

Mandatory deduction of one-third value of agreement towards land is not sustainable in case the value of land is clearly ascertainable- Gujarat High Court

20 May 2022



Summary

The Gujarat High Court (HC) has held that when the actual value of land is ascertainable, then the mandatory deduction of 1/3rd of total consideration towards land is not enforceable. The HC opined that application of deeming fiction of deduction of one-third value is discriminatory, arbitrary and violative of Article 14 of the Constitution of India as it is applied irrespective of the land plot size and construction therein. The court observed that the minutes of the 14th Goods and Services (GST) Council meeting clearly contemplate that such deduction was inserted only in the context of flats wherein value of undivided share of land was unascertainable. The HC further stated that wherever a delegated legislation is challenged as being ultra vires, it cannot be defended merely on the ground that the government had the competence to issue such delegated piece of legislation. Accordingly, the HC read down the paragraph of the notification to the effect that the deeming fiction of one-third value of land will not be mandatory. The court also directed the GST authority to refund the excess taxes paid along with interest to the applicant.

Facts of the case

- The applicant¹, a practicing advocate, had entered into an agreement² for sale of land and construction of bungalow on the land. As per the agreement, the parties agreed for a separate and distinct consideration for sale of land and construction of a bungalow on the land.
- The respondent raised an invoice on the applicant to pay GST on entire consideration payable for land as well as construction of bungalow after deducting one-third value towards land. The entire consideration towards the sale of land has not been excluded for the purpose of computing tax liability because of the impugned notification³.
- The applicant submitted that the agreement is severable and the amount of consideration towards sale of land is outside the purview of GST⁴.
- The applicant sought an advance ruling w.r.t. the tax liability on supply of developed land, wherein it was held that the deduction for sale of land was admissible only to the extent of one-third of the total consideration on the basis of the impugned notification. The Gujarat Appellate authority for Advance Ruling (AAAR) has affirmed the decision passed by Advance Ruling Authority (AAR).
- Thus, the aggrieved petitioner filed the present petition challenging the validity of the impugned notification and against the ruling passed by the AAAR.
- The applicant placed reliance on the decision⁵ of the Supreme Court (SC) and contended that when actual value can be ascertained then fictional value

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² with Navratna Organisers & Developers Pvt. Ltd.

³ Para 2 of Notification No. 11/2017-Central Tax (Rate) dated 28th June 2017

⁴ Sale of land is included in the Entry No. 5 of the Schedule III to the GST Act

⁵ Larsen and Toubro Ltd.

cannot be taken into consideration. Accordingly, the notification is contrary and illegal.

Gujarat HC observations and ruling⁶:

- **Legislative intent is to impose tax on construction activity:** The Apex Court in its decision⁷ had held that in a tripartite agreement between the landowner, developer and buyer, the construction undertaken after the agreement will be held as works contract. The construction carried out by developer in agreement with the buyer is now taxed under the GST Act along with deduction given for sale of land. The legislative intent is to impose tax on construction activity undertaken by supplier pursuant to a contract with recipient. There is no intent to levy tax on sale of land in any form as it is neither a supply of good nor supply of service.
- **Sale of land covers sale of developed land as well:** The only service provided by supplier is construction undertaken for the buyer. This is the supply alone which can be taxed. The contention of the revenue authorities that sale of land does not include sale of developed land cannot be a ground for imposing tax on sale of land. Moreover, sale of land⁸ includes sale of developed land even as per the notification.
- **Deeming fiction can be applied only when actual value not ascertainable:** The agreement specifies consideration for sale of land and for construction of bungalow. Even the revenue authorities have not argued the impossibility of bifurcation. When provisions require

valuation in terms of actual price, then tax shall be imposed on actual price. Thus, mandatory application of deeming fiction when the actual value of land is clearly ascertainable is contrary and arbitrary to statutory provisions.

- **Arbitrariness of deeming fiction:** The standard one-third deduction on account of deeming fiction is uniform irrespective of size of plot, Further, there has not been made distinction between a flat and a bungalow. The minutes of the council meeting⁹ clearly contemplate that the deduction was notified only in the context of flats wherein value of undivided share of land could not be ascertained. Thus, the deeming fiction leads to arbitrary and discriminatory consequences which are clearly violative of principles of constitution.
- **Provisions cannot be defended on ground of government's competence:** The valuation provisions have to be prescribed by way of rules and not by a notification. Whenever a legislation is challenged for being ultra-vires, then the same cannot be defended on the ground that government had the competence to issue such delegated legislation. Thus, if deeming fiction is found to be arbitrary, then it can be held to be ultra-vires.
- **Controversy relates to valuation and not chargeability to tax:** The Schedule II to the GST Act is not meant to define or extend the scope of supply but only clarifies whether a transaction will be supply of goods or services. The impugned schedule is irrelevant in the present case as this has more to do with valuation rather than chargeability of tax.

⁶ R/Special Civil Application No. 1350 of 2021 with R/Special Civil Application No. 6840 of 2021 with R/Special Civil Application No. 5052 of 2022; Dated 06 May 2022

⁷ 1st Larsen and Toubro case

⁸ Under Schedule III to the GST Act

⁹ 14th GST Council Meeting

Our comments

The taxation issues related to real estate industry have been a matter of extensive litigation since pre-GST regime. Under GST laws, service tax and value added tax (VAT) subsumed into a single tax, however, land, not being subjected to GST, has given scope for continuation of earlier disputes. Thus, a mechanism was prescribed under GST by way of a notification¹⁰ to identify the land value as one-third of the total value irrespective of the actual value available/identifiable. However, such notification was challenged on the ground of delegation and arbitrariness and hence, various writ petitions were filed before various high courts.

In the present ruling, the Gujarat HC held that the legislative intent is to impose tax on construction activity undertaken by a supplier at the behest of or pursuant to contract with the recipient. 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 the Schedule III of the GST laws.

This is a welcome judgement for the entire real estate industry which may bring a boom in this industry which will set precedence in similar matters. Further, taxpayers may consider revisiting their arrangements to have a clause specifying the land value in the arrangement and a refund application may also be filed to claim excess tax paid in the previous years.

However, the Revenue may approach filing an appeal before the Apex Court which is a wait-and-see situation.

¹⁰ No.11/2017-CT(R) dated 28.06.2017

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