IN THE HIGH COURT OF JUDICATURE AT MADRAS

RESERVED ON: 27.03.2018

PRONOUNCED ON: 06.04.2018

CORAM

THE HONOURABLE DR.JUSTICE ANITA SUMANTH

W.P.No.21799 of 2017
and
W.M.P.No.22810 of 2017

Firm Foundations & Housing Pvt. Ltd.,
represented by Mr.R.Sarvendran,
Vice President/Authorised Signatory
93, 4th Main Road Anna Nagar East, Q-Chennai - 600 040 .. Petitioner

-vs-

Principal Commissioner,
Office of the Principal Commissioner of Service Tax,
Service Tax 1 Commissionerate,
Newry Towers, No.2054-I, II Avenue,
Anna Nagar,
Chennai - 600 040 .. Respondent

Prayer: Petition filed under Article 226 of The Constitution of India praying for the issuance of Writ of Certiorari calling for the records of Order in Original No.CHN-SVTAX-001-COM-2/2017-18 dated 21.04.2017 in C.No.IV/09/54/2016-STC Adjn issued by the respondent and quash the same as arbitrary and illegal.

For Petitioner: Mr.Joseph Prabakar

For Respondent: Mr.S.R.Sundar

O R D E R

The Writ Petitioner prays for a Writ of Certiorari calling for the records of Order-in-Original dated 21.04.2017 passed by the respondent and quashing of the same as arbitrary and illegal.

2. The petitioner is a company engaged in the business of promotion and construction of residential apartments and complexes. The projects are undertaken on a joint venture basis, the petitioner being the builder, along with land owners. Service tax liability arises in respect of the portion of the project enuring to the land owners as well as to its own account. The issue raised in the present Writ Petition concerns only the service tax liability of the builder, the petitioner herein.

3. Detailed submissions of Mr.Joseph Prabakar, learned counsel for the petitioner and Mr.S.R.Sundar, learned counsel for the respondent have been heard.

4. The sequence of relevant dates and events is as follows:

(i)A show cause notice (in short 'SCN') was issued by the respondent calling upon the petitioner to explain why differential service tax of an amount of Rs.1,70,07,530/- not be demanded from the petitioner in terms of section 73(1) of the Finance Act, 1994 for the period January, 2013 to March, 2015.

(ii)The respondent at paragraph 4.2 of the SCN, states as follows:

'4.2. Since it appeared that in terms of Rule 3 of Point of Taxation Rules, 2011 the assessee is required to pay service tax immediately on raising invoices and the practice adopted by the assessee i.e making payment of Service Tax only on realization basis from the clients as against the accrual basis is in contravention of Rule 3 of the Point of Taxation Rules 2011. From the verification of value declared as Revenue from Operations in the Profit and Loss account and payment of service tax declared in the respective ST-3 returns, it appeared that the assessee have short paid service tax for the period 2012-13 (January to March 2013), 2013-14 and 2014-15. The service tax actually payable as per Profit and Loss account, service tax actually paid and service tax due were calculated and it appeared that the assessee are liable to pay the differential Service Tax amount of Rs.1,70,07,530/- from January 2013 to March 2015 on account ***builder's*** *portion and Rs.16,34,586/- on account of* ***land owner's*** *portion which were already handed over to the owner.'*

(iii)The petitioner filed a reply dated 22.09.2016 to the effect that the entire amount demanded has already been remitted by the petitioner and as such, the present show cause notice makes a double levy upon the petitioner that is impermissible in law.

(iv)The petitioner specifically relied upon the provisions of Rule 3 of the Point of Taxation Rules, 2011 (hereinafter referred to as 'Rules') to state that the methodology followed by it was in line with the prescription contained in the Rule and as such no further demand could be made.

(v)The petitioner also relied upon Circular No.144/13 of 2011 dated 18.11.2011 issued by the Central Board of Excise and Customs (in short 'CBEC') providing various clarifications on the aspect of 'continuous supply of service' under the Point of Taxation Rules, 2011.

(vi)Additional submissions dated 28.02.2017 were filed reiterating those made earlier and citing case law in support of the stand taken. A tabulation of the payments made along with the agreements entered into by the petitioner with its customers were also provided in support of the position that service tax demanded has already been remitted in time.

(vii)A personal hearing was conducted in the course of which certain other information was called for. The petitioner provided the same under cover of reply dated 11.04.2017.

(viii)Notwithstanding the submissions made, an Order-in-Original dated 21.04.2017 was passed reiterating the demand in the SCN on the basis of the revenue accounted for in the Profit and Loss account (in short 'P and L) of the petitioner. The aforesaid order of assessment is under challenge in this writ petition.

5. The relevant portion of the order is as follows:

> *'13.5. Assessee had further averred that they follow percentage of completion method under AS-7, which is prescribed for accounting of revenue for profit and loss in the financial statement by the construction industry on the basis of stage of completion. Whereas AS-7 has no relevance with payment of service tax as service tax is governed by Finance Act and Service Tax Rules. In terms of explanation to Rule 3 of Point of Taxation Rules, if the service provider receive any advance towards the provision of service, the date of payment of service tax shall be the date of receipt of each such advance. Hence the assessee are required to pay service tax immediately on receipt of advance. The assessee had averred that they had paid service tax on receipt basis and there was no short payment of service tax by them and the demand of service tax leads to double taxation on the service income for which service tax has already*

been paid. However, the assessee have neither given any statement/details on the receipt of consideration received from the buyers during the material period and payment of service tax within the time nor given any break-up details of income reflected as Revenue from Operations in the balance sheet to get exclusion from service category. Assessee had only furnished Annexure A- which is a sample of details reflecting only the advance received from buyers and recognized as income in the subsequent years. The assessee has not given any details of Advance received from the buyers project wise & year wise and details of payment of service tax within relevant date on such advances received during notice period. The assessee have all along stated the method of computation in ST-3 and AS-7 but not furnished any details for the difference in value between ST-3 Return and Balance sheet. In absence of any details, mere averment by the assessee that they had paid service tax at the time of receipt of advance is not acceptable and the allegation of the assessee that the demand of service tax results in double taxation is not correct. Hence I hold that the assessee are liable to pay service tax on the differential value as detailed in para 13.3 above.'

6.A counter has been filed by the respondent raising two main defenses - firstly, that the impugned order is statutorily appealable and as such the present Writ Petition is not maintainable and secondly that no materials have been furnished to support the stand of the petitioner that the service tax, as computed on the builders' portion, has, in fact, been paid. Thus, according to the Revenue, the argument relating to double taxation has not been established.

7.On the ground of non-maintainability, reliance has been placed on the judgments of the Supreme Court in the case of *Commissioner of Income Tax and others vs Chhabildass Agarwal* ((2014) 1 SCC 603), *Karnataka Chemical Industries vs Union of India* (113 ELT 17) and *Titaghur Paper Mills*

Co. Ltd. and another vs State of Orissa and others ((1983) 2 SCC 433) and a decision of this Court in the case of *Hypertherm (India) Thermal Cutting Private Limited vs. Deputy Commissioner of Service Tax* (2016 SCC OnLine Mad 32553)

8. Mr.Sundar also supports the basis of assessment stating that the computation of service tax as per the Profit and Loss account, as adopted by the respondent was perfectly in order. He relies on three decisions of the Delhi, Mumbai and Ahmadabad Benches of the Customs, Excise and Service Tax Appellate Tribunal (in short 'CESTAT') in support of his submission that reliance on the Balance Sheet and Profit and Loss Account was proper in deciding service tax liability. Both learned counsel draw attention to the provisions of Rule 3 of the Rules dealing with the determination of Point of Taxation.

9.Rule 3 is extracted below:

> *`Rule 3 - Determination of point of taxation: For the purposes of these rules, unless otherwise provided, 'point of taxation' shall be, -*
>
> *(a) the time when the invoice for the service [provided or agreed to be provided] is issued:*
>
> *[Provided that where the invoice is not issued within the time period specified in rule 4A of the Service Tax Rules, 1994, the point of taxation shall be the date of completion of provision of the service.]*
>
> *(b) in a case, where the person providing the service, receives a payment before the time specified in clause (a),*

the time, when he receives such payment, to the extent of such payment:

(Provided that for the purposes of clauses(a) and (b),-

(i) in case of continuous supply of service where the provisions of the whole or part of the service is determined periodically on the completion of an event in terms of a contract, which requires the receiver of service to make any payment to service provider, the date of completion of each such event as specified in the contract shall be deemed to be the date of completion of provision of service;

(ii) Wherever the provider of taxable service receives a payment up to rupees one thousand in excess of the amount indicated in the invoice, the point of taxation to the extent of such excess amount, at the option of the provider of taxable service, shall be determined in accordance with the provisions of clause (a).]

Explanation – For the purpose of this rule, wherever any advance by whatever name known, is received by the service provider towards the provisions of taxable service, the point of taxation shall be the date of receipt of such advance.]

10.Rule 3 finds part in the Point of Taxation Rules, 2011 applicable with effect from 01.04.2011. It provides for a methodology for determining the accrual and quantification of services, the exact delivery of which is not certain or ascertainable, and that may also be continuous in nature.

11.Before me, two legal issues arise for determination:

(i) Relevance of the P and L accounts of the petitioner in the determination of point of rendition of service and the method of quantification of receipts in respect thereof and

(ii) The application of Rule 3 itself in the admitted facts and circumstances of the present case.

12.Rule 3 specifically provides clarity on the determination of point of taxation. Had the respondent merely applied the said Rule to determine taxability of the services rendered by the petitioner, the basis of assessment would have been perfectly in order. The flaw, as I see it, arises from reliance by the respondent upon the entries in the P and L account to determine the point of taxation of the services rendered and quantification thereof.

13.Before going to the basis of the SCN and impugned order, I extract the basis of finalization of the P and L account itself. Admittedly, the financials, including the P and L account have been prepared on the basis of the Accounting Standards (in short 'AS') issued by the Institute of Chartered Accountants of India (in short 'ICAI). In the present case, the petitioner states unambiguously in the reply to the SCN that the basis of preparation of financials as far as the income from the building project is concerned is the 'Project Completion method'.

14.AS 7 deals with the recognition of income from building projects on the basis of the 'Project Completion Method' and I extract the relevant portions of AS 7, in so far as it is relevant to this writ petition, hereunder:

. . . .

Recognition of Contract Revenue and Expenses

21. When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected loss on the construction contract should be recognised as an expense immediately in accordance with paragraph 35.

22. In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied: Construction Contracts 73 (a) total contract revenue can be measured reliably; (b) it is probable that the economic benefits associated with the contract will flow to the enterprise; (c) both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and (d) the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.

23. In the case of a cost plus contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied: (a) it is probable that the economic benefits associated with the contract will flow to the enterprise; and (b) the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

24. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.

25. Under the percentage of completion method, contract revenue is recognised as revenue in the statement of profit and loss in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the statement of profit and loss in the accounting periods in which the work to which they relate is performed. However, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with paragraph 35.

26. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognised as an asset provided it is probable that they will be recovered. Such costs represent an 74 AS 7 amount due from the customer and are often classified as contract work in progress.

27. When an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognised in the statement of profit and loss, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense rather than as an adjustment of the amount of contract revenue.

28. An enterprise is generally able to make reliable estimates after it has agreed to a contract which establishes: (a) each party's enforceable rights regarding the asset to be constructed; (b) the consideration to be exchanged; and (c) the manner and terms of settlement. It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of contract revenue and contract costs as the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated

29. The stage of completion of a contract may be determined in a variety of ways. The enterprise uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include: (a) the proportion that contract costs incurred for work performed upto the reporting date bear to the estimated total contract costs; or (b) surveys of work performed; or (c) completion of a physical

proportion of the contract work. Progress payments and advances received from customers may not necessarily reflect the work performed.

30. When the stage of completion is determined by reference to the contract costs incurred upto the reporting date, only those contract costs that reflect work performed are included in costs incurred upto the reporting date. Examples of contract costs which are excluded are:

> *(a) contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and*
>
> *(b) payments made to subcontractors in advance of work performed under the subcontract.*

. . . .

15.AS 7 thus provides for a detailed methodology for the reporting and determination of the percentage of income from the contract over the term of the project and sets out the mode of computation for arriving at the same. The basis of such recognition and reporting is the apportionment of the income earned and expenditure incurred over the tenure of the project. This is entirely different and distinct from the scope, object and application of the Point of Taxation Rules that seeks to set out a methodology for determination of when the service was rendered and consequently when the receipt of income from such rendition be taxed.

16.The emphasis and thrust of each methodology is in alignment with the different purposes that they bear reference to – AS 7, in the context of

the preparation of financials, addresses the 'how much' of the transaction over the term of contract whereas Rule 3 of the Rules addresses the 'when' in relation to the rendition of service for computing taxability under the Finance Tax Act 1994.

17.The basis of the addition by the respondent is clear from the SCN wherein he states that *'further, on verification of the profit and loss account of the assessee for the financial years 2012-13, 2013-14 and 2014-15 along with Service Tax Payment shown in the ST3 returns, it appears that the assessee have not paid the appropriate Service Tax.'* Despite the explanation offered by the petitioner to the effect that it is the Point of Taxation Rules that would govern the determination of time of rendition of service and consequent accrual of receipt and liability to tax thereof, and not the P and L accounts of the petitioner, the respondent persists in adopting the financials for the determination of service tax liability as well.

18.The foundation of the assessment is thus, in my view, flawed. The SCN calls upon the assessee to produce material in support of its stand and, at paragraph No.11, states that the audited balance sheets for the financial years 2012-13, 2013-14 and 2015-16, statement recorded from the VP of the petitioner, worksheet and written submissions are the basis of issuance of the SCN. By way of replies, the petitioner on 22.09.2016, 28.02.2017 and 11.04.2017 explains yet again that the P and L account cannot be the basis

of the assessment. The impugned order is passed notwithstanding the objections raised, and negating the same.

19.Clause (i) of the proviso to Rule 3 specifically provides for determination of the point of taxation in cases of continuous supply as in the case of the petitioner herein.

20.The petitioner enters into agreements with customers for the construction of apartments. The agreement provides for demarcated activities, described stage-wise (in short 'landmarks') upon the completion of which, payments are to be released by the customer. The rendition of the service results in the accrual of the receipt of consideration in respect thereof.

21.The relevant clause in the construction agreement dated 30.12.2014 (provided as a sample) reads thus:

…..

1.The party of the Second Part shall pay the party of the First Part a sum of Rs.1,75,43,320/- (Rupees One Crore Seventy Five Lakhs Forty Three Thousand Three Hundred And Twenty Only) for the construction of a Three Bed Room Flat measuring 2055 sq. ft. as per the specifications mentioned in Schedule B and Schedule C in the following manner:

At the time of booking - Rs.25,43,320/-

On completion of Basement work - Rs.26,00,000/-

On completion of Ground Floor Roof - Rs.18,00,000/-

On completion of First Floor Roof - Rs.18,00,000/-

On completion of Second Floor Roof - Rs.18,00,000/-

On completion of Third Floor Roof - Rs.18,00,000/-

On completion of Brick Work - Rs.18,00,000/-

On completion of Internal Plastering - Rs.18,00,000/-

On completion of Tile Laying in your flat - Rs.12,00,000/-

On Handing Over Possession of your flat - Rs. 4,00,000/-

2. The Party of the Second Part has paid a sum of Rs.87,43,320/- (Rupees Eighty Seven Lakhs Forty Three Thousand Three Hundred And Twenty Only) by the way of cheque no.049006 drawn on ICICI Bank, dated 05.11.2014., to the Party of the First Part as Advance, the receipt of which sum, the party of the First Part hereby acknowledges.

3. The Party of the Second party shall pay the Balance Sum of the Rs.88,00,000/-(Rupees Eighty Eight Lakhs Only) to the Party of the First Part as specified in Clause 1 of this Agreement.

4.Payment shall be made by the Party of the Second Part without default to the Party of the First Part.

…..

22.Rule 3(a) provides for a situation where the accrual of service is predicated upon the raising of an invoice. In the present case, the admitted position is that the petitioner does not raise invoices as and when a particular landmark is reached and the accrual of the consideration stage-wise is occasioned automatically upon completion of the stage of construction set out in the agreement itself.

23.It is the specific case of Mr.Prabhakar that the customers have remitted, in advance, the consideration relating to several of the initial landmarks as a lump-sum and that the said amount has been offered to tax. It was then incumbent upon the respondent to have, in the light of the stand adopted by the petitioner in its Service Tax Returns, to have examined whether the receipts offered to tax correspond and cover the stages in respect of which consideration has accrued as per the agreement with the customer.

24.Rules 3(a) and (b) provide for the point of taxation to be either the point of raising of invoice (Rule 3(a)) or in a case where the service provider has received the payment even prior to the time stipulated in the invoice, upon receipt of such payment(Rule 3(b)). In the present case, no invoice is said to have been raised. However, the petitioner confirms that it has, in fact, received lump-sum advances corresponding to several initial landmarks in the contract, even prior to the achievement of such landmarks. As per the provisions of Rule 3(b), the entire sum received thus becomes taxable upon receipt and according to Mr.Prabhakar, has been offered to tax.

25.Instead of such determination by application of the provisions of Rule 3, the respondent relies upon the P and L accounts to conclude that the amounts reflected therein have not been offered for service tax. The reporting of income in the P and L being irrelevant for the purposes of

determination of service tax payable, the basis of the impugned assessment is erroneous.

26.It is a well settled position that when a statutory provision or Rule addresses a specific scenario, such rule/provision is liable to be interpreted on its own strength and context and one need look no further to alternate sources to seek clarity in regard to the issue that has been addressed by the aforesaid rule/provision.

27.I am conscious of the fact, and indeed Mr.Sundar has repeatedly emphasized, that there is an alternate statutory remedy available in respect of the impugned order and as such there is no warrant for the interference of this court in extra-ordinary jurisdiction under Article 226 of the Constitution of India. However, all relevant facts are on record. Both learned counsel concur on the position that the agreements that provide for the landmarks or stages of completion of work by the petitioner and consequential payments by the customers, is available with the Department.

28.The petitioner has also filed an Annexure tabulating the consideration actually received from the customers as a lump-sum as against the amounts that would be payable in accordance with the landmarks under contract to illustrate that in almost all cases, the advance received is in excess of what would have been received, if the consideration had been received stage-wise. It is for the assessing officer to have

examined the same and sought further information to his satisfaction in completion of the assessment.

29.In the facts and circumstances as I have noticed above, where the basis of the assessment is itself contrary to the provisions of the Finance Tax Act, 1994 and the Rules, I am inclined to interfere.

30.The decisions of the CESTAT relied upon by Mr.Sundar are distinguishable since they have been rendered prior to the enactment of the Point of Taxation Rules and Rule 3 thereof. The judgements of the Supreme Court and of this Court relied upon have been rendered in distinguishable factual matrices. While there is no quarrel on the proposition that normally courts will be slow in interfering in matters where the relevant statute provides for a statutory appeal, there is enough precedent available to support the view that courts will interfere where the basis of the impugned order is palpably erroneous and contrary to law. (See *State of HP and Others vs. Gujarat Ambuja Cement Limited* (2005 (6) SCC 499) and *Whirlpool Corporation vs. Registrar of trade Marks Bombay and others* (1998 (8) SCC 1)).

31.The petitioner is, admittedly, recognizing revenue under the 'Project Completion Method' in terms of AS-7 issued by ICAI. We need not, in the present case, concern ourselves with the method followed for the preparation of financials as the same has no impact upon the Point of Taxation Rules. Suffice it to state that the AS provides a certain methodology

for the computation of income from projects that is at variance with the method set out under Rule 3.

32.Insofar as Rule 3 sets out a specific *modus operandi* in this regard, it assumes priority and is the only relevant factor to be taken into account in the determination of point of rendition and accrual of services for the purpose of imposition of service tax. The first issue is answered accordingly.

33.As far as the application of Rule 3 is itself concerned, Mr.Sundar insists that the materials in support of the petitioners' stand have not been produced and relies upon the finding in the impugned order to this effect at paragraph 13.5 thereof (extracted earlier). The petitioner has, admittedly, produced the agreements setting out the slabs for payment and an annexure tabulating the receipts, upon completion of each stage of completion of the project before the authorities. It was for the respondent to have looked into the same and called for further information if necessary to assess the receipts in line with Rule 3 of the Rules. Admittedly this has not been done and the respondent merely adopts the income reflected in the P and L account as the receipts for the purpose of service tax which is contrary to the method set out in Rule 3 for the determination of point of taxation and the quantification thereof.

34.In the light of the discussion above, the impugned order of assessment dated 21.04.2017 is set aside and the matter remitted to the file of the Respondent to be re-done de novo strictly in accordance with the

provisions of Rule 3 of the Rules and in the light of the observations made in this order after affording due opportunity to the petitioner, within a period of three (3) months from date of receipt of this order.

35. The Writ Petition is allowed in the above terms. No Costs. Consequently, connected Miscellaneous Petition is closed.

06.04.2018

Index:Yes/No

Internet:Yes/No

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Note:Issue Order Copy on 11.04.2018

DR.ANITA SUMANTH,J.

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Pre-delivery order made in

W.P.No.21799 of 2017

06.04.2018