services would include both monetary and non-monetary consideration. In this Section, no reference is made to free issue materials. However, valuation provisions provide for taxation of free issue of materials. The valuation options available for the works contract service provider could be as under:

I. The contract for supply of goods and provision of services can be separated with penal clauses for each bifurcated. In that case there would be no works contract at all.

II. For Works Contract

   a. Regular method

   b. Standard deduction method

a) Regular method

Rule 2A of Valuation provides that the service portion would be as follows:

Value of works contract service = Gross amount charged for contract – Value of property in goods transferred.

For the purpose of above formula, gross amount does not include value of VAT / CST paid or payable on goods transferred in contract.

b) Standard deduction method

Standard deduction method is easier method where deduction is allowed at specified rate on total amount. It may so happen that the value of materials involved is more than the deduction allowed. In such a case, the assessee ends up paying service tax on excess value. The deduction allowed is as under:

Sl. No.	Description of service	Deduction value of total amount	Taxable value of total amount
1	Original works which includes new construction + Erection/ commissioning/installation of goods	60%	40%
2	Repair and maintenance of any goods	30%	70%
3	Repair and maintenance of immovable property and other works	30%	70%

The deduction is to be claimed on the total amount. For the purpose of this Section, "total amount" is sum total of the gross amount charged for the works contract and the fair market value of **all goods and services supplied** in or in relation to the execution of the works contract. The fair market value of goods and services so supplied may be determined in accordance with the generally accepted accounting principles.

Free of cost materials

The contractor could receive free materials like cement and steel as per the terms of contract. Sometimes, such goods need not be free but at concessional rate / reduced rate as well. In such a case, question arises as to inclusion or non inclusion of value of such free materials for payment of

service tax by contractor especially when claiming standard deduction.

From the meaning of 'total amount' discussed above, it is clear that the intention of this law is to include value of goods and services supplied in relation to execution of works contract for discharging the service tax. However, many assessees are not agreeing to this view as the goods do not belong to such assessees and demand of service tax on such materials belonging to customers in their view would not be in line with Section 67 and against the decision in BSNL [2006(2) STR 161 (SC)] wherein it was held that on the value of goods service tax should not be charged and on the value of service sales tax should not be charged.

In support of such view, the larger bench Tribunal in case of *Bhayana Builders Pvt Ltd. Vs CST, Delhi 2013 (32) STR 49 (Tri-LB)* had held that the value of goods and materials supplied free of cost would be outside the taxable value or the *gross amount charged.* The tribunal concluded that goods and materials which belong to the provider which are supplied/ provided/ used would alone constitute the gross amount charged. It was also held that the free issue materials would not either constitute monetary or non-monetary consideration for payment of service tax. Similar view was expressed in the earlier case of *Cemex Engineers v. CCE - 2010 (017) STR 0534 (Tri-).*

Readers should note that question in litigation in this case was claiming abatement towards value of materials under Notification No. 15/2004-ST. In this said notification, Works contract service provider had the option of claiming abatement of 33% of gross amount charged. For the purpose of claiming the abatement, the gross amount shall include the ***value of goods and materials supplied or provided*** or used by the provider of the construction service for providing such service. The larger bench has clarified that **such gross amount charged** would not include the value of free issue materials.

Relying on this landmark judgment, the assessee engaged in construction contract with due intimation to revenue claim the deduction towards the free issue materials. The view expressed by the larger bench is also logical as in case of free issue materials no direct or indirect and no monetary or non-monetary benefit is accrued to the service provider in terms of Section 67.

Precautionary steps to be taken

As the matter is not clear and free from doubt, the assessee could ensure that following steps are taken to mitigate the implication even if held to the contrary in future:

1) Contracts to be on net amount with scope of customer being supply of material.

2) Detailed stock register be maintained with respect to quantity and value of goods and the services received from the customers. This should include even the details of goods not used and returned.

   This would ensure that the value of goods could be deducted on actual basis where there is no dispute.

3) A letter to the department disclosing the practice being followed with respect to free materials and judgments relied should be filed and confirmation sought.

4) Assessee could also examine the option of taking an indemnity from customer when he has decided to rely on the larger bench decision. This would ensure that even in future, if the demand arises, the same could be recovered from the customers.

Conclusion: Cautious approach is required if the assessee wants to claim deduction towards free issue materials. One should wait for CBEC to provide clarity on this or for the decision of Supreme Court in case of Bhayana Builders to reach logical end to this issue.

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Is Landowner liable to pay VAT under the Commercial Tax Laws?

CA. G.B. Srikanth Acharaya & CA. Annapurna Kabra

The Recent Judicial pronouncement in case of Chaitanya Properties Private Limited Vs the State of Karnataka STRP No.355 OF 2012 & STRP No.726 OF 2013 has discussed the issue with respect to liability of tax on the landowner.

The Revenue has preferred the Revision petitions against the order passed by the Karnataka Administrative Tribunal holding that there is no liability on the part of the owner of the land to pay tax under Section 4(1)(c) of the Karnataka Value Added Tax, 2003 as the land was given for the construction of building and as such, the land value cannot be subjected to tax. Further it was held that as the landowner was not involved in any execution of the works contract, the liability to pay tax under Section 4(1)(c) of the Act is not attracted.

The landlord has entered into a joint development agreement with M/s Prestige Estates Projects, Pvt. Ltd., Bangalore for development of the land. In terms of the agreement entered into between them, the developer M/s Prestige Estates Projects, Pvt. Ltd., has agreed to develop an integrated small town which consists of Commercial Complexes, Community Halls, Lodges, Apartments and Cinema Theatres. The Land owner and developer have entered into Joint Development for development of property in the ratio of **31.77%** (for land owner) and **68.23%** (for developer) wherein the landowner has agreed to transfer by way of sale or otherwise 68.23% of undivided share in the property so constructed and the builder shall deliver to the landlord 31.77% of the super built up area in the development. In terms of the agreement the landowner was entitled to 793 flats constructed by the builder. Further there was tripartite agreement entered by land owner (as seller), builder and purchaser for sale of flats belonging to the land owner's share for 293 flats prior to the construction of apartments.

From the terms of tripartite Agreement it is clear that the landlord has to execute a registered sale deed in respect of the undivided interest in land. Further the landowner has to construct an apartment and handover the same to the purchaser. The landowner has authorized the builder to receive the consideration for construction as his agent. In terms of the agreement entered into between the builder and the landlord, the entire cost is to be borne by the builder. The above recital shows that purchaser paid the money to the land owner and land owner has authorized the builder to collect money as their agent. The Builder did not collect money in his individual right in terms of the agreement entered between land owner and the builder.

It is not in dispute that tripartite contract is works contract. The Apex Court in case of Larsen and Toubro Limited and another Vs State of Karnataka and another reported in 2008 17 VST 460(SC) held that three conditions to be fulfilled that there must be works contract, the goods should have been involved in the execution of works contract and the property in those goods must be transferred to a third party either as goods or in some other form. Therefore it is believed by the Courts that landowner has fulfilled all the above three conditions and therefore it amounts to works contract and liable to tax.

The Issues for consideration is who should transfer the goods and who is liable to pay tax?

The contentions taken by the landlord is that he is not the owner of the goods which were transferred into the construction of apartment. The physical work is done by the Builder under the Joint Development Agreement. The landlord was under no obligation to put up such construction. Merely because the landlord has entered into a Tripartite Agreement, no liability can be enforced on him. The liability is on the Builder. The Builder at the time of sale of these apartments to the purchasers, not only has collected the cost of construction but also collected the tax payable and therefore, relying on Section 47 of the Act, it is submitted that when he is not liable, if he has by mistake collected the money, the department should proceed against him and collect the amount. However, he submitted that the liability to pay tax precisely is that of the Builder and not that of the landlord.

It is held by the Court that notwithstanding the Joint Development agreement between land owner and the builder, the land owner is responsible for construction and sale of flat along with undivided interest in land therefore **land owner is liable to pay tax**. It is open for the land owner to pay tax and recovery the money from the builder by virtue of the terms of Joint Development Agreements. It is also open to the department to proceed against the builder in accordance

with the law including section 47 (forfeiture of tax) of the act to recover the amount collected by the builder and then give deduction of the same to the assessee.

The decision with respect to levy of tax in case of Joint development agreement is not discussed in the above case as there was no question of law raised in this regard.

With reference to the analysis of the above case wherein it is stated that the Honorable High Court has directed to recover the tax from the builder under section 47 of the Act. Therefore it can be understood that the recovery provision should be applied only when the builder has collected the taxes of landlord share and not deposited the taxes on the landlord share. But in case if the builder has paid the taxes pertaining to sale of flats pertaining to landlord share then there should not be any recovery of taxes from the builder and accordingly declaration given by the builder should suffice to assess the taxes of the landlord. Also it is held that the builder is an agent of the landlord and accordingly if the builder has paid the taxes then there should not be any recovery tax proceedings against the landlord.

It can also be further analyzed that builder is registered dealer under KVAT Law and most of the landlord are not registered dealer under the KVAT law. In case of works contract the transfer of property in goods happens only once, there cannot be multiple transfer (L & T case (SC)) in the execution of works contract. Therefore if tax already discharged by builder on the works executed for 293 flats (pertaining to the land owner's share), then levying tax on land owner on the basis of terms of the agreements runs contrary to the law laid down by the Hon'ble Apex Court in L & T.

Therefore based on the above analysis of the case it is held that the landlord is leviable to tax on the sale of flats made with the customer in the execution of works contract subject to conditions as specified and accordingly it will reopen various issues with reference to deductions and credits as claimed by the builder like labour and like charges, input tax credit, tax collection and various other issues as applicable.

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Did the Supreme Court apply the wrong legal standard in *Kone Elevators?*

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A few months earlier, I had written about the genesis of the dominant intention test and traced its evolution to its current form and status.[1] In conclusion, I had stated that the dominant intention test is still very much alive and kicking in respect of contracts not falling within the purview of Article 366(29-A), but that it has no application in respect of composite contracts that fall within its ambit, that is, if the contracts are either works contracts or catering contracts. In Kone Elevator India Ltd. v. State of Tamil Nadu, (2014) 71 VST 1, in deciding that a contract for manufacture, supply, and installation of an elevator in a building is a works contract and not a contract for sale of goods,the Supreme Court appears to have erred in not applying the dominant intention test on the basis that it is no longer relevant after the insertion of Article 366(29-A). This is not to say that the Court's conclusion is incorrect, and that it ought to have held the contract to be a sale of goods. The thesis of this article is merely that the Court did not apply the correct legal standard in deciding the issue, namely, whether the contract of manufacture, supply, and installation of an elevator is a works contract or one for sale of goods.

Evolution of the Concept of Works Contract vis-à-vis Sale.

In order to understand why the Supreme Court may have applied the wrong legal standard in Kone Elevators, it is relevant to trace the development of case law relating to the difference between contracts for sale and works contracts.

In State of Madras v. Gannon Dunkerley, (1958) 9 STC 353, the Supreme Court held that the essential ingredients of a contract for sale of goods are: (1) an agreement to sell movables, (2) for a price, and (3) property passing therein pursuant to that agreement. Pertinently, the Court held that there must be an agreement between the parties to sell the very goods in which property eventually passes and, therefore, in a building contract, where the agreement between the parties is that the contractor should construct a building, there is no contract to sell the materials used in the construction. The essence of the Court's judgment was that in order constitute a sale of goods, the parties must intend that property in goods be transferred as goods from one party to another.

In Carl Still GMBH v. State of Bihar, (1961) 12 STC 449, the Supreme Court held that if the contract between the parties does not embody an agreement for sale of materials as such, there is no sale of goods. Therefore, the Court relied on the intention of the parties in deciding whether a contract is one for sale of goods or a contract for work and labour.

In Patnaik & Co. v. State of Orissa, (1965) 16 STC 364, a Constitution Bench of the Supreme Court was faced with the issue of whether a contract for supply of a bus body after fitting it on a chassis was a contract for sale of the bus body or a contract for labour. While holding that the contract is for sale of the bus body, the Court observed that, "whether a contract is one for execution of work or for performance of service, or is contract for sale of goods must depend upon the intention of the parties gathered from the terms of the contract[.]"Furthermore, after analyzing the terms of the contract, the Court held that the property in the bus body, which was a movable, passed only at the time of delivery of the bus body after it is fitted on the chassis and that, therefore, it was a transfer of chattel as chattel. Therefore, the Court relied on both the dominant intention of the parties as well as the time of passing of property in the goods in concluding that the contract was one for sale of goods.

In State of Rajasthan v. Man Industrial Corporation Ltd., (1969) 24 STC 349, the issue was whether a contract for providing and fixing of windows of various shapes and sizes according to specifications set out in the contract was a contract for work and labour or a contract for sale of goods. The Court, while holding that the contract was one for work and labour, observed that the "test in each case is whether the object of the party sought to be taxed is that the chattel as chattel passes to the other party and the services rendered in connection with the installation are incidental to the execution of the contract of sale."

In Vanguard Rolling Shutters and Steel Works v. Commissioner of Sales Tax, (1977) 39 STC 372, the assessee manufactured rolling shutters according to specifications given by parties and fixed the same at the customers' premises.In holding that the transaction was a works contract and not a sale simpliciter, the Court, after observing that there was no straightjacket formula to answer the question, relied on the following aspects: (1) the consideration paid by the customer was a lumpsum amount without specifying the portion relatable to the sale of goods and services; (2) the goods were not transferred as chattel, but by way of accretion to immovable property; and (3) the work done at the site could not be said to be merely incidental to the contract, but was a fundamental part of the contract, as the contract cannot be said to be completed merely by sending the materials to the site.

In Sentinel Rolling Shutters v. Commissioner of Sales Tax, (1978) 42 STC 409, the Supreme Court, while dealing with an issue almost identical to that in Vanguard Rolling Shutters, held as follows:

[1] See KSCAA News Bulletin, April 2015.

"[T]he component parts do not constitute a rolling shutter until they are fixed and erected on the premises. It is only when the component parts are fixed on the premises and fitted into one another that they constitute a rolling shutter. The erection and installation of the rolling shutter cannot, therefore, be said to be incidental to its manufacture and supply. It is a fundamental and integral part of the contract because without it the rolling shutter does not come into being."

"The manufacturer would undoubtedly be the owner of the component parts when he fabricates them, but at no stage does he become the owner of the rolling shutter as a unit so as to transfer the property in it to the customer. […] There is no transfer of property in the rolling shutter by the manufacturer to the customer as chattel. It is essentially a transaction for fabricating component parts and fixing them on the premises so as to constitute a rolling shutter. The contract is thus clearly and indisputably a contract for work and labour and not a contract for sale."

On a reading of the above judgments, it can be discerned that the recurring basis of the Supreme Court's findings was that, although there was no straightjacket formula to determine whether a contract was a contract for sale or a works contract, the dominant intention of the parties to the contract was the single most dispositive factor in deciding the question. In other words, in determining whether a contract was one for sale of goods or a works contract, the Supreme Court consistently relied upon the intention of the parties, more specifically, whether the supplier intended to supply the goods as chattel and if the labour and work to be performed was integral to or merely incidental to the contract.

It was at this stage that the Parliament, in 1984, inserted Article 366(29-A) into the Constitution vide the 46th Constitution Amendment Act. As a result of the insertion of Article 366(29-A)(b), the meaning of the expression "tax on the sale or purchase of goods" was amplified to include a "tax on the transfer of property in goods (whether as goods or in some other form) involved in the execution of a works contract," and "such transfer, delivery or supply [was] deemed to be a sale of those goods by the person making the transfer, delivery or supply." Crucially, Article 366(29-A) did not define what a works contract is and, consequently, the insertion of the Article did not alter the basis for the difference between a contract for sale and a works contract. The said Article merely authorized the States to levy sales tax on the value of goods transferred during the course of executing works contracts.In other words, the effect of the Amendment was that if a contract fell within the meaning of the expression "works contract," the States were now permitted to levy tax on the sale of goods effected while executing the said contract.

Therefore, in Hindustan Shipyard v. State of Andhra Pradesh, (2000) 119 STC 533, the Supreme Court, despite the insertion of Article 366(29-A), applied the tests devised by the Court in cases prior to the 46th Amendment in determining whether a contract for construction and supply of ships was a contract of sale or a works contract.

Kone Elevators' Case.

In State of Andhra Pradesh v. Kone Elevators, (2005) 140 STC 22 ("Kone Elevators – I"), the Supreme Court held that held that, in deciding whether a contract is one of sale or a works contract, the essence of the transaction or the predominant intention of the parties has to be considered. The Court observed that if the intention of the parties is to transfer for a price a chattel in which the transferee had no previous property, then the contract is one for sale. According to the Court, another test is when and how the property of the dealer passes to the customer, that is, is it by transfer at the time of delivery of the finished article as chattel or by accession during the execution of work. Applying the above tests to the terms of the agreement, the Court held that a contract for manufacture, supply, and installation of elevators is a contract for sale and not a works contract.

On February 13, 2008, the Supreme Court doubted the correctness of the above judgment on the ground that it appeared to be in conflict with prior judgments of the Court in Man Industrial Corporation, 24 STC 349, Nenu Ram, 26 STC 268, and Vanguard Rolling Shutters, 39 STC 372.

On May 6, 2014, a Constitution Bench of the Supreme Court (with Justice Ibrahim Kalifulla dissenting), reversed its earlier judgment in Kone Elevators – I, and held that a contract for manufacture, supply, and installation of an elevator was a works contract and not a sale of goods.After examining the terms of the contract, the Court held that, "[t]he nature of the contracts clearly exposit that they are contracts for supply and installation of the lift where labour and service element is involved."The Court further held that:

"Once there is a composite contract for supply and installation, it has to be treated as a works contract, for it is not a sale of goods/chattel simpliciter. It is not chattel sold as chattel, or for that matter a chattel being attached to another chattel. Therefore, it would not be appropriate to term it as a contract for sale on the bedrock that the components are brought to the site, i.e., building and prepared for delivery."

"[T]he contract itself profoundly speaks of an obligation to supply goods and materials as well as installation of lift which obviously conveys performance of labour and service. Hence, the fundamental characteristics of works contract are satisfied. Thus analyzed, we conclude and hold that the decision rendered in Kone Elevators, (2005) 140 STC 22, does not correctly lay down the law and it is, accordingly, overruled."

It can, therefore, be seen that the Court proceeded to decide the case on the premise that any contract that envisages an obligation to supply goods and to render labour and service satisfies the fundamental characteristics of a works contract. The Court's decision was primarily based on its finding that "the concept of

'dominant nature test' or for that matter, the 'degree of intention test' or 'overwhelming component test' for treating a contract as a works contract is not applicable." Therefore, according to the Court, so long as a contract was composite in nature and involved the supply of goods and the provision of service, the contract would have to be categorized as a works contract, irrespective of whether the element of labour and service was integral or incidental to the contract.

Discussion.

The fallacy in the Court's analysis lies in the fact that the Court disregarded the dominant intention test in order to determine whether the contract for manufacture, supply, and installation of an elevator is a contract for sale or a works contract. As explained earlier, the Supreme Court has consistently relied on the dominant intention of the parties in determining whether a contract is one for sale of goods simpliciter or a works contract. In Kone Elevators, the Court merely proceeded on the basis that, after the insertion of Article 366(29-A), the dominant intention test isno longer relevant. However, the Court appears to have lost sight of the fact that, after the insertion of Article 366(29-A), the dominant intention test has been held to be inapplicable only with regard to those contracts that fall within the purview of the said Article. Therefore, if a contract is held to be a works contract or a catering contract, the assessee cannot then argue that the dominant intention is the rendering of service and, hence, the value of goods transferred is not taxable.

On the other hand, in Kone Elevators, the question as to whether the contract was a works contract (and thereby a deemed sale falling within the scope of Article 366(29-A)(b)) or a pure sale was the very issue in dispute. Therefore, the Court ought not to have proceeded on the basis that the contract for supply and installation of an elevator falls within the purview of Article 366(29-A)(b). The said fallacy in the Court's judgment is distinctly apparent from the following extract:

> *"If the contract is a composite one which falls under the definition of works contract as engrafted under clause (29A) (b) of article 366 of the Constitution, the incidental part as regards labour and service pales into total insignificance for the purpose of determining the nature of the contract."*

In the above extracted sentence, the Court first assumes that the contract is a works contract, and then relies on that assumption to state that the incidental rendering of service cannot be used to determine the nature of the contract. The above observation is clearly self-contradicting as the Court relies on the fact that a contract is a works contract to determine whether the contract is a works contract.

Moreover, the judgment suggests that any composite contract involving an element of supply of goods as well as rendering of service is a works contract. This observation, too, is wrong. In Bharat Sanchar Nigam Ltd. v. Union of India, (2006) 3 SCC 1, a Constitution Bench of the Supreme Court observed as follows:

> *"[T]he test for composite contracts other than those mentioned in article 366(29A) continues to be – did the parties have in mind or intend separate rights rising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated. The test for deciding whether a contract falls into one category or the other is as to what is 'the substance of the contract'. We will, for want of a better phrase call this the dominant nature test."*

The above extract makes it amply clear that not all composite contracts are works contracts and that the test to determine the true nature of those composite contracts not falling within the purview of Article 366(29-A) continues to be the dominant intention test. The Court has, therefore, clearly in error in stating that once there is a composite contract for supply and installation, it has to be treated as a works contract.

In fact, the dissenting judgment of Justice Kalifulla has succinctly explained why the majority's analysis is flawed. The relevant observations of Justice Kalifulla in this regard are as follows:

> *"When the very contract itself was for supply of lift to it purchaser, simply because there was some work element involved for the purpose of installation of the lift, it cannot be held that the whole contract is a 'works contract.'"*
>
> *"The contract as a whole will have to be examined to see as to what was the real intention of the parties. In my opinion, the said legal principle will continue to apply even after the 46th Amendment while examining each case."*
>
> *"Simply because some element of work is involved in a contract, it cannot be straightaway concluded that such contract would become a works contract, irrespective of the nature of the contract, which if probed into would show that it is a contract for sale."*

Conclusion.

This article merely points out the fallacy in the Supreme Court's approach in analyzing the issue of whether a contract for supply and installation of an elevator is a contract for sale or a works contract. According to the author, it is the manner in which the issue has been analyzed that is incorrect. The conclusion arrived at the by the Court is not being questioned, and I am not arguing that the contract ought to have been held to be a sale. It is quite possible that, even if the dominant intention test was applied in analyzing the terms of the contract, the Court could have arrived at the decision that the contract was indeed a works contract.

Nevertheless, it is important to keep in mind that the Court's observations, particularly regarding the inapplicability of the dominant intention test to composite contracts, have the potential to confuse assessees and the authorities in all cases where the contract is a composite one involving the supply of goods and the rendering of services.

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