



2025 INSC 1234

REPORTABLE

**IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION**

CIVIL APPEAL NO. 8318 OF 2011

**AUTHORITY FOR CLARIFICATION AND
ADVANCE RULINGS, GANDHINAGAR
KARNATAKA & ANR.**

APPELLANT(S)

VERSUS

**M/S SKYLINE CONSTRUCTION AND HOUSING
PVT. LTD.**

RESPONDENT(S)

O R D E R

1. This appeal is at the instance of the revenue and is directed against the judgment and order passed by the High Court of Karnataka dated 17.11.2009 in STA No.24 of 2006 by which the appeal filed by the respondent herein under Section 66(1) of the Karnataka Value Added Tax Act, 2003

(for short, "the Act, 2003") came to be allowed and thereby the order passed by the Authority for Clarification and Advance Rulings bearing No. AR.CLR.CR.480/06-07 came to be set aside.

2. The High Court formulated two questions of law for its consideration. Those are as follows:-

"1. whether under the Karnataka Value Added Taxes Act, 2003 for the period from 1.4.2005 to 31.3.2006, in respect of principal contractors involved in the business of carrying out works contract of construction of buildings for the purpose of computing liability to pay taxes on composition basis under Section 15, whether the consideration for execution of works contract executed refers to consideration received for execution of works contract by the principal contractor by himself or includes any consideration received but paid to sub-contractors as consideration for portions of work executed by sub-contractors.

2. Whether under Section 15 of the KVAT Act, 2003 for the period prior to 1.3.2006 the principal contractors involved in the business of carrying out work contract of constructing buildings is entitled for deduction of payment made by them to sub-contractors who are registered dealers to whom portions of the work has been sub-contracted, as consideration to them for the portions of the work executed by such contractors, from the total consideration received by the principal contractor."

3. The High Court answered the two questions formulated

as referred to above as under:-

"(i) The consideration for execution of works contract executed refers to consideration received by the principal contractor and does not include the consideration received and paid to sub-contractor.

(ii) Under Section 15 of the KVAT Act, 2003 for the period upto 1-3-2006 the principal contractor is entitled for deduction of payment made by sub-contractors only if they are registered dealers and the said sub-contractor has accounted for it and paid tax thereon."

4. Thus, the questions of law as formulated by the High Court referred to above came to be answered against the revenue and in favour of the assessee.

5. In such circumstances, referred to above, the revenue is here before this Court with the present appeal.

6. In the present litigation the respondent-assessee was a registered dealer under the Act, 2003. The assessee was engaged in the business of executing works contracts and part of the work was executed by the assessee through the sub-contractors. The assessee had applied for advance ruling on the question as to whether the amounts paid to the sub-contractors were liable to be included in its

consideration for the purpose of liability of tax under the VAT Act. The contention of the assessee was that the amount paid to the sub-contractors was not liable to be included in taxable consideration of the works contract under Section 15(1) of the VAT Act read with the Notification dated 23.3.2005 even though there was no specific provision providing deduction under the VAT Act.

7. The authority for advance ruling held that since there was no specific provision till 31.3.2006 in the VAT Act for providing deduction of payment made to the sub-contractors, no such deduction was admissible.

8. The respondent-assessee being dissatisfied with the decision of the Authority for Clarification and Advance Rulings went before the High Court in appeal.

9. The High Court allowed the appeal filed by the respondent-assessee taking the view that in case of execution of a works contract through a sub-contractor, the sub-contractor was liable to pay tax under the VAT Act

and therefore the payment made by the main contractor to the sub-contractor was not liable to be included in the taxable consideration of the main contractor as this would lead to double taxation. It was further held that the deduction for payment made to the sub-contractors would be admissible provided such sub-contractors were registered under the VAT Act and they had paid tax.

10. We heard Mr. Aman Panwar, the learned Additional Advocate General appearing for the State of Karnataka and Mr. Chinmay Deshpande, the learned counsel appearing for the respondent.

11. The learned AAG appearing for the State of Karnataka vehemently submitted that the High Court committed an error in disturbing the order passed by the Advance Ruling Committee thereby clarifying that the amount of sub-contractor's turnover is not liable to be included in the main contractor's turnover. He further submitted that the reliance placed by the High Court on the decision of this Court in the case of State of Andhra Pradesh V. Larsen & Toubro & Others reported in 2008 (17) VST Page 1 was

thoroughly misconceived.

12. The learned counsel would submit that the issue of levy of tax on the consideration received by the main contractor from the contractee which is different from the tax levied on the consideration received by the sub-contractor from the main contractor was not considered in the decision of this Court in the case of Larsen & Toubro (supra).

13. He would submit that the levy of tax under Section 15 of the Act, 2003 on the total turnover is justifiable and permissible in law.

14. The learned counsel further submitted that Section 15 of the Act, 2003 read with Rule 3(2) of the KVAT Rules, 2005 (for short, "the Rules") would clearly indicate that the tax levied under Section 15 is on the total turnover and in the case on hand the same had not been subjected to tax under any other charging Section. In other words, the submission canvassed is that the sale consideration paid to the main contractor by the contractee not being taxed

under any of the other provisions is liable to be included in the determination of the total turnover.

15. In the aforesaid context, the learned counsel appearing for the State placed strong reliance on the decision of this Court in the case of *State of Kerala & Anr. Vs. Builders Association of India & Ors.* reported in (1997) 2 SCC 183.

16. On the other hand, the learned counsel appearing for the respondent-assessee would submit that no error not to speak of any error of law could be said to have been committed by the High Court in passing the impugned judgment and order.

ANALYSIS

17. Having heard the learned counsel for the parties and having gone through the materials on record the only question that falls for our consideration is whether the main contractor is entitled to reduce the amount paid to sub-contractor from total consideration while calculating

the tax payable under the VAT Act in respect of works contract without there being specific provision under the VAT Act granting such deduction?

RELEVANT PROVISIONS OF THE ACT, 2003

18. Section 2(31) defines 'Taxable sale' which reads thus:

"2(31) 'Taxable sale' means any sale of goods, which is taxable under the provisions of this Act."

19. Section 2(35) defines 'total turnover' which reads as under:

"2(35) 'Total turnover' means the aggregate turnover in all goods of a dealer at all places of business in the State, whether or not the whole or any portion of such turnover is liable to tax, including the turnover of purchase or sale in the course of interstate trade or commerce or in the course of export of the goods out of the territory of India or in the course of import of the goods into the territory of India and the value of goods transferred or despatched outside the State otherwise than by way of sale."

20. Section 2(36) defines 'turnover' which reads as under:

"2(36) 'Turnover' means the aggregate amount for which goods are sold or distributed or delivered or otherwise disposed of in any of the ways referred to in clause (29) by a dealer, either directly or through another, on his own account or on account of others, whether for cash or for deferred payment or other valuable consideration, and includes the aggregate amount for which goods are purchased from a person not registered under the Act and the value of goods transferred or despatched outside the State otherwise than by way of sale, and subject to such conditions and restrictions as may be prescribed the amount for which goods are sold shall include any sums charged for anything done by the dealer in respect of the goods sold at the time of or before the delivery thereof."

[Explanation.- The value of the goods transferred or despatched outside the State otherwise than by way of sale, shall be the amount for which the goods are ordinarily sold by the dealer or the prevailing market

price of such goods where the dealer does not ordinarily sell the goods.]

21. Section 2(37) defines 'Works contract' which reads as under:

"2(37) '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 movable or immovable property."

22. Section 3 defines 'Levy of tax' which reads as under:

"3. Levy of tax.- (1) The tax shall be levied on every sale of goods in the State by a registered dealer or a dealer liable to be registered, in accordance with the provisions of this Act. (2) The tax shall also be levied, and paid by every registered dealer or a dealer liable to be registered, on the sale of taxable goods to him, for use in the course of his business, by a person who is not registered under this Act."

23. Section 4 defines 'Liability to tax and rates thereof' which reads as under:

"4. Liability to tax and rates thereof.-

(1) Every dealer who is or is required to be registered as specified in Sections 22 and 24, shall be liable to pay tax, on his taxable turnover,

(a) in respect of goods mentioned in,-

(i) Second Schedule, at the rate of one per cent,

(ii) Third Schedule, at the rate of five per cent, and;

(iii) Fourth Schedule, at the rate of twenty per cent.

(b) in respect of.-

(i) declared goods as specified in Section 14 of the Central Sales Tax Act, 1956 (Central Act 74 of 1956) at the maximum rate specified for such goods under Section 15 of the said Act;

(ii) cigarettes, cigars, gutkha and other manufactured tobacco at the rate of twenty percent;

(iii) other goods at the rate of fourteen per cent

[Provided that the rate of tax in respect of declared goods as specified in section 14 of the Central Sales Tax Act, 1956 (Central Act 74 of 1956) shall be four per cent from Eighth day of April, 2011 to Eleventh day of April, 2011.]

(c) in respect of transfer of property in goods (whether as goods or in some other form) involved in the execution of works contract specified in column (2) of the Sixth Schedule, subject to sections 14 and 15 of the Central Sales Tax Act, 1956(Central Act 74 of 1956), at the rates specified in the corresponding entries in column (3) of the said Schedule.

(2) Where goods sold or purchased are contained in containers or are packed in any packing material liable to tax under this Act, the rate of tax applicable to taxable turnover of such containers or packing materials shall, whether the price of the containers or packing materials is charged for separately or not, be the same as the rate of tax applicable to such goods so contained or packed, and where such goods sold or purchased are exempt from tax under this Act, the containers or packing materials shall also be exempt.

(3) The State Government may, by notification, reduce the tax payable under subsection (1) in respect of any goods [subject to such restrictions and conditions as may be specified in the notification.]

(3-A) Any notification issued under sub-section (3), shall be valid until it is cancelled or varied, notwithstanding that the tax payable in respect of any such goods is modified by amendment to this Act.

(4) Notwithstanding anything contained in sub-section (1), subject to such conditions as may be prescribed, a registered dealer, if he so elects, may pay tax on the sale of goods specified in serial number 60 of the Third Schedule, or any other goods on the maximum retail price indicated on the label of the container or pack thereof or on such maximum retail price reduced by an amount equal to the tax payable.

(5) Notwithstanding anything contained in sub-section (1), a registered dealer shall be liable to pay tax on the sale of cigarettes, cigars, gutkha and other manufactured tobacco, on the maximum retail price indicated on the label of the container or pack thereof, after reducing from such maximum retail price an amount equal to the tax payable, where the total amount payable to the dealer as the consideration for sale of such goods exceeds five hundred rupees or any other higher amount as may be

notified by the Commissioner.

(6) Where tax in respect of his purchase of goods is collected in

accordance with sub-section (5)-

(a) a registered dealer whose sale of such goods is not liable to tax under subsection (5), shall be eligible for refund or adjustment of any amount of tax collected on his purchase, which is in excess of the tax payable on his turnover relating to sale of such goods, and the burden of proving that the tax has been collected and paid in accordance with the said sub-section shall be on the dealer;

(b) a person who is not a dealer liable to get registered under the Act, may claim refund of any amount paid by the selling dealer in excess of the tax payable on the consideration paid by him to such dealer in such manner and subject to such conditions as may be prescribed."

24. Section 15 defines 'composition of tax' which reads as under:

"15. Composition of tax.-

(1) Subject to such conditions and in such circumstances as may be prescribed, any dealer other than a dealer who purchases or obtains goods from outside the State or from outside the territory of India, liable to pay tax as specified in Section 4 and,

(a) whose total turnover in a year does not exceed an amount as may be notified by the State Government which shall not exceed fifty lakh rupees, and who is not a dealer falling under clause (b) or (c) or (d) below;

(b) who is a dealer executing works contracts; or

(c) who is a hotelier, restaurateur, caterer; or dealer running a sweetmeat stall or an ice cream parlour or bakery or any other class of dealers as may be notified by the Government.

(d) who is a mechanised crushing unit producing granite or any other metals; may elect to pay in lieu of the net amount of tax payable by him under this Act by way of composition, an amount at such rate not exceeding five per cent on his total turnover or on the total consideration for the works contracts executed or not exceeding two lakh

rupees for each crushing machine per annum as may be notified by the Government as may be prescribed.

(2) Notwithstanding anything contained in sub-section (1), a dealer whose nature of business is of a type falling under more than one clause of sub-section (1), shall be eligible to opt for composition under the said sub-section in respect of tax payable on his turnover relating to any or all of such types of business subject to the condition that,

(a) such dealer maintains separate account of each type of his business;

(b) the total turnover in a year in respect of all types of business of such dealer falling under clause (a) of sub-section (1) does not exceed the amount as may be notified under the said clause;

(c) the amount payable by way of composition by such dealer on his total turnover or the total consideration in respect of each type of such business shall be as may be notified for such type under sub-section (1);

(d) the total turnover of such dealer from all his types of business shall be reduced to the extent of the total turnover or total consideration in respect of each such type, for calculating the amount payable by way of composition for such type of business under subsection (1); and

(e) in respect of such type of business for which, he has not exercised his option or is not eligible, for composition under sub-section (1), then on the taxable turnover as determined from the balance total turnover after reduction as specified in clause (d), he shall be liable to tax as specified under section 4.

(3) Any dealer eligible for composition of tax under sub-section (1) may report, to the prescribed authority, the exercise of his option and he shall pay such amount due and furnish a return in such manner as may be prescribed.

(4) Any dealer opting for composition of tax under this section shall not be permitted to claim any input tax on any purchases made by him.

(5) Notwithstanding anything contained in sub-section (1)

(a) a dealer executing works contracts and who purchases or obtains goods from outside the State or from outside the territory of India shall be eligible to opt for

composition under sub-section (1), and if the property in such goods (whether as goods or in some other form) is transferred in any works contract executed by him, the dealer shall be liable to pay tax on the value of such goods at the rate specified in section 4, and such value shall be deducted from the total consideration of the works contracts executed on which an amount as notified is payable under sub-section (1) by way of composition in lieu of the tax payable under the Act;

(b) in the case of a dealer executing works contracts and opting for composition of tax under sub-section (1), no tax by way of composition shall be payable on the amounts payable or paid to a sub-contractor as consideration for execution of works contract whether wholly or partly and such amounts shall be deducted from the total consideration of the works contracts executed on which an amount as notified is payable under sub-section (1) by way of composition in lieu of the tax payable under the Act subject to production of proof that such sub-contractor is a registered dealer liable to tax under the Act and that such amounts are included in the return filed by such sub-contractor;

(c) in the case of a dealer executing works contracts, after opting for composition of tax under sub-section (1), who effects sale of any goods liable to tax under the Act other than by transfer of the property in such goods (whether as goods or in some other form) in any works contract executed by him, the dealer shall be liable to pay tax on the value of such goods at the rate specified in section 4, without any deduction for input tax on purchase of such goods made by him;

(d) in the case of a dealer opting for composition of tax under clause (a) or (c) of sub-section (1), the turnover on which tax is leviable under sub-section (2) of section 3 shall be deducted from the total turnover on which an amount as notified is payable under sub-section (1) by way of composition in lieu of the tax payable under the Act;

(e) a dealer executing works contracts and opting for composition of tax under subsection (1), shall be liable to pay tax, if any, under sub-section (2) of section 3, in addition to tax by way of composition on the total consideration for the works contracts executed;"

25. It is well established that in a works contract the property in goods passes through theory of accretion. The nature of a building construction contract was very succinctly explained by this Court in its decision rendered in the case of *State of Madras v/s Gannon Dunkerley and Co. (Madras) Ltd.* AIR 1958 SC 560. The relevant observations are as under:

"27. The nature and incidents of works contracts have been the subject of consideration in numerous decisions of the English Courts, and there is a detailed consideration of the points now under discussion, insofar as building contracts, are concerned, in Hudson on Building Contracts, 7th Edn., pp. 386-89 and as regards chattels, in Benjamin on Sale, 8th Edn. pp. 156-68 and 352-55. It is therefore sufficient to refer to the more important of the cases cited before us. In Tripp v. Armitage [(1839) 4 M & W 687 : 150 ER 1597] one Bennett, a builder, had entered into an agreement with certain trustees to build a hotel. The agreement provided inter alia that the articles which were to be used for the structure had to be approved by the trustees. Subsequently, Bennett became bankrupt, and the dispute was between his assignees in bankruptcy, and the trustees as regards title to certain wooden sash-frames which had been approved on behalf of the trustees but had not yet been fitted in the building. The trustees claimed them on the ground that property therein had passed to them when once they had approved the same. In negating this contention.

Lord Abinger, C.B., observed:

"... this is not a contract for the sale and purchase of goods as movable chattels; it is a contract to make up materials, and to fix them; and until they are fixed, by the nature of the contract, the property will not pass."

Parke, B., observed:

"... but in this case, there is no contract at all with respect to these particular chattels – it is merely parcel of a larger contract. The contract is, that the bankrupt shall build a house; that he shall make, amongst other things, window-frames for the house, and fix them in the house, subject to the approbation of a surveyor; and it was never intended by this contract, that the articles so to be fixed should become the property of the defendants, until they were fixed to the freehold."

26. It was further observed that the property in goods would stand passed to the buyer by the theory of accretion i.e. as and when the building is actually constructed for the buyer. The relevant observations in this regard are as under:

"33. Another difficulty in the way of accepting the contention of the appellant as to splitting up a building contract is that the property in materials used therein does not pass to the other party to the contract as movable property. It would so pass if that was the agreement between the parties. But if there was no such agreement and the contract was only to construct a building, then the materials used therein would become the property of the other party to the contract only on the theory of accretion. The position is thus stated by Blackburn, J., at pp. 659-60 in Appleby v. Myres [(1867) LR 2 CP 651] :

"It is quite true that materials worked by one into the property of another become part of that property. This is equally true, whether it be fixed or movable property. Bricks built into a wall become part of the house; thread stitched into a coat which is under repair, or planks and nails and pitch worked into a ship under repair, become part of the coat or the ship."

When the work to be executed is, as in the present case, a house, the construction imbedded on the land becomes an accretion to it on the principle quicquid plantatur solo, solo cedit, and it vests in the other party not as a result of the contract but as the owner of the land. Vide Hudson on Building Contracts, 7th Edn., p. 386. It is argued that the maxim, what

is annexed to the soil goes with the soil, has not been accepted as a correct statement of the law of this country, and reliance is placed on the following observations in the Full Bench decision of the Calcutta High Court in Thakoor Chunder Poramanick v. Ramdhone Bhattacharjee[(1866) 6 WR 228]:

"We think it should be laid down as a general rule that, if he who makes the improvement is not a mere trespasser, but is in possession under any bona fide title or claim of title, he is entitled either to remove the materials, restoring the land to the state in which it was before the improvement was made, or to obtain compensation for the value of the building if it is allowed to remain for the benefit of the owner of the soil, – the option of taking the building, or allowing the removal of the material, remaining with the owner of the land in those cases in which the building is not taken down by the builder during the continuance of any estate he may possess."

27. It was further held by this Court in Gannon Dunkerley and Co. (supra) that the State legislatures had no legislative competence to impose sales tax on the indivisible works contracts under Entry 54 of List II of the Seventh Schedule to the Constitution of India.

28. The 46th Constitutional amendment was thereafter passed whereby, inter-alia, the transfer of property in goods involved in the course of execution of a works contract was deemed to be a sales of goods under clause (b) of Article 366(29A) of the Constitution of India.

29. While the State legislatures have the competence to impose sales tax on the works contracts after the 46th Constitutional Amendment, the principle that property in goods passes on the basis of principle of accretion in a works contract remains unchanged. In fact, the passing of property through accretion is a fundamental feature of a works contract.

30. In *Larsen and Toubro Ltd. (supra)* the question was one relating to the tax liability of a contractor in case where contract is awarded to a sub-contractor. This Court held that since in execution of works contract, sales take place on the principle of accretion, the sales are directly from the sub-contractor to the contractee even though the contract is between the main contractor and the contractee and even if the sub-contractor does not have contractual relationship with the contractee. The following observations are relevant:

"16. By virtue of Article 366(29-A)(b) of the Constitution, once the work is assigned by the contractor (L&T), the only transfer of property in goods is by the sub-contractor(s) who is a registered dealer in this case and who claims to have paid taxes under the Act on the goods involved in the execution of the works. Once the work is assigned by L&T to its

sub-contractor(s), L&T ceases to execute the works contract in the sense contemplated by Article 366(29-A)(b) because property passes by accretion and there is no property in goods with the contractor which is capable of a retransfer, whether as goods or in some other form."

The question which is raised before us is whether the turnover of the sub-contractors (whose names are also given in the original writ petition) is to be added to the turnover of L&T. In other words, the question which we are required to answer is whether the goods employed by the sub-contractors occur in the form of a single deemed sale or multiple deemed sales. In our view, the principle of law in this regard is clarified by this Court in Builders' Assn. of India [(1989) 2 SCC 645 : 1989 SCC (Tax) 317 : (1989) 73 STC 370] as under : (SCC p. 673, para 36)

"36. ... Ordinarily unless there is a contract to the contrary in the case of a works contract, the property in the goods used in the construction of a building passes to the owner of the land on which the building is constructed, when the goods or materials used are incorporated in the building."

(emphasis supplied by us)

18. As stated above, according to the Department, there are two deemed sales, one from the main contractor to the contractee and the other from sub-contractor(s) to the main contractor, in the event of the contractee not having any privity of contract with the sub-contractor(s).

19. If one keeps in mind the above quoted observation of this Court in Builders' Assn. of India [(1989) 2 SCC 645 : 1989 SCC (Tax) 317 : (1989) 73 STC 370] the position becomes clear, namely, that even if there is no privity of contract between the contractee and the sub-contractor, that would not do away with the principle of transfer of property by the sub-contractor by employing the same on the property belonging to the contractee. This reasoning is based on the principle of accretion of property in goods. It is subject to the contract to the contrary. Thus, in our view, in such a case, the work executed by a sub-contractor, results in a single transaction and not as multiple transactions. This reasoning is also borne out by Section 4(7) which refers to the value of goods at the time of incorporation in the works executed. In our view, if the argument of the Department is to be accepted, it would result in plurality of deemed sales which would be contrary to Article 366(29-A)(b) of the Constitution as held by the impugned

judgment of the High Court. Moreover, it may result in double taxation which may make the said 2005 Act vulnerable to challenge as violative of Articles 14, 19(1)(g) and 265 of the Constitution of India as held by the High Court in its impugned judgment."

31. The reasoning assigned by the High Court in its impugned judgement is absolutely in consonance with the judgement of this Court in L&T (supra).

32. The reliance placed by AAG appearing for the State on the judgement of this Court in the case of *Builders Association of India & Ors.* (supra) is completely misconceived. In the said case the controversy was whether in the case of works contract it was open for the State to formulate an alternative scheme of composition providing for a lump sum rate of tax on the contract value so that the exact value of goods may not have to be computed. In this context this Court upheld the validity of the provision on the ground that it only provided an optional alternate method of computation.

33. In the present case the issue is of interpretation and not of constitutionality. The Notification dated

23.3.2005 issued under Section 15(1) the VAT Act provided that tax was payable by the dealer at the rate of 4% of the total consideration for the works contract executed by him. To the extent the contract was executed through sub-contractors, it cannot be said that the works contract was executed by the main contractor. Hence the total consideration for works contract executed by the main contractor can be derived only if the payments made to the sub-contractors are reduced. Thus, the judgement in the case of Builders Association of India (supra) has no applicability in the present case.

CONCLUSION

34. The view taken by the High Court that the payment made to the sub-contractors is required to be deducted for determining taxable value for the purpose of calculating tax under Section 15(1) of the VAT Act is in accordance with law. Deduction of payment made to the sub-contractor cannot be equated with input tax credit as argued by the State as in the case of sub-contractor the value goes out

of the charging provision itself as to that extent the deemed sale is made directly by sub-contractor to contractee.

35. In the result the appeal fails and is hereby dismissed.

36. Pending application(s), if any, stand disposed of.

.....J.
[J.B.PARDIWALA]

.....J.
[K.V. VISWANATHAN]

New Delhi
9th October, 2025.

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