

**SUPREME COURT OF INDIA**

Steel Authority of India Ltd.

Versus

State of Orissa

(S.P. Bharucha, S.N. Phukan and Ruma Pal, JJ.)

Civil Appeal No. 1750 of 1998 with C.A. Nos. 1748-49 & 2606 of 1998.

25.02.2000.

JUDGMENT

**S.P. Bharucha, J.**

Before it was held to be unconstitutional on 28th April, 1993, Section 13AA of the Orissa Sales Tax Act read thus :

"13-AA : Deduction of tax at source from the payment of works contractor -

(1) Notwithstanding anything contained in Section 13 or any other law or contract to the contrary, any person responsible for paying any sum to any contractor for carrying out any works contractor in pursuance of a contract between the contractor said -

(a) Central Government or any State Government, or

(b) any local authority, or

(c) any authority or Corporation established by or under a statute, or

(d) any Company incorporated under the Companies Act, 1956 (1 of 1956) including any State or Central Government undertaking, or

(e) any Co-operative Society or any other Association registered under the Societies Registration Act, 1860, (21 of 1860).

shall at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or any other mode, whichever is earlier, deduct an amount towards sales tax equal to two percentum of such sum in respect of the works contract :

Provided that if the value of the works contract does not exceed rupee one lakh, no such deduction shall be made.

(2) While making deduction as referred to in sub-section (1), the deducting authority shall grant a certificate to the contractor in the form prescribed and shall send a copy thereof to the Sales Tax Officer within whose jurisdiction the works contract is executed.

(3) The amount deducted from the Bills or Invoices shall be deposited into the Government Treasury within one week from the date of deduction in such form or challan as may be prescribed.

(4) Such deposit into the Treasury shall be adjusted by the Sales Tax Officer towards the sales tax liability of the Works contractor and would also constitute a good and sufficient discharge of the liability of the deducting authority to the contractor to the extent of the amount deposited.

(5) If any person contravenes the provisions of sub-section (1) or sub-section (2) or sub-section (3) of this Section, the Sales Tax Officer shall, after giving him an opportunity of being heard, by an order in writing, impose on such person penalty not exceeding twice the amount required to be deducted and deposited by him into Government Treasury."

2. Section 13AA as it was then read, was struck down by the High Court of Orissa on 28th April, 1993 in the case of *Brajendra Mishra v. State of Orissa & others, 1994(92) STC 17*. The High Court held that Section 13AA did not provide any mechanism to exclude a transaction from its purview even if, ultimately, the transaction was not at all liable to the levy of sales tax. In other words, even in the case of a pure and simple labour contract or service contract where the question of sale would not arise, the person responsible for making any payment to a contractor had no option but to deduct two per cent of such sum towards sales tax. Though a transaction which might not be a sale at all was made liable for levy of sales tax, yet in respect of that transaction power had been conferred to make deduction of two per cent from the amount to be paid. In the absence of any discretion with the authority and in the absence of any mechanism by which the contractor could approach any authority and obtain a certificate to the effect that the transaction did not amount to a sale, the deduction of two per cent from the amount could not be held to be grossly discriminatory and confiscatory in nature and, therefore, the same had to be struck down. The High Court added that by conferring arbitrary, unbridled and uncanalised powers on the person concerned to deduct two per cent from the sum payable to the contractor, irrespective of the question whether, ultimately the transaction was liable for payment of any sales tax at all, could not be held to be a levy of tax under any valid legal provision. It was true that the deduction of two per cent under Section 13AA was to be ultimately adjusted where the transaction in question was liable for levy of sales tax, but where the transaction was not at all liable for levy of sales tax there the question of adjustment would not arise and, therefore the deduction would be confiscatory in character and effect and it could not be held to be a valid provision within the legislative competence of the legislature imposing the tax and authorising the collection thereof. A bare reading of Section 13AA made it explicitly clear that the amplitude of the incidence of tax had been widened so as to include transactions which were outside the sphere of taxation available to the State legislature under Entry 54 of List II of the Seventh Schedule to the Constitution. Inasmuch as even in respect of a purely labour contract or service charges, Section 13AA authorised deduction of two per cent from the bills of the contractor, it could not but be held to be unconstitutional and void.

3. The decision of the High Court was accepted and Section 13AA was replaced on 4th October, 1993 in the following terms, which are now under challenge.

"13-AA : Deduction of tax at source from the payment to works contractors -

(1) Notwithstanding anything contained in Section 13 or any other law or contractor to the contrary, any person responsible for paying any sum to any contractor (hereinafter referred

to in this section as the "deducting authority") for carrying out any works contract which involves transfer of property in goods, in pursuance of a contract between the contractor and

- (a) Central Government or any State Government, or
- (b) any local authority; or
- (c) any authority or Corporation established by or under a statute, or
- (d) any Company incorporated under the Companies Act, 1956 (1 of 1956) including any State or Central Government undertaking, or
- (e) any Co-operative Society or any other Association registered under the Societies Registration Act, 1860 (21 of 1860).

shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or any other mode, whichever is earlier, deduct on amount towards sales tax equal to (four percentum) of such sum in respect of the works-contract, if the value of the works contract exceeds rupee one lakh.

(2) While making deduction as referred to in sub-section (1), the deducting authority shall grant a certificate to the contractor in the form prescribed and shall send a copy thereof to the Sales Tax Officer within whose jurisdiction the works-contract is executed.

(3) The amount deducted from the Bills or Invoices shall be deposited into a Government Treasury within one week from the date of deduction in such form or challan as may be prescribed.

(4) Such deposit into Government Treasury shall be adjusted by the Sales Tax Officer towards the Sales Tax liability of the contractor and would also constitute a good and sufficient discharge of the liability of the deducting authority to the contractor to the extent of the amount deposited.

(5)(a) Where, on an application being made by the contractor in this behalf, the Commissioner is satisfied that any works contract of the nature referred to in sub-section (1) invoices both transfer of property in goods and labour or service or involves only labour or service and, accordingly, justifies deduction of tax on a part of the sum in respect of the works-contract or, as the case may be, justifies no deduction of tax, he shall, after giving the contractor a reasonable opportunity of being heard, grant him such certificate as may be appropriate, in the manner prescribed :

Provided that nothing in the said certificate shall affect the assessment of the sales tax liability of the contractor under this Act.

(b) Where such a certificate is produced by a contractor before the deducting authority, until such certificate is cancelled by the Commissioner, the deducting authority shall either make no deduction of tax or make the deduction of tax as the case may be, in accordance with the said certificate. 373\_ §

(6) If any person contravenes the provisions of sub-section (1) or (2) or (3) or of clause (b) of sub-section (5), the Sales Tax Officer shall, after giving him an opportunity of being heard, by an order in writing impose on such person penalty not exceeding twice the amount required to be deducted and deposited by him into government treasury."

4. The appellant has a steel plant at Rourkela in the State of Orissa. A vast modernisation programme has been implemented there. The appellant has entered into contracts with parties in India and abroad for the design and engineering of plant and equipment and for the manufacturing of plant, equipment, components, machinery and spares which will be incorporated into the contracts for erecting the modernised system and plant. In other words, it has entered into, *inter alia*, works contracts.

One of such works contractors was M/s Mukund Iron and Steel Works Ltd. (hereinafter called the 'Mukund'). The contract between the appellant and Mukund was for the design, engineering, manufacture, supply, transportation, erection, installation, testing and commissioning of a basic oxygen furnace plant. The value thereof was Rs. 532 crores. According to the appellant, the break-up thereof is as follows :

(a) Supply of equipments from States outside Orissa by way of CST Sales. Central Sales Tax paid in Non-Orissa States. Both under Section 3(a) and 6(2) of the CST	Rs. 317 Crores
(b) Supply of equipments from other countries outside India on High Seas Sales basis under Section 5 of the CST Act	Rs. 16 Crores
(c) Supply of Steel by SAIL	Rs. 18 Crores
(d) Design Engineering and other services	Rs. 103 Crores
(e) Fabrication, erection, structural, construction, civil construction, etc.	Rs. 78 Crores."

5. Under the terms of Section 13AA, as presently enacted, the appellant deducted sales tax at source at the rate of four per cent in respect of payments to Mukund pertaining to (d) and (e) above. It did not deduct tax at source in respect of payments under items (a), (b) and (c) for the reason that they were in respect of inter-State sales, outside sales and import sales and, therefore, outside the purview of the Orissa Sales Tax Act. The Commercial Tax Officer, Rourkela, did not accept this stand of the appellant and issued to it notices to show cause why penalty proceedings should not be initiated in respect of the Assessment Years 1994-95 and 1995-96. The notices were challenged by the appellant by a writ petition filed in the High Court of Orissa. At an interim stage, the authorities were permitted to proceed with the hearing on the show cause notices but the final order thereon was made subject to the result of the writ petition. Thereafter, the High Court ordered that no coercive steps for recovery should be taken against the appellant. Pursuant to the show cause notices, the Sales Tax Officer imposed penalties upon the appellant for the Assessment Years 1994-

95 and 1995-96 on the ground that the appellant should have deducted four per cent of the totality of its payments to Mukund. The penalties, in the sum of Rs. 26.98 crores imposed by the order dated 11th November, 1997, for the Assessment Years 1994-95 and 1995-96, were challenged by the appellant in a fresh writ petition. On the earlier writ petition the order under challenge in the appeal was passed. It held that Section 13AA was not ultra vires the Constitution. On the second writ petition an order of deposit of fifty per cent of the demand was made, and that order is separately challenged.

6. Upon the petition for leave to appeal to this Court, recovery of tax and penalty was stayed pending the disposal of the appeal.

7. By virtue of Entry 54 of List II of the Seventh Schedule read with Article 246 of the Constitution of India, the States are empowered to levy taxes on the sale or purchase of goods, other than newspapers. The Forty-sixth Amendment to the Constitution introduced, *inter alia*, clause (29A)(b) in Article 366 of the Constitution; as a result, tax on the purchase or sale of goods included 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." Article 286(1) of the Constitution states that no law of a State shall impose, or authorise the imposition of, a tax on the sale or purchase of goods where such sale or purchase takes place outside the State or in the course of the import of goods into, or export of goods out of the territory of India. Article 286(2) authorises Parliament by law to formulate principles for determining when a sale or purchase of goods takes place in any of the ways mentioned in sub-Article (1). Acting upon this power, Parliament has set out in Sections 3, 4 and 5 of the Central Sales Tax Act, 1956 principles for determining when a sale or purchase of goods can be said to take place in the course of inter-State trade or commerce, when a sale or purchase of goods can be said to take place in the course of import or export. In *M/s. Gannon Dunkerley and Co. & others v. State of Rajasthan & others, 1993(1) SCC 364*, this Court has held that it is necessary to exclude from the value of a works contract the value of goods which are not taxable by a State in view of Sections 3, 4 and 5 of the Central Sales Tax Act, 1956. The value of goods involved in the execution of a works contract has to be determined after making these exclusions from the value of the works contract.

8. With this background, we turn to analyse Section 13AA as it presently stands. By reason of sub-section (1) thereof, the person responsible for paying any sum to any contractor for carrying out any works contract which involves the transfer of property in goods (now, for convenience, referred to as the 'owner') is obliged to deduct, at the time of credit of that sum to the account of the contractor or payment thereof to him, an amount "towards sales tax equal to four per cent of such sum in respect of the works contract", provided the value of the works contract exceeds rupees one lakh. The deduction, therefore, is towards the sales tax that is payable to the State upon the works contract and it is of four per cent of the value of the works contract. Sub-section (2) requires the owner to grant to the contractor as certificate in respect of such deduction. By reason of sub-section (3), the amount that the owner has deducted must be deposited by him into the Government treasury within a week of the deduction. By reason of sub-section (4), such deposit is required to be adjusted by the Sales Tax Officer towards the sales tax liability of the contractor and it constitute good and sufficient discharge of the liability of the owner to the contractor to make an application to the Commissioner of Sales Tax and if the Commissioner is satisfied thereon that any work contract "involves both transfer of property in goods and labour or service or involves only labour or service and, accordingly, justifies deduction of tax on a part of the sum in respect of the works contract or, as the case may be justifies no deduction of tax, he shall, grant him such certificate as may be appropriate in the manner prescribed." To the extent of the amount mentioned in the certificate the

owner must, by reason of sub-section 5(b), make no deduction of tax. The Commissioner is required only to see whether the works contract involves transfer of property in goods and labour or service or only labour or service. If it involves only labour or service, he must certify that no deduction of tax shall be made and if it involves both transfer of property in goods and labour or service, he shall certify the deduction of a part of the sum payable by the owner to the contractor. Sub-section 5(a) takes no account of the fact that even if a works contract involves both transfer of property in goods and labour or service, State sales tax may not be payable upon the entire value ascribable to the transfer of property in goods for the reason that it is in the course of inter-State sales, outside sales or sales in the course of export; nor is such account taken elsewhere in Section 13AA.

4. The form of the certificate which is referred to in sub-section (5) of Section 13AA is to be found in Form XI-C of the Orissa Sales Tax Rules, Part I thereof is the form for the application for the grant of a certificate and Part II is the form of the certificate itself. Both the forms make it clear that all that the Commissioner is required to look at is whether any labour or service is involved in the works contract.

10. Under sub-section (6) of Section 13AA, owner who acts contrary to the provisions of sub-sections (1), (2), (3) and (5)(b) thereof is liable to "penalty not exceeding twice the amount required to be deducted and deposited ....." The owner, therefore, should he contravene sub-section (1), would be liable to a penalty not exceeding twice the amount that he should have deducted under that sub-section.

11. In *Bhiwani Cotton Mills Ltd. v. State of Punjab & another, 1967(3) SCR 577*, this Court said "If a person is not liable for payment of tax at all, at any time, the collection of a tax from him, with possible contingency of refund at a later stage, will not make the original levy valid; because, if particular sales or purchase are exempt from taxation altogether, they can never be taken into account, at any stage, for the purpose of calculating or arriving at the taxable turnover and for levying tax."

12. There can be no doubt, upon a plain interpretation of Section 13AA, that it is enacted for the purposes of deduction at source of the State sales tax that is payable by a contractor on the value of a works contract. For the purposes of the deduction neither the owner nor the Commissioner who issues to the contractor a certificate under Section 13AA(5) is entitled to take into account the fact that the works contract involves transfer of property in goods consequent upon of an inter-State sale, an outside sale or a sale in the course of import. The owner is required by Section 13AA(1) to deposit towards the contractor's liability to State sales tax four per cent of such amount as he credits or pays to the contractor, regardless of the fact that the value of the works contract includes the value of inter-State sales, outside sales or sales in the course of import. There is, in our view, therefore, no doubt that the provisions of Section 13AA are beyond the powers of the State legislature for the State legislature may make no law levying sales tax on inter-State sales, outside sales or sales in the course of import.

13. It was contended on behalf of the State that the appellant, as owner, had no locus to challenge the validity of Section 13AA. It was contended that the moneys that were deducted were moneys that belonged to the contractor and it was only the contractor who could successfully lay such a challenge. The contention ignores the fact that the appellant owner is aggrieved and damnified by the penalty that has been imposed upon it under sub-section (5) for contravention of sub-section (1) of Section 13AA. It has, therefore, the standing to contest the validity of Section 13AA.

14. It was then contended by learned counsel for the State that the Preamble of the Orissa Sales Tax Act took account of the fact that that statute was limited to the sale or purchase of goods in Orissa. Unfortunately, it would appear that the State legislature overlooked its limitations, even as contained in the Preamble, when enacting Section 13AA. It was also contended that the deduction that was required to be made under Section 13AA(1) was of four per cent of the amount credited or paid by the owner to the contractor, whereas the sales tax liability of the contractor thereon was eight per cent. It was contended that this requirement proceeded on the assumption that half of the amount was not liable to tax being in respect of inter-State sales, outside sales and export sales. No such assumption based on the rate of tax at any given point of time can be made. Section 13AA should have been precisely drafted to make it clear that no tax was levied on that part of the amount credited or paid that related to inter-State sales, outside sales and sales in the course of import, particularly after the previous Section 13AA had been struck down by the Orissa High Court for the reason that it was couched in terms wider than were permissible to the State legislature and that judgment was accepted.

15. In the result, the appeal is allowed and the judgment and order under appeal is set aside. Section 13AA of the Orissa Sales Tax Act, as amended with effect from 4th October, 1993, is struck down as being beyond the purview of the Orissa State Legislature. Such amount as has been collected from the appellant under the provisions of Section 13AA shall forthwith be refunded by the State.

There shall be no order as to costs.

*Civil Appeal Nos. 1748-1749 & 2606 of 1998 :*

Following the judgment just delivered in C.A. No. 1750 of 1998, the appeals are allowed and the orders under appeal are set aside. Such amount has been collected from the appellant under the provisions of Section 13AA shall forthwith be refunded by the State.

No order as to costs.