**COMPOSITION PROVISIONS**

**UNDER THE GUJARAT VALUE ADDED TAX ACT, 2003**

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**INTRODUCTION**

Option is always preferable to compulsion. Therefore in complex tax laws such as value added tax if the legislature gives alternative methods of computation of tax, attempt must be made to take the maximum advantage of the alternatives. This is possible only if the nuances of the options are fully grasped. The object of this paper is to deal with the provisions of composition of tax under the Vat Act as well as controversial issues relating to such provisions.

**CHAPTER I – ORIGIN, HISTORY AND CONSTITUTIONAL VALIDITY OF COMPOSITION PROVISIONS**

**I.1Origin**

1. The concept of “composition” under the sales tax law has its roots in the 46th Constitutional amendment, whereby transfer of property in the course of execution of works contract was inter-alia recognized as deemed sales for the purpose of Entry 54 of List II of the Seventh Schedule to the Constitution of India.
2. Prior to the 46th Constitutional amendment, Hon. Supreme Court in the case of **State of Madras v/s Gannon Dunkerley and Co. (1958) 9 S.T.C. 353 (S.C.)** examined the scope of the phrase “sale of goods” appearing in the Government of India Act, 1935. The question to be decided by the Court was whether tax could be levied on supply of materials used in indivisible works contracts. It was held by Hon. Supreme Court that “sale of goods” was to be given the same meaning as it has in the Sale of Goods Act, 1930 and that it should not be construed in its popular sense. The Court decided that in case of an indivisible works contract the property in materials did not pass to the other party as movable property. The property in the goods passed on the theory of accretion and therefore it did not constitute sale of goods as understood under the Sales of Goods Act, 1930.
3. To overcome the effect of this judgement, Article 366(29A) was inserted in the Constitution of India by the 46thConstitutional Amendment whereby “sale” was inter-alia deemed to include transfer of property in goods in the course of execution of works contract.
4. Consequently the State legislatures amended the definition of “sale” in the respective Sales tax laws so as to include within its ambit inter-alia transfer of property in goods involved in the execution of works contracts.
5. The Constitutional validity of the 46th Constitutional Amendment was upheld by Hon. Supreme Court in the case of **Builders Association of India v/s Union of India (1989) 73 STC 370 (SC)** and it was held by Hon. Supreme Court that sales tax was leviable on transfer of property in goods involved in the execution of works contract subject to the restrictions under Article 286 of the Constitution of India as applicable to normal sales.
6. Thus it was settled that State Legislatures had the legislative competence to levy sales tax on goods involved in the execution of indivisible works contract subject to the restrictions as applicable to normal sales. However the tax was leviable only on the value of goods involved in the execution of works contract.
7. In order to obviate the necessity of tedious and cumbersome computations for the purpose of arriving at taxable value of goods involved in the execution of works contract, Section 55A was introduced in the Gujarat Sales Tax Act, 1969 (herein after referred to as “the Sales Tax Act”) w.e.f. 5.8.1985, which empowered the Commissioner to permit dealers executing works contract to pay lump sum tax by way of composition at the rate fixed by the State Government.
8. The legal position that sales tax could be levied by State Legislature only on the value of goods involved in the execution of indivisible works contract was confirmed by Hon. Supreme Court by its decision in the case of **Gannon Dunkerley & Co. v/s State of Rajasthan (1993) 88 STC 204 (SC).**The contention of the State that sales tax could be levied on the value of the goods as well as cost of incorporation of goods in the works was rejected by Hon. Supreme Court. However Hon. Supreme Court also rejected the contention of the dealers that sales tax could be levied on the cost of acquisition of the goods involved in the execution of works contract. Profits relatable to supply of materials were held to be includible in the value of goods exigible to sales tax. Thus ultimately it was held by Hon. Supreme Court that in case of indivisible works contract, sale value of goods involved in the execution of the contract was taxable by State Legislatures. Hon. Supreme Court observed that the following elements were deductible while deriving the value of goods in the execution of works contract (page 235 in 88 STC):
9. Labour charges for execution of the works
10. Amount paid to the sub-contractor for labour and services
11. Charges for planning, designing and architect’s fees
12. Charges for obtaining on hire or otherwise machinery and tools used for the execution of the works contract
13. Cost of consumables such as water, electricity, fuel, etc., used in the execution of the works contract the property in which is not transferred in the course of the execution of a works contract and
14. Cost of establishment of the contractor to the extent it is relatable to supply of labour and services;
15. Other similar expenses relating to supply of labour and services
16. Profit earned by the contractor to the extent it is relatable to supply of labour and services.
17. It was further observed by Hon. Supreme Court that the amounts deductible under these heads would have to be determined in the light of the facts of a particular case on the basis of materials produced by the contractor.
18. In other words, the dealers as well as the assessing officer were required to ascertain the taxable value of goods involved in the execution of works contract for each and every contract by taking into account the deductions as laid down by Hon. Supreme Court.
19. The insertion of Section 55A of the Sales Tax Act for composition of tax thus proved to be a boon for both dealers as well as assessing officers as they could do away with the complicated computations of deriving the sale value of the goods involved in the execution of indivisible works contract as directed by Hon. Supreme Courtin the case of the 2nd Gannon Dunkerley case (supra).
20. I may point out that another composition provision was also enacted by way of Section 55B of the Sales Tax Act for providing an option to pay lump sum tax on transfer of right to use specified goods such as shamianas.

**I.2Composition provisions under the Vat Act**

1. While under the Sales Tax Act the composition provision wasenacted mainly for works contracts, the Gujarat Value Added Tax Act, 2003 (herein after referred to as “the Vat Act”) envisages lump sum tax permission under the following sections:
2. Section 14 – Composition provision for small scale dealers.
3. Section 14A – Composition provision for works contracts.
4. Section 14B – Composition provision for commission agents engaged in the business of agricultural produce.
5. Section 14C – Composition provision for transfer of right to use goods.
6. Section 14D – Composition provision for hotels, restaurants, caterers, etc.

**I.3Constitutional validity of Composition provision upheld**

1. The Constitutional validity of composition provisions was earlier challenged before Hon. Kerala High Court in the case of **Builders Association of India v/s State of Kerala (1995) 98 STC 490 (Ker.)**. The principal ground of challenge was that when the composition provision provided for payment of tax on the “whole amount of contract”, it did not provide for any deduction for declared goods, goods sold in the course of inter-State trade and commerce, etc. Division bench of Hon. Kerala High Court accepted the contention of the Petitioners and struck down the composition provision in the Kerala General Sales Tax Act, 1963 as violating Article 366(29A) and Article 14 of the Constitution of India read with Sections 3,4,5,14 and 15 of the Central Sales Tax Act, 1956.
2. The aforesaid decision of Hon. Kerala High Court was reversed by Hon. Supreme Court by its judgement reported as **State of Kerala v/s Builders Association of India (1997) 104 STC 134 (SC)**. Hon. Supreme Court upheld the Constitutional validity of the composition provisions in the Kerala General Sales Tax Act, 1963 on the ground that composition provisions provided for an alternate method of taxation which is optional. The Section clearly provided that such method would only be applicable to a contractor who elects to be governed by the alternative method of taxation. There was no compulsion on the contractor to opt for composition. Hon. Supreme Court observed that the legislature had evolved a convenient, hassle free and simple method of assessment. The contractor saved himself the bother of book-keeping, assessment, appeals, etc. It was not necessary to enquire and determine the extent or value of goods transferred in the course of execution of works contract. Thus the composition provisions were a rough and ready method of assessment of tax and it was left to the contractor whether to opt for composition or pay tax under the normal provisions. It was ultimately held that the legislature was not precluded by the Constitution from evolving such alternate, simplified and hassle free method of assessment of tax when it is made optional for assessees. Similar provision under the Karnataka Sales Tax Act, 1957 was held to be constitutionally valid by Hon. Supreme Court in the case of **Mycon Construction Ltd. v/s State of Karnataka (2002) 127 STC 105 (SC)**.
3. Constitutionality of composition provisions was upheld on similar grounds by Hon. Punjab & Haryana High Court in the case of **National Heavy Engineering Co-operative Ltd. v/s State of Haryana (1994) 93 STC 265 (P&H)** and by Hon. Andhra Pradesh High Court in the case of **Media Communications v/s Government of Andhra Pradesh (1997) 105 STC 227 (AP)**.
4. All the composition provisions under the Vat Act are also optional. It is for the dealers to decide whether or not to go for composition under the Vat Act. Therefore, in my opinion, there cannot be an iota of doubt that all the provisions are Constitutionally valid and within the competence of the State Legislature.

**CHAPTER II – COMPOSITION FOR SMALL SCALE DEALERS (SECTION 14 OF THE VAT ACT)**

**II.1Composition under Section 14 of the Vat Act**

1. Since the Sales Tax Act envisaged levy of sales tax at the first point of sale, tax was essentially payable only by manufacturers and importers. Traders were entitled to claim resale deduction if goods were purchased from registered dealers of the State of Gujarat and hence they were not liable to pay any tax under the Sales Tax Act.
2. With the coming into force of the Vat Act, multi point tax system was introduced. Thus traders who hitherto were not liable to pay sales tax became liable to pay tax on value addition under the Vat Act. However the scheme of the Vat Act is that all dealers need to collect tax on their sale price, claim input tax credit of the tax paid on purchases made from registered selling vendors and deposit the balance amount of tax into the Government treasury.
3. Input tax credit needs to be claimed on the basis of tax invoice of selling dealers and it is subject to many conditions as prescribed under Section 11 of the Vat Act. In order to simplify tax computation for small scale dealers, apart from enacting composition provisions for special transactions such as works contract, transfer of right to use goods, etc, Section 14 of the Vat Act has been enacted for providing option to pay lump sum tax essentially to traders whose turnover does not exceed Rs.50,00,000. The limit has been revised to Rs.75,00,000 w.e.f. 1.4.2013.
4. Proviso to Section 14(1) of the Vat Act enlists the following circumstances in which composition permission may not be granted to dealers:
5. A dealer who sells goods in the course of inter-State trade and commerce or exports goods out of the territory of India.
6. A dealer who has purchased in the previous year or purchases in the course of inter-State trade and commerce or has imported in the previous year or imports goods from a place out of the territory of India.
7. Dispatches goods to his branch or consigning agent outside the State or has received in the previous year or receives goods from his branch situated outside the State or from consigning agent outside the State.
8. Was engaged in the previous year or engaged in the activity of manufacture other than such activity as State Government may, by order in writing, specify.
9. Has effected in the previous year or effects the sales or purchases through the commission agent.
10. Effects the sales falling under sub-clauses (b) or (d) of clause (23) of section 2.

**II.2Whether a dealer who has made inter-State or export sales in the previous year can opt for composition?**

1. The underlined words in the aforestated Proviso to Section 14(1) of the Vat Act were inserted by Gujarat Value Added Tax (Amendment) Act 9 of 2008 w.e.f. 1.4.2008. The amendment was made to overcome a series of decisions of Hon. Gujarat Value Added Tax Tribunal such as **Indian Watch Co. v/s State of Gujarat 2008 GSTB 437** wherein it was held that Proviso to Section 14(1) of the Vat Act would not act as a bar to grant permission to dealers who had purchased goods from outside the State or imported goods from outside the country in the previous years prior to grant of permission for composition.
2. The effect of such decisions was that it became possible for dealers to purchase goods from outside the State and then apply for composition permission. This led to unintended tax benefit on sale of goods in stock which were purchased from outside the State or imported from outside the country at the time when the dealer opted for composition.
3. To nullify the effect of these decisions, clauses (ii) to (v) of Proviso to Section 14(1) of the Vat Act were amended to provide that composition permission could not even be granted to dealers who had entered into such transactions in the previous year. For example if the dealer had purchased goods from outside the State in the year 2007-08, then he cannot be granted permission for composition for the year 2008-09.
4. It is important to note that clause (i) of the Proviso to Section 14(1) of the Vat Act has not been amended. Thus if a dealer has sold some goods outside the State of Gujarat or exported some goods in the previous year, he can still opt for composition in the next year provided that he is hitherto not going to enter into such transactions of inter-State sales or exports. The decisions of Hon. Tribunal in the case of Indian Watch Co. (supra) and other cases would continue to govern clause (i) of the Proviso to Section 14(1) of the Vat Act.
5. In my opinion this is a valid interpretation because of two reasons:
6. The Legislature intentionally did not amend clause (i) of the Proviso while amending the other clauses which shows that its intention was not to bar grant of composition permission if inter-State or export sales were made by the dealer in the previous year.
7. The fear of revenue leakage which prompted the legislature to amend the Proviso was possible only if a dealer purchased goods from outside the State in the previous year and thereafter opted for composition. Inter-state or export sale in the previous year would not result into any arbitrage opportunity for the dealer opting for composition. Thus the fact that clause (i) of the Proviso to Section 14(1) of the Vat Act was not amended by the legislature is supported by commercial logic.
8. Such a view is supported by a decision of Hon. Madras High Court in the case of **Bharani Readymades v/s State of Tamil Nadu (2013) 60 VST 149 (Mad.).** In this case the composition provision provided that every dealer who effected second and subsequent sales of goods purchased within the State could opt to pay lump sum tax. The dealer had purchased goods from outside the State in the previous years on the basis of which the contention of the State was that the dealer was not entitled to option of composition. Hon. High Court held that there was no provision which disentitled a dealer to opt for composition simply because he had made purchases from outside the State in the previous year. Thus under the Vat Act, even after the amendment to the Proviso to Section 14(1) of the Vat Act, there is no bar to dealers who had effected inter-State sales in the previous year from opting for composition provided that they will now not make inter-State sales.

**II.3Repercussions if total turnover is enhanced in assessment**

1. Another issue which may arise in borderline cases is if total turnover as per returns is less than Rs.75,00,000 while in assessment the total turnover is derived to be more than Rs.75,00,000. If the Commissioner had granted permission on the basis of the returns, then it is possible that on assessment he will issue notice for cancellation of permission of lump sum tax with retrospective effect on the ground that the same had been wrongly granted.
2. In such circumstances I of the opinion that the facts because of which assessed turnover is more than turnover as per returns will determine the repercussion on the composition permission granted under Section 14 of the Vat Act. If the turnover has been enhanced in assessment because of suppression of purchases, sales, etc by the dealer, then it will be well within the rights of the Commissioner to cancel the composition permission of the dealer with retrospective effect.
3. However if the turnover of the dealer is enhanced based on legal dispute such as admissibility of deduction of discount, sales return, etc then apart from challenging the enhancement of turnover in assessment, the dealer may also challenge the cancellation of permission by the Commissioner on the alternative ground that the application for permission to pay lump sum tax was made under a bonafide belief that its total turnover was less than Rs.75,00,000. All the facts were on record and therefore the Commissioner could have granted permission for composition after verification of the total turnover as per returns. Once the permission has been granted and if there is no suppression of facts on the basis of which turnover has been enhanced in assessment, the permission for composition cannot be cancelled with retrospective effect.
4. While such a ground is not likely to be easily accepted, I of the opinion that if a dealer is litigating against enhancement of turnover of assessment along with cancellation of permission for composition, then such an alternative contention should definitely be taken.

**II.4Rate of lump sum tax under Section 14 of the Vat Act**

1. Section 14(2) of the Vat Act empowers the State Government to prescribe the rate of tax for dealers who opt for composition under Section 14(1) of the Vat Act. In exercise of the powers conferred under this Section, the State Government by notification no. (GHN-20) Vat-2006/S.14(2)(1)-TH dated 31.3.2006 fixed the rate of lump sum tax to be 0.5% of the “total turnover” of sales.
2. However immediately by a notification dated 29.4.2006, the earlier notification was amended and the phrase “total turnover” was replaced by “taxable turnover”.
3. Thus in so far as traders who have opted for composition of tax under Section 14(1) of the Vat Act, they are liable to pay tax at the rate of 0.5% of their taxable turnover. In other words they are not liable to pay lump sum tax on tax free sales.

**II.5Lump sum tax for specified manufacturers**

1. Clause (iv) of Proviso to Section 14(1) of the Vat Act debars grant of permission to pay lump sum tax to dealers engaged in manufacturing activity except to manufacturers specified by the State Government. In exercise of power granted under clause (iv) of Proviso to Section 14(1) of the Vat Act read with Section 14(2) of the Vat Act, the State Government issued notification number (GHN-24) VAT-2006/S.14(1 and 2)(1)-TH dated 31.3.2006 by which bakeries, bricks and hotels/restaurants were specified as manufacturers to whom permission for composition could be granted by the Commissioner. The rate of tax was prescribed as 2% of the “turnover of sales”.
2. By a notification dated 17.8.2006 the entry for hotels and restaurants in the afore-stated notification was deleted as specific Section 14D was inserted in the Vat Act providing for composition of tax for hotels, restaurants and caterers.
3. Thus bakery and brick manufacturers are the specified manufacturers who are allowed to opt for composition under Section 14(1) of the Vat Act. Now in so far as bakeries are concerned, “bread in any form” is covered by Entry 9(1) of Schedule I to the Vat Act. Goods covered by Schedule I to the Vat Act are generally exempt from tax.
4. So the question which arosewas whether bakeries which have opted for composition under Section 14(1) of the Vat Act are liable to pay tax on the turnover of sales of bread which are otherwise tax free goods. Hon. Gujarat Value Added Tax Tribunal has held in the case of **Star Bakery and Others v/s State of Gujarat S.A. No. 928 of 2011 decided on 21.4.2014**that bakeries who have opted for composition under Section 14(1) of the Vat Act are liable to pay tax even on the turnover of sales of bread. The decision of Hon. Tribunal is essentially based on the following grounds:
5. The phrase “turnover of sales” is defined under Section 2(33) of the Vat Act to include sale of all goods. Since the notification prescribes the rate of tax as 2% of the turnover of sales, lump sum tax is payable on taxable as well as tax free goods.
6. While the State Government specifically amended notification no. (GHN-20) meant for traders and substituted the phrase “total turnover” by the phrase “taxable turnover”, notification no. (GHN-24) for specified manufacturers was not simultaneously amended. Thus the intention of the Government is clearly to stipulate payment of tax on taxable as well as tax free goods for specified manufacturers who opt for composition.
7. On a harmonious interpretation of Sections 2(33), 5, 7 and 14 of the Vat Act, lump sum tax is payable by bakeries on bread even if they are otherwise tax free goods.
8. With due respect I disagree with the decision of Hon. Tribunal in the case of Star Bakery (supra) because the true scope of Section 5 of the Vat Act has not been appreciated by Hon. Tribunalparticularly in light of the definition of the term “tax” given under Section 2(27) of the Vat Act.
9. Section 5(1) of the Vat Act provides that the sales and purchases of the goods specified in Schedule I shall be exempt from ‘tax’ subject to the conditions and exceptions set out therein against each of them in column 3 of that Schedule.
10. The term tax has been defined under Section 2(27) of the Vat Act to mean tax leviable and payable under the Act on sales or purchase of goods and include lump sum tax leviable or payable under Section 14, 14A, 14B, 14C or 14D of the Vat Act.
11. Thus, in my opinion, presuming that bakeries are liable to pay tax on sale of tax free goods under Section 14 of the Vat Act, such tax is exempted by the operation of Section 5 of the Vat Act particularly because ‘tax’ has been expressly defined to include lump sum tax.
12. The matter can be looked into even for another angle. Section 7 of the Vat Act, which is the charging Section, provides for levy of tax on goods specified in Schedule II and Schedule III to the Vat Act. Thus there is no charge of tax as such on goods specified in Schedule I to the Vat Act.
13. Hence in so far as dealers paying tax under the normal provisions of the Vat Act are concerned, tax is not payable on goods covered by Schedule I to the Vat Act primarily because there is no charge of tax on such goods under Section 7 of the Vat Act. Even in the absence of Section 5(1) of the Vat Act, dealers would not be required to pay tax on goods covered under Schedule I to the Vat Act.
14. Therefore in my opinion the only operation of Section 5(1) of the Vat Act can be in cases where by virtue of special provisions such as lump sum tax scheme, tax is payable on goods covered by Schedule I to the Vat Act. The tax payable under Section 14 of the Vat Act is exempt because of Section 5(1) of the Vat Act.
15. I am of the opinion that if Section 5(1) of the Vat Act is held to be not applicable to dealers who have opted for composition, then the provision will as such be rendered redundant because dealers paying tax under the normal provisions of the Vat Act are as such not required to pay tax on goods covered under Schedule I to the Vat Act as there is no charge of tax on such goods under Section 7 of the Vat Act.
16. However the fact is that as per the decision of Hon. Tribunal, bakeries who have opted for composition under Section 14 of the Vat Act are liable to pay lump sum tax on turnover of sales of bread even if it is covered under Schedule I to the Vat Act. I may point out that the decision of Hon. Tribunal has been challenged before Hon. Gujarat High Court by **Tax Appeal No. 885 of 2014**filed in the case of **New Bismillah Bakery v/s State of Gujarat** and this tax appeal has been admitted by Hon. High Court by its order dated **22.8.2014**.

**II.6Restrictions and conditions on dealers who have opted for composition under Section 14 of the Vat Act**

1. The following restrictions are placed by Section 14(3) of the Vat Act by dealers who have opted for composition under Section 14 of the Vat Act:
2. Such dealers are not entitled to claim tax credit of tax paid by them on purchases.
3. They cannot charge any tax under the Act in their sales bill or sales invoice in respect of the sales on which lump sum tax is payable.
4. They cannot issue tax invoice to any dealer who has purchased goods from them.
5. Section 14(4) of the Vat Act provides that dealers who opt for composition will be liable to pay purchase tax under Sections 9(1), 9(3) and 9(6) of the Vat Act in addition to the lump sum tax payable under the Vat Act.
6. Thus if a dealer who has opted for composition under Section 14(1) of the Vat Act purchases goods from unregistered dealers or if he commits breach of any declaration given under the Vat Act, then he will be liable to pay purchase tax under Section 9 of the Vat Act. He will not be entitled to claim input tax credit of such purchase tax because of Section 14(3) of the Vat Act.
7. Rule 28(3A) requires reversal of input tax credit relating to goods held in stock when a dealer opts for composition under Section 14 of the Vat Act. The second part of the sub-rule provides that “the amount of such reversal of tax credit” shall be paid by him.” The sub-rule has not been properly worded and the impression on first reading may be that it requires reversal of tax credit as well as payment of amount equal to reversal of tax credit. However such an interpretation would lead to anomalous and unintended results.
8. In my opinion if the sub-rule is purposively and logically interpreted, the requirement is thatthe balance of input tax credit relating to goods in stock needs to be reversed andif tax credit relating to goods in stock has already been utilized by the dealer then he will be required to pay an amount equal to such tax credit.

**CHAPER III – COMPOSITION FOR WORKS CONTRACTS (SECTION 14A OF THE VAT ACT)**

**III.1Composition provision under Section 14A of the Vat Act**

1. Composition provision for works contract is contained in Section 14A of the Vat Act. Section 14A of the Vat Act empowers the Commissioner to permit a works contractor to pay at his option lump sum tax in lieu of the tax leviable from him under the Vat Act at such rate as may be fixed by the Government by notification in the official Gazette.
2. The first concomitant for a dealer in order to apply for composition under Section 14A of the Vat Act is that he needs to prove that the contract he is entering into is a works contract. The term “works contract” is defined in Explanation (ii) of Section 2(23) of the Vat Act to mean a contract for execution of works and include such works contracts as the State Government by notification in the official Gazette specify.
3. The State Government has notified works contracts for the purpose of Section 2(23) of the Vat Act by notification number (GHN-23)VAT-2006/(S.2)(23)(1)/TH dated 31.3.2006. In my opinion after the recent decision of the Constitution Bench of Hon. Supreme Court in the caseof **Kone Elevator India Pvt. Ltd. v/s State of Tamil Nadu (2014) 71 VST 1 (SC)** any composite contract involving material and labour would be considered as works contract and not normal sale if property is transferred by accretion. The fact that use of material is merely incidental to the contract and that the contract is pre-dominantly for provision of service have been held to be irrelevant for the purpose of determining whether a contract is a works contract or not.
4. It may be noted that although Sr.No. 5 of the notification relating to installation, fabrication, assembling, commissioning or repairsof lifts, elevators or escalators was deleted by notification dated 16.5.2008 pursuant to 3 judge bench decision of Hon. Supreme Court in the case of **State of Andhra Pradesh v/s Kone Elevators (India) Ltd. (2005) 140 STC 22 (SC)** wherein it was held that such contracts were contracts of sale and not works contract, since this decision has been overruled by Constitution bench of Hon. Supreme Court, permission for composition can be taken even for contracts for installation, fabrication, etc of lifts.
5. Thus in my opinion, a contractor can opt for composition under Section 14A of the Vat Act in respect of any contract which involves use of material as well as labour and the property is transferred to the purchaser by accretion. Reference may be made in this regard to a determination order passed in the case of **Saini Diesel Power Services Pvt. Ltd. 2009 GSTD 244** wherein it was held that a dealer could opt for composition under Section 14A of the Vat Act in respect of Annual Maintenance Contracts.

**III.2Rate of lump sum tax for works contracts**

1. The State Government has prescribed the rate of lump sum tax for the purpose of Section 14A of the Vat Act by notification no. (GHN-88).S.14(A)(4) dated 17.8.2006. The rate for processing of polyester textile fabrics including bleaching, dyeing and printing thereof is fixed at one half per cent of total value of the works contract. The rate for contracts relating to roads, building construction, drainage structures, laying of pipelines, dams, canals, excavation, mining, jetty, ports, airport runways and water storage structures is prescribed as 0.6% of total value of works contract. The rate for any other type of works contract is prescribed as 2% of total value of the works contract.
2. Entry No. (iii) of Sr.No. 3 of the aforesaid notification which is capable of leading to controversies and litigation reads as “Works of building construction including reinforced cement concrete and masonary work but excluding air conditioning, firefighting, interior works and electrical work if its total value exceeds ten per cent of total value of works contract”.
3. Thus, if a building construction contract is entered into and if the contract also involves air conditioning, firefighting, interior works and electrical work whose value exceeds 10% of the total value of the works contract, then lump sum tax will be payable at the rate of 0.6% on the building construction portion of the works contract while tax will be payable at the rate of 2% on the air conditioning, firefighting, interior works and electrical work portion of the contract. However if the value of such works in less than 10% of the total value of works contract then tax is payable at the rate of 0.6% on the total value of the entire works contract.
4. Thus before entering into such building construction contracts, it is advisable to derive the exact proportion of each such element of the contract in order to ascertain the applicable rate of lump sum tax for the purpose of Section 14A of the Vat Act.

**III.3Deduction of land value whether permissible?**

1. It is now settled by the decision of Hon. Supreme Court in the case of **Larsen and Toubro v/s State of Tamil Nadu (2013) 65 VST 1 (SC)** that a development agreement or tripartite agreement whereby a building is constructed for a customer is a works contract even though the agreement also involves sale of land and even if the title of the property is subsequently transferred by a sale deed.
2. Hencethe question which arises in such cases is whether land value is deductible from the value of the contract for the purpose of payment of tax. If a developer opts for paying tax under the normal provisions of the Vat Act then tax is payable on the sale value of the material used in the course of construction of the building. Hence there can be no doubt that consideration receivable towards land is not to be taken into account while paying tax on the sale value of material.
3. However dispute may arise regarding deduction of land value where a developer has opted for composition under Section 14A of the Vat Act. The departmental authorities may demand tax on the entire amount received towards the contract even though the contract also envisages transfer of land particularly because of Rule 28(8)(c) of the Gujarat Value Added Tax Rules, 2006 (herein after referred to as “the Vat Rules”) which requires payment of composition amount on the full amount received in respect of the contracts for which permission for composition has been granted.
4. I am of the opinion that even if the developer has opted for composition under the Vat Act, tax is payable on the value of the contract derived after deducting the consideration receivable towards transfer of land. The rate of tax for building construction contracts is notified at 0.6% of the “total value of works contract”. A works contract is a contract for material and labour wherein property of goods is transferred to the buyer by accretion. Therefore value of works contract is the value of the material and labour involved in the contract. Transfer of title in land is altogether a separate transaction even though a single agreement may be entered into for both transfer of land as well as construction of building.
5. Such interpretation is also supported by the legislative history of the composition provision. When Hon. Supreme Court in the case of 2nd Gannon Dunkerley and Co. (supra) laid down the deductions which were required to be made from the value of works contract for the purpose of arriving at the taxable value of goods involved in the execution of works contract, it never envisaged transfer of land as part of the same agreement and therefore land value was not enlisted as a deduction. The composition provision which was incorporated by way of Section 55A of the Sales Tax Act was also meant for avoiding the need of claiming deduction of the labour element of the works contract. Even Rule 18AA of the Vat Rules regarding deduction in case of contractors who have not opted for composition provides for deduction of labour, service and like charges. Thus works contract was always and is still understood to have only elements of material and labour and composition provision has been devised so as to avoid complicated calculations of labour deduction.
6. Therefore I am of the opinion that even in the absence of an express provision allowing deduction of land, consideration towards works contract can only be consideration for material and labour and therefore no lump sum tax is payable on consideration received towards land.
7. If consideration towards land is not separately mentioned in the agreement then the fair market value of land as on the date of transfer can be deducted. However in order to reduce the chances of litigation, it is advisable to mention the consideration receivable towards land separately in the agreement itself.
8. Reference is also invited in this regard to a decision of Hon. Karnataka High Court in the case of **State of Karnataka v/s Reddy Structures Pvt. Ltd. (2014) 70 VST 329 (Kar.)** and in the case of **State of Karnataka v/s Vaswani Estates Developers Private Limited (2014) 70 VST 411 (Kar.)** wherein it has been held that land value cannot form part of the taxable value for the purpose of levy of Vat or sales tax.

**III.4Taxability in case of fully constructed and partially constructed property**

1. Hon. Supreme Court has specifically observed in the case of Larsen and Toubro (supra) that sale of fully constructed properties do not involve sale of goods in the course of execution of works contract. Thus it is clear that if agreement to sell a building is entered into after the construction of building is complete then the developer will not have any liability of tax on the sale of such building even if he has opted for composition under Section 14A of the Vat Act.
2. The rationale behind the conclusion of there being no sales tax or Vat liability on sale of fully constructed property is that this is a sale of immovable property and does not involve sale of goods in the course of execution of works contract.
3. I am of the view that the same logic can be applied to minimize tax liability if agreement of sale is entered into after part of the property has already been constructed. In my opinion, in so far as that part of the property that was already constructed prior to the agreement of sale with the customer is concerned, there is no sale in the course of execution of works contract. The execution of works contract commences only after the agreement for sale is entered into and therefore the sales tax or Vat liability is restricted to the consideration receivable for work done after entering into the agreement for sale.
4. In such cases, the agreement for sale will involve 2 parts – first is the sale of partially constructed immovable property and the second is sale in the execution of works contract. In my opinion if consideration is bifurcated against these two parts in the agreement itself based on the actual work already done and work yet to be done, then tax liability under the Vat Act is attracted only on the consideration towards the second part. In my opinion only that part of the agreement that relates to construction of remaining building for the customer can be treated as works contract while the first part relating to building already constructed prior to agreement is sale of immovable property and not works contract.
5. For instance if half of the building is already constructed after which agreement for selling the building is entered into with the customer for say Rs.1 crore. In such case the builder may mention in the agreement itself that Rs.50 lakhs is towards the part of building already constructed and Rs.50 lakhs is towards works contract for construction of remaining building. If this is done then in my opinion lump sum tax under the Vat Act can be imposed only on Rs.50 lakhs which is towards works contract.
6. It needs to be kept in mind that ‘agreement of sale’ need not be only in writing. Therefore even if agreement of sale is formally entered into at a later date, if the builder has started receiving installments from the customer then it is to be presumed that the building is being constructed for a customer even though formal agreement is entered into at a later date and therefore the transaction involves sale of goods in the course of execution of works contract.

**III.5Options for composition under Section 14A of the Vat Act**

1. The dealer has the following two options under Rule 28 of the Vat Rules if he wants to opts for composition under Section 14A of the Vat Act:
2. The dealer can get separate permission for composition of tax under Rule 28(8)(a) of the Vat Rules for each works contract entered into by him. For this purpose application needs to be made in Form 214 within 30 days from the beginning of the contract. Permission shall be granted within 15 days of receipt of application and the permission shall be effective from the date of beginning of the contract till its conclusion. If tax is paid under the normal provisions of the Vat Act prior to the date of application and if such tax amount is less than the amount of composition payable for that particular period, then the differential amount shall be paid by the dealer along with interest at the rate of 1.5% per month. Such amount is to be paid before making application for composition.
3. The dealer can get permission for composition of tax for all ongoing as well as new works contracts to be executed during the year under Rule 28(8)(bb) of the Vat Rules. For this purpose application needs to be made in Form 214A within 30 days before the commencement of the year and the permission shall be effective from the beginning of the year. In other words, if permission for composition is required for the year 2015-16, then application for composition in Form 214A needs to be filed before 1st March 2015.

**III.6Pure labour contracts whether taxable?**

1. If the contractor chooses the second option under Rule 28 of the Vat Rules and opts for composition for all works contracts which are entered into during the year, then a question may arise as to whether tax is payable on pure labour contracts entered into by such contractor during the year.
2. Iam of the view that pure labour contracts are not works contracts for the purpose of the Vat Act and hence no tax is payable on the value of such contracts even if the contractor opts for paying lump sum tax under Section 14A of the Vat Act on all works contracts entered into during the year. The arguments in favour of such contention are as under:
3. Works contract is historically understood as involving both material and labour right from the decision of Hon. Supreme Court in the case of 1st Gannon Dunkerley and Co. (supra).
4. The 46th Constitutional amendment deemed transfer of property in goods involved in the execution of works contracts to be sale. However the States do not have the right to levy tax on transactions that do not involve use of goods at all.
5. Composition provisions have been introduced for ease of computation so that the taxable value of materials used in the course of execution of contracts need not be derived by complex computations. The Constitutional validity of Composition provisions was upheld by Hon. Supreme Court in the case of Builders Association of India (supra) on the ground that they provided an optional rough and ready method to quantify tax liability if materials are used in the course of execution of works contracts. Such provisions cannot be used as a tool for imposing tax on contracts that undisputedly do not involve use of goods at all.
6. Permission for composition under Section 14A of the Vat Act is for payment of tax “in lieu of the amount of tax leviable” from the dealer under the Vat Act. Since admittedly no tax is leviable on pure labour contracts under the normal provisions of the Vat Act, no tax is attracted even under Section 14A of the Vat Act.
7. Section 14A of the Vat Act provides that permission for composition may be granted to a dealer referred to in Section 2(10)(f) of the Vat Act. Section 2(10)(f) of the Vat Act refers to a person who transfers property in goods (whether as goods or in some other form) involved in the execution of works contract. Therefore qua pure labour contracts, the contractor is not a dealer under Section 2(10)(f)of the Vat Act.
8. Section 14A of the Vat Act provides for payment of tax at the rate fixed by the State Government having regard to the incidence of tax on the nature of the goods involved in the execution of the works contract. Therefore Section 14A of the Vat Act specifically envisages involvement of goods in the execution of the works contract and hence pure labour contracts are not works contracts as contemplated under Section 14A of the Vat Act.
9. I am supported in such view by adecision of Hon. Kerala High Court in the case of **C.J. Micheal v/s State of Kerala (1997) 107 STC 347 (Ker.)** wherein it was held that there is no question of deduction of tax at source in cases of pure labour contracts. Similarly Hon. Karnataka High Court held in the cases of**H.S. Chandra Shekhar Hande v/s State of Karnataka (2013) 57 VST 234 (Karn.)** and**State of Karnataka v/s Khoday Eshwara and Sons (2012) 52 VST 204 (Karn.)** that no tax is payable on labour works contract since there is no sale of goods involved in such contract. Hon. Kerala High Court has also expressed similar view in the case of **Geogy George v/s State of Kerala (2014) 71 VST 510 (Ker.).**
10. It may be noted that Hon. Karnataka High Court had earlier taken a contrary view in the case of **T.H. Venkate Gowda v/s Commissioner of Commercial Taxes (2007) 5 VST 553 (Kar.)**. Although the question before Hon. High Court was with regard to taxability of pure labour contracts, the decision of Hon. High Court proceeds on the footing that the dealer wanted to bifurcate the contract itself. It was held on the basis of the decision of Hon. Supreme Court in the case of Builders Association of India (supra) that once a dealer had opted for composition, he could not bifurcate the contracts. However I am of the opinion that Hon. High Court has not at all decided the question as to whether pure labour contracts can be considered to be works contracts or not. The question as to whether the State legislature has jurisdiction to tax pure labour contracts has also not been considered. This question has been later on decided in favour of the assessee by the same High Court in the case of H.S. Chandra Shekhar Hande (supra) and that too specifically with regard to composition provision. Thus I am of the opinion that the later decision lays down the correct law.
11. Reference may also be made to a decision of Hon. Gauhati High Court in the case of **Manu Brick Industries v/s State of Tripura (2011) 40 VST 342 (Gauhati)**. In this case the dealers entered into an agreement for composition of tax with the Government. Under the agreement the dealers were liable to pay fixed installments to the Government as lump sum tax. However since actual production and sale of goods was delayed, the dealers did not pay the lump sum tax amount as per the agreement.
12. Hon. Gauhati High Court held that since admittedly the dealers had not sold goods within the State of Tripura and since independent of the agreement there was admittedly no tax liability of the dealer, under no circumstances could tax be realized from the dealers under the Tripura Value Added Tax Act, 2004. A contrary view has been taken by Hon. Allahabad High Court in the case of **Bhadauria Gram Sewa Sansthan v/s Assistant Commissioner, Sales Tax (2006) 148 STC 356 (All.)** wherein demand of lump sum tax has been confirmed even though admittedly manufacturing of bricks was delayed and they were not sold in the period in question. However this decision is distinguishable because the scheme of lump sum tax in that case specifically provided that the amount of composition would neither be reduced nor be changed even if the firing of the brick kiln started late or it was not commenced.
13. Thus I am of the opinion that no tax is payable under the Vat Act on value of pure labour contracts even if the dealer has opted for composition under Section 14A of the Vat Act even if he has chosen the option for paying lump sum tax in respect of all works contracts executed during the year. To avoid litigation, if a dealer is contemplating to execute pure labour contracts then he should choose the contract wise permission for composition rather than yearly permission and thus he should not opt for composition in respect of pure labour contracts.

**III.7Deduction of payment made to sub-contractors**

1. Rule 28(8)(c) of the Vat Rules provides for deduction of amount paid by way of price for entire sub-contract, if any, made with the sub-contractor. It may be noticed that while Rule 18AA which is relating to assessment of contractors under the normal provisions of the Vat Act provides for deduction of payment made to ‘registered sub-contractor’, the word ‘registered’ is not used in Rule 28(8)(c) of the Vat Rules.
2. While it is arguable that even under the normal provisions deduction of payment made to unregistered sub-contractors cannot be denied, in so far as composition provision is concerned, there is no ambiguity that payment made to any sub-contractor, whether registered or unregistered, is allowable as deduction.
3. The issue which however arises in composition provision is when the entire contract is executed by the main contractor through sub-contractor. Hon. Supreme Court has held in the case of **State of Andhra Pradesh v/s Larsen and Toubro Ltd. (2008) 17 VST 1 (SC)** that if a contract is executed through a sub-contractor then the sale is made directly by the sub-contractor to the contractee. Therefore in case of a back to back contract where the entire contract is sub-contracted, there is no sale of goods by the main contractor and therefore it is possible to argue that no tax is payable by the main contractor even if has opted for composition.
4. However such a stand is likely to lead to litigation and the department is likely to demand tax on the differential margin between the total contract value and amount paid to sub-contractor. To avoid such controversy, if a dealer knows that he is going toexecute some contracts entirely through sub-contractors then it is advisable that he should opt for composition and pay lump sum tax as applicable on the differential margin.

**III.8 At what point of time is tax payable?**

1. Rule 28(8)(e) of the Vat Rules provides that the amount shall be considered to have been received for the purpose of payment of lump sum tax from the date on which it becomes due as per the Schedule of payment in respect of contracts which provide for such Schedule of payment. However if no Schedule of payment is mentioned in the contract then the amount is considered to have been received on the date on which bill is prepared or the amount is received whichever is earlier.

**III.9Restrictions and conditions on dealers opting for composition under Section 14A of the Vat Act**

1. Section 14A(2) of the Vat Act makes the provisions of Section 14(3) and 14(4) applicable mutatis mutandis to dealers who have opted for composition under Section 14A of the Vat Act. In other words a dealer who has opted for composition under Section 14A of the Vat Act cannot claim input tax credit, cannot charge tax from buyers and cannot issue tax invoice.
2. Apart from this, following additional conditions are imposed under Rule 28(8)(vi-a) of the Vat Rule.
3. The dealer shall not use goods in the execution of works contracts covered under the permission to pay lump sum tax if such goods are purchased in the course of inter-State trade or commerce or imported from outside the territory of India or if they are received from a branch situated outside the State or from consigning agent outside the State.
4. If the dealer uses any taxable goods in the execution of works contract covered under the permission to pay lump sum tax, such goods ought to have borne the tax payable under the Act.
5. If a dealer has already claimed input tax credit for the goods held in stock on the date of effect of permission and such goods are going to be used in the works contract for which permission to pay lump sum tax is sought for, such tax credit shall be reversed.
6. If lump sum tax permission is granted for all contracts during the year, then the dealer shall not dispatch goods to his branch or consignment agent situated outside the State of Gujarat.

**III.10Whether capital goods can be purchased from outside the State by dealers who have opted for composition?**

1. A question that arises is whether Rule 28(8)(vi-a)(1) of the Vat Rules bars use of capital goods that are imported or purchased from outside the State of Gujarat. I may point out that a similar provision debarring dealers who purchased goods from outside the State from opting for composition was challenged before Hon. Andhra Pradesh High Court in the case of **Maruthi Constructions v/s Government of Andhra Pradesh (2007) 10 VST 362 (AP)** on 2 grounds: (i) such provision created a direct and immediate restriction on the freedom of trade guaranteed under Article 301 of the Constitution of India and (ii) such provision was discriminatory and therefore violating Article 14 of the Constitution of India. While the first ground was rejected by Hon. High Court, the provision was struck down as being discriminatory and violating Article 14 of the Constitution of India.Contrary view has been taken by Hon. Karnataka High Court in the case of **New Taj Mahal Cafe Pvt. Ltd. v/s State of Karnataka (2009) 26 VST 101 (Kar.)**.
2. Whether Rule 28(8)(vi-a)(1) of the Vat Rules, which debars use of goods purchased from outside the State of Gujarat if a dealer has opted for composition, is discriminatory or not is a question which cannot be gone into by the adjudicating or appellate authorities and can be decided only by Hon. High Court or Hon. Supreme Court in exercise of writ jurisdiction.
3. However in my opinion the sub-rule imposing restrictions on use of goods imported or purchased from outside the State is required to be interpreted in the context of the statutory provision and such interpretation is definitely within the jurisdiction of the adjudicating and quasi judicial authorities. Section 14A of the Vat Act provides for permission to pay lump sum tax at the rate fixed by the State Government having regard to the incidence of tax on the nature of goods involved in the execution of works contract. Thus the rate of tax is fixed by the State after taking into account the taxes leviable on the transfer of property in goods involved in the execution of works contract. In other words the rate of lump sum tax is an approximation of the tax which would have been otherwise payable by a dealer on value addition of the goods sold in the execution of works contract.
4. If sub-rule (vi-a)(1) of Rule 28(8) of the Vat Rules is interpreted in this light, then the restriction can be made applicable only on import or purchase from outside the State of Gujarat of goodswhose property is to be transferred in the course of execution of works contract and not to capital goods since a dealer never transfer property in capital goods in the course of execution of works contract. Support can be taken even from the language of the sub-rule that prohibits use of goods “in” the execution of works contract and not “for” the execution of works contract.
5. Reference may be made in this regard a decision of Hon. Madhya Pradesh High Court in the case of **Commissioner of Sales Tax v/s Vippy Solvex Products Pvt. Ltd. (1997) 105 STC 394 (MP)**wherein it has been held that capital goods are not used “in” the execution of works contract but they are used “for” the execution of works contract.
6. Attention is also invited to a decision of Hon. Kerala High Court in the case of **Sasikumar v/s State of Kerala (2012) 47 VST 446 (Ker.)**. Under the Kerala Value Added Tax Act, 2003 a dealer was entitled to take benefit of the presumptive tax provisions if he was inter-alia not an importer. Importer was defined to mean a person who obtained or brought taxable goods from any place outside the State or country whether as a result of purchase or otherwise for the purpose of business. The facts of the case were that the dealer was engaged in the purchase and sale of medical oxygen in the State. The oxygen was traded in cylinders. The dealer purchased cylinders from outside the State of Kerala for the purpose of his business. The question was whether the dealer was an importer and therefore ineligible for paying tax under the presumptive scheme. Hon. High Court held that the term ‘importer’ was used in the context of trading. Therefore while a person importing goods from outside the State for resale would be an ‘importer’, purchase of capital goods such as cylinders from outside the State would not make him a dealer so as to disentitle him from the option of paying tax under presumptive scheme.
7. I may point out that Hon. Karnataka High Court has held in the case of **S.R. Ravishankar v/s Additional Commissioner of Commercial Tax (2012) 54 VST 448 (Karn.)** that a dealer who purchased capital goods from outside the State was not eligible for availing composition benefit. However in this case the dealer himself wanted to opt out of composition and therefore the contention of the dealer was that he was using the capital goods in the execution of works contract. It is on the basis of such facts and submissions it was held that the dealer had used goods purchased from outside the State in the execution of works contract and thus he was right in contending that he was not liable to be assessed under the composition provisions.
8. Thus, although it is an arguable proposition that the restriction contained in Rule 28(8)(vi-a)(1) is not applicable to capital goods, the fact remains that if a dealer has opted for composition under Section 14A of the Vat Act and if he purchases capital goods from outside the State of Gujarat then it is likely to lead to litigation.
9. I am of the opinion that composition provisions lead to simplicity for both the dealer as well as departmental officers. Thus it is in the larger interest of both the dealers as well as the commercial tax department that more dealers opt for composition. However it may neither be commercially, technologically and practically possible nor feasible for dealers to obtain all capital goods from within the State of Gujarat. In such circumstances I am of the view that an administrative clarification in favour of allowing dealers who have opted for composition to purchase capital goods from outside the State of Gujarat will be appreciable.
10. However till there is clarity on the issue, if a dealer who has opted for composition under the Vat Act wants to purchase capital goods from outside the State of Gujarat, then in order to avoid litigation it is advisable to purchase such goods through a trader registered under the Vat Act.

**III.11Whether condition breached if goods are converted into some other form and then used in the execution of works contract?**

1. Clause (2) of Rule 28(8)(vi-a) provides that if a dealer uses any taxable goods in the execution of works contract covered under the permission to pay lump sum tax then such goods ought to have borne the tax payable under the Act.
2. Reference is invited in this regard to a decision of Hon. Gujarat Value Added Tax Tribunal in the case of **Super Tiles and Marbles Pvt. Ltd. v/s State of Gujarat First Appeal No. 18 of 2009 decided on 8.2.2013.**In this case the fact was that the dealer had received a contract for laying of paving blocks. For this purpose the dealer purchased sand, cement, etc from registered dealers of the State of Gujarat. From such goods the dealer manufactured paving blocks at the site of the customer and these blocks were thereafter affixed at such sites.The learned determining authority held that the dealer was not eligible for composition permission under Section 14A of the Vat Act since paving blocks which were installed pursuant to the contract would not have bornethe tax payable under the Vat Act and therefore it would tantamount to breach of Rule 28(8)(vi-a)(2) of the Vat Rules. Hon. Tribunal quashed the determination order passed in this regard. It was observed that the contract was an indivisible works contract. It was held that sand, cement, etc which had been used by the dealer for making the paving blocks had admittedly borne the tax payable under the Vat Act, Rule 28(8)(vi-a)(2) of the Vat Rules had not been breached merely because the property in the goods was transferred in the form of paving blocks.
3. I am of the opinion that apart from the ground on which Hon. Tribunal has decided the issue, it can also be urged that the condition is that the goods ought to he borne the tax “payable” under the Vat Act. Since admittedly the dealer manufactured the paving blocks, they were never sold earlier in the State of Gujarat. Tax becomes “payable” in the State of Gujarat only if the goods are sold. Therefore there was no tax payable in respect of the paving blocks prior to their installation for the purpose of works contract and therefore the dealer would not have breached Rule 28(8)(vi-a)(2) by manufacturing and selling paving blocks in the course of execution of works contract. It may however be noted that this decision of Hon. Tribunal has been challenged by the State of Gujarat before Hon. Gujarat High Court. The tax appeal has been admitted by Hon. High Court and the same is pending for final disposal.

**CHAPTER IV – COMPOSITION FOR COMMISSION AGENTS OF AGRICULTURAL PRODUCE (SECTION 14B OF THE VAT ACT)**

**Composition provision under Section 14B of the Vat Act**

1. Section 14B of the Vat Act envisages permission for composition of tax for commission agents engaged in the business of agricultural produce provided that the Commission agent exclusively carries on business of agricultural produce and provided that he is licensed as general commission agent with a market committee established under the Gujarat Agricultural Produce Markets Act, 1963.
2. The salient features of the composition provision under Section 14B of the Vat Act are as under:
3. Section 14B(3) of the Vat Act is similar to Proviso to Section 14(1) of the Vat Act in so far as it prohibits grant of permission to pay lump sum tax to sell or purchase goods in the course of inter-State trade and commerce or dispatches to or receives goods from branch or commission agents located outside the State of Gujarat. Additionally permission can also not be granted to dealers who sell goods to unregistered dealers or to dealers who have been permitted to pay lump sum tax under Section 14 of the Vat Act.
4. Interestingly Section 14B(3) has not been amended simultaneously with the amendment of Proviso to Section 14(1) of the Vat Act and hence transactions of previous year are not referred to in the provision. In other words the decision of Hon. Tribunal in the case of Indian Watch Co. (supra) is still relevant for the purpose of Section 14(3) of the Vat Act and hence composition permission cannot be denied under Section 14B of the Vat Act on the ground that goods were purchased or received from outside the State in the previous year.
5. Commission agents who have opted for composition under Section 14B of the Vat Act are also not entitled to claim input tax credit, charge tax from buyers or issue tax invoice to the dealers.
6. The dealers are liable to pay purchase tax under Section 9(1), 9(3), 9(4) and 9(6) of the Vat Act in addition to lump sum tax under Section 14B of the Vat Act.
7. The rate of lump sum tax is prescribed as 0.05% of “the total turnover of sales” by Notification No. (GHN-62)VAT-2006-S.14B(1)(2)-TH dated 17.5.2006. Thus the decision of Hon. Gujarat Value Added Tax Tribunal in the case of Star Bakery (supra) which is rendered in the context of Section 14 of the Vat Act is applicable to Section 14B of the Vat Act. In other words, as per the decision of Hon. Tribunal, Commission agents will be liable to pay lump sum tax on sale of agricultural produce such as cereals, pulses, etc even though such goods are otherwise tax free goods covered under Schedule I to the Vat Act. I may reiterate that tax appeal against this decision of Hon. Tribunal is pending for final hearing before Hon. Gujarat High Court.
8. It may be noted that Section 9(4) of the Vat Act is a special provision which provides for imposition of purchase tax if a dealer purchases goods from a Commission Agent to whom lump sum tax is granted under Section 14B of the Vat Act and if the goods so purchased by him are not resold within the State. If Section 14B of the Vat Act and Section 9(4) of the Vat Act are read together, scheme of taxation of agricultural produce becomes clear as under:
9. Tax liability is substantially postponed to the last Commission Agent if the agricultural produce is ultimately purchased and consumed as such by end consumers of the State of Gujarat since the rate of lump sum tax at every point of sale prior to the last sale will only be 0.05% of the total turnover if all Commission Agentsin the chain opt for composition under Section 14B of the Vat Act.There will not be any purchase tax liability on any dealer under Section 9(4) of the Vat Act since all dealers will resell the goods within the State of Gujarat. However the last seller who sells goods directly to the end consumers will not be entitled to the benefit of Composition under Section 14B of the Vat Act since Section 14B(3)(d) of the Vat Act prohibits grant of permission to a dealer who sells goods to a person who is not a registered dealer. Therefore the last seller will be required to discharge tax liability under the normal provisions of the Vat Act at Schedule Rate.
10. However if the agricultural produce is used in manufacturing process then all the resellers will be liable to pay lump sum tax at the rate of 0.05% if they opt for composition under Section 14B of the Vat Act and the manufacturer will become liable to pay purchase tax at the Schedule rate under Section 9(4) of the Vat Act. It may however be noted that purchase tax leviable under Section 9(4) of the Vat Act has been exempted from whole of tax by Entry 51 of the notification issued under Section 5(2) of the Vat Act subject to the condition that the purchaser shall use the goods in the manufacture of goods and the manufactured goods will be further sold within the State of Gujarat.

**CHAPTER V – COMPOSITION FOR TRANSFER OF RIGHT TO USE GOODS (SECTION 14C OF THE VAT ACT)**

**Composition provision under Section 14C of the Vat Act**

1. Section 14C of the Vat Act enables Commissioner to grant permission to pay lump sum tax to dealers referred to in Section 2(10)(h) of the Vat Act being persons who transfer right to use goods for any purpose for cash, deferred payment or any other valuable consideration.
2. The rate of lump sum tax is prescribed as 4% of the total turnover of sales. Thus even for the purpose of this Section, the decision of Hon. Gujarat Value Added Tax Tribunal in the case of Star Bakery (supra) will be applicable and hence, as of now, the legal position is that lump sum tax is payable even on transfer of right to use tax free goods covered under Schedule I to the Vat Act.
3. In my opinion this provision provides an arbitrage opportunity for dealers who transfer right to use goods for which the applicable rate of tax is otherwise more than 4%. Section 11(5)(mmm) disentitles claim of input tax credit in respect of turnover of purchases of goods for which right to use is transferred for any purpose. A debatable question is whether this provision disentitles input tax credit (a) of the dealer who transfer right to use goods or (b) of the dealer to whom the right to use goods is transferred or (c) of both. The stand of the departmental authorities in some cases is that input tax credit is not admissible to both. Therefore if the seller charges tax at the rate of say 12.5% under the normal provisions of the Vat Act on transfer of right to use goods even then purchaser will not be allowed input tax credit on such purchases because of Section 11(5)(mmm) of the Vat Act and thus the ultimate tax burden on the transaction will be at the rate of 12.5%. While there is a possibility of challenging the view of the department regarding admissibility of input tax credit, if a dealer does not want to enter into such controversy, then he can opt for composition under Section 14C of the Vat Act and reduce his tax liability from say 12.5% under the normal provisions to 4% lump sum tax under Section 14C of the Vat Act.
4. It is interesting to note that Section 14C of the Vat Act, unlike Sections 14 and 14B of the Vat Act, does not prohibit the dealer who opts for composition from making inter-State sales. Now the rate of tax for the purpose of this Section is prescribed as 4% of the “total turnover of his sales”. The phrase “total turnover” has been defined under Section 2(34) of the Vat Act to include inter-alia inter-State sale of goods. Therefore if a dealer who has opted for composition under Section 14C of the Vat Act makes inter-State deemed sale by way of transfer of right to use goods, then it is likely that lump sum tax will be demanded on the total turnover including on inter-State deemed sale even though Central Sales Tax is paid on the inter-State sale transaction.
5. In my opinion such a stand, if taken, can be controverted by relying upon Section 4 of the Vat Act which is an overriding provision and which provides that nothing contained in the Vat Act or the rules made thereunder should be deemed to authorize imposition of tax on any sale or purchase of any goods if they take place in the course of inter-State trade and commerce. The term “tax” has been defined under Section 2(27) of the Vat Act to include lump sum tax under Section 14C of the Vat Act and hence no lump sum tax is payable under Section 14C of the Vat Act on inter-State sales even if the notification provides for payment of tax on total turnover of sales.

**CHAPTER VI - COMPOSITION FOR HOTELS, RESTAURANTS AND OUTDOOR CATERERS (SECTION 14D OF THE VAT ACT)**

**VI.1 Composition provision under Section 14D of the Vat Act**

1. Section 14D of the Vat Act enables the Commissioner to permit dealers such as hotels, restaurants and caterers who are engaged in the business of sale of eatables in any form, whether processed or unprocessed and which are served, delivered or given in package from the place of business of the dealer or any other place to pay lump sum tax.
2. The term ‘eatables’ is defined in Explanation to Section 14D of the Vat Act as under:

“For the purpose of this section, the word “eatables” means all kind of goods for the purpose of consumption including all types of alcoholic and non-alcoholic beverages, water (mineral, purified or aerated) and soda water, ice-cream and kulfi, sweet and sweetmeats, fruits and fruit juice, all types of milk preparations, bakery products and such other goods as the State Government may, by order specify”

1. Thus the term “eatables” has been given a wide definition and in my opinion covers all types of food and beverages. Therefore any person who is engaged in the business of selling any type of eatables can opt for composition under Section 14D of the Vat Act. Reference may be made to a determination order passed in the case of **M/s Chandravilas Hotel Dec 2009 Tax Reporter 625** wherein it has been held that tea-coffee are also eatables and therefore composition permission can be granted under Section 14D of the Vat Act to restaurants engaged in the sale of tea-coffee.
2. Proviso to Section 14D(1) of the Vat Act however provides that the Commissioner shall not grant permission to pay lump sum tax to a dealer who is engaged in the manufacture of such goods as the State Government may, by notification in the Official Gazette, specify. In exercise of such powers, the State Government has notified by Notification No. (GHN-90) VAT-2006/S.14D(1)(3)-TH dated 17.8.2006 the following goods for which the dealers engaged in the activity of manufacture of such goods cannot be granted permission to pay lump sum tax under Section 14D of the Vat Act:
3. Alcoholic and non-alcoholic beverages including soda water
4. Aerated, mineral, purified, medicinal, ionic or de-mineralized water or water sold in sealed container
5. Ice-cream and Kulfi
6. Biscuit (branded).
7. Rule 28C(3B) of the Vat Rules provides that permission cannot be granted under Section 14D of the Vat Act to a registered dealer who has any eatables or raw materials in stock which have been purchased in the course of inter-State trade or commerce or imported from a place outside the territory of India or have been received from his branch or consignment agent outside the State or they have not borne the tax payable under the Act.
8. It may be noted that the restriction on inter-State purchase and import is only with respect to eatables and therefore other goods such as capital goods can be purchased from outside the State of Gujarat. This has been so clarified by the Learned Commissioner of Commercial Tax by public circular no. Gujka/Vat/14D/2008-09/Ja.54/49 dated 11.7.2008.
9. I may point out that the department was taking a stand in the cases of restaurants having liquor license that if the restaurants had opted for composition under Section 14D of the Vat Act then they cannot purchase liquor from outside the State of Gujarat because of Rule 28D(6). The contention of the dealers was that trading of liquor was altogether a separate business for which they had never obtained composition permission and that such restriction was impracticable since there was a ban on manufacture of liquor in the State of Gujarat. On the basis of representations made by the dealers, the State Government has introduced Proviso to Rule 28D(6) retrospectively w.e.f 17.8.2006 allowing purchase of goods from outside the State of Gujarat if such goods are not produced in the State due to legal constraints.

**VI.2 Rate of lump sum tax for the purpose of Section 14D of the Vat Act**

1. The rate of lump sum tax for the purpose of Section 14D of the Vat Act is prescribed by the State Government as 4% of “total turnover of sales” by Notification No. (GHN-89)VAT-2006/S.14D(1)(2)-TH dated 17.8.2006.
2. Since the rate has been prescribed with reference to “total turnover of sales”, the decision of Hon. Gujarat Value Added Tax Tribunal in the case of Star Bakery (supra) will be applicable to Section 14D of the Vat Act. For instance unbranded farsan is covered by Entry 22 of Schedule I to the Vat Act. However as per the decision of Hon. Tribunal, if a sweet-mart has opted for composition under Section 14D of the Vat Act, then it will be liable to pay lump sum tax even on the turnover of sale of unbranded farsan.

**VI.3 Sale price of food served in hotels, restaurants, etc**

1. Another relevant question in the case of hotels, restaurants, etc is what can be considered to be the ‘sale price’ of food served in hotels, restaurants, etc. so as to be includible in the ‘turnover of sales’ for the purpose of payment of lump sum tax.
2. For this purpose it is necessary to refer to the legislative history of sales tax on hotels and restaurants. The question of legislative competence of States to levy sales tax on meals served by hotels to in-house guests came up before Hon. Supreme Court in the case of **State of Himachal Pradesh v/s Associated Hotels of India Ltd. (1972) 29 STC 474 (SC)**. It was held that the transaction between a hotelier and a visitor to his hotel is essentially one of service in the performance of which and as part of the amenities incidental to that service, the hotelier serves meals at the stated hours. There was no intention on the part of the parties to sell and purchase food-stuff. It was therefore ultimately held that the State was not entitled to split up the transaction into two parts – one of service and the other of sale of food-stuffs and also to split up the bill charged by the hotelier as consisting of charges for lodging and charges for food-stuff served to him with a view to levy sales tax on the latter part.
3. The question then arose whether the same principle would apply even in case of food served to casual visitors by restaurants. Hon. Supreme Court held in the case of **Northern India Caterers (India) Ltd. v/s Lt. Governor of Delhi (1978) 42 STC 386 (SC)** that there was no sale of food involved even if food was served by restaurants to casual visitors irrespective of whether charge was imposed for the meal as a whole or according to the dishes separately ordered. Hon. Supreme Court adopted the concept of English law that when a number of services are concomitantly provided by way of hospitality, the supply of meals must be regarded as administering to a bodily want or to the satisfaction of human need.
4. Thus in both the above cases, the transaction of supply of food by hotels and restaurants was considered to be in the nature of service and was held to be not identifiable as a transaction of sale.A review petition was filed before Hon. Supreme Court against its decision in the case of Northern India Caterers (India) Ltd. (supra). The review petition was rejected by Hon. Supreme Court by its decision reported as **Northern India Caterers (India) Ltd. v/s Lt. Governor of Delhi (1980) 45 STC 212 (SC)**. However it was clarified that the basis of the earlier decision was that the customer was merely entitled to eat the food served to him and not to remove and carry away the unconsumed portion of the food. It was specifically held in the concurring judgement by Justice Krishna Iyer that liability of sales tax had not been excluded by Hon. Supreme Court in a case where the customer had a right to carry away the unconsumed food and where it was established that the dominant nature of the transaction was sale of food.
5. Thus before the 46th Constitutional Amendment the legal position was that hotels and restaurants supplying food as a part of service wherein the customers did not have a right to take away unconsumed food was not exigible to sales tax. By the 46th Constitutional Amendment, “supply of food by way of or as part of service” was deemed to be sale under Article 366(29A) of the Constitution of India.
6. After the Constitutional Amendment, the next question that arose was of sale price of the supply of food on which sales tax could be levied. In the case of **K. Damodarasamy Naidu v/s State of Tamil Nadu (2000) 117 STC 1 (SC)** it was urged before Hon. Supreme Court that tax on food served in restaurants could not be levied on the sum total of the price charged to the customer. It was argued that restaurants provided services in addition to food and these had to be accounted for. Restaurants provided elegant décor, uniformed waiters, good linen, crockery and cutlery. It could even be that they provided live or recorded music, dance floor and cabaret. It was thus argued that the bill that the customer paid in the restaurant had to be split up between what was charged for such service and what was charged for the food. Such contention in the context of restaurants was rejected by Hon. Supreme Court by making the following observations in para 9 of the judgement:

*“The tax, therefore, is on the supply of food or drink and it is not of relevance that the supply is by way of a service or as part of a service. In our view, therefore, the price that the customer pays for the supply of food in a restaurant cannot be split up as suggested by learned counsel. The supply of food by the restaurant owner to the customer though it may be a part of the service that he renders by providing good furniture, furnishings and fixtures, linen, crockery and cutlery, music, a dance floor and a floor show, is what is the subject of the levy. The patron of a fancy restaurant who orders a plate of cheese sandwiches whose price is shown to be Rs.50 on the bill of fare knows very well that the innate cost of the bread, butter, mustard and cheese in the plate is very much less, but he orders it all the same. He pays Rs.50 for its supply and it is on Rs.50 that the restaurant owner must be taxed.”*

1. However in the context of residential hotels it was observed by Hon. Supreme Court in the same decision that it was undisputed that if a hotel collects composite charges for lodging and boarding, sales tax could be levied only on the component relating to supply of food and drink. The argument of the assessee was that tax could not be levied on the composite charge for boarding and lodging unless the State made Rules which set down formulae for determining the component of the composite charge relating to food and drink which was exigible to tax. The revenue’s argument was that no rules were necessary in this regard and the Sales Tax Officers would make assessments depending upon the facts of each individual case.
2. Hon. Supreme Court accepted the submissions of the assessee and held that in practical terms it was impossible for the sales tax authorities to make assessments upon the basis of the facts relevant to each individual customer in each individual hotel. Generalizations would be inevitable and generalization of one officer would differ from that of another that would lead to unacceptable arbitrariness. It was held that Rules to indicate to the Sales Tax officers how to treat composite charges for lodging and boarding would eliminate arbitrariness. The State of Maharashtra was therefore directed not to make assessments in the cases of residential hotels unless Rules were framed in this regard.
3. Thus in so far as restaurants are concerned, it is made crystal clear by the decision of Hon. Supreme Court in the case of K. Damodarasamy Naidu (supra) that the price charged from customer for the food is the sale price of the food and such price cannot be split up. Hence for the purpose of computation of turnover of sales of restaurants who have opted for composition under Section 14D of the Vat Act, whatever amount is charged by the restaurants from the customers in the menu towards food is to be included.
4. I may clarify that this however does not mean that whatever is charged by the restaurants from the customer is includible in the taxable turnover. If for instance a restaurant has air-conditioned as well as non air-conditioned section. Suppose menu and price list for both the sections is the same. However it is noted in the menu that if the customer sits in the air-conditioned section, then he will have to pay extra charges. In my opinion such charges are not recovered towards supply of food and therefore they need not be included in the turnover of sales for the purpose of paying lump sum tax under Section 14D of the Vat Act.
5. In so far as residential hotels are concerned, there is no rule in the Vat Rules which provides for a formulae for determining the component of composite charges for lodging and boarding that are to be treated as towards supply of food and drink. I am of the opinion that non-existence of any such rule is contrary to the decision of Hon. Supreme Court in the case of K. Damodarasamy Naidu (supra) and hence assessments of residential hotels under the Vat Act are liable to be challenged before Hon. High Court on this ground.
6. However this does not mean that residential hotels should stop paying taxes under the Vat Act. Tax under the Vat Act should be paid on the approximate sale value of food served to in-house guests as a part of package. If however in assessment computation of such tax is disputed by the assessing officer on the ground that some other method was more suitable, then such a stand can be challenged before Hon. High Court on the ground of non-existence of rules in this regard.

**VI.4 Combined effect of Service tax and Vat provisions**

1. While there are service tax issues even in case of works contracts and transfer of right to use goods, I am only specifically referring to the service tax provisions relating to restaurants because according to me there is still ambiguity in the case of restaurants with regard to valuation of goods and services and therefore service tax provisions and decisions are directly relevant even for the purpose of assessment under the Vat Act.
2. It may be noted that when the decision of Hon. Supreme Court was rendered in the case of K. Damodarasamy Naidu (supra), service tax was yet to be introduced in India. Therefore valuation from the point of view of service tax was not under consideration.
3. Section 66E of the Finance Act, 1994 expressly declares service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity as “declared service” for the purpose of service tax.
4. Rule 2C of the Service Tax (Determination of Value) Rules, 2006 (herein after referred to as “Service Tax Valuation Rules”) provides that the value of service portion in an activity wherein goods being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity, at a restaurant will be 40% of the total amount.
5. In my opinion it was clarified by Hon. Supreme Court in the case of Northern India Caterers (I) Ltd. (supra), that in a case where customers had a right to take away the unconsumed food the transaction would be one of sale. Therefore even for the purpose of service tax, in case of restaurants where food is served to the customers and they have a right to take away unconsumed food, it can be argued that this is an outright sale transaction. Food is not supplied by way of or as part of service and hence no service tax is payable under Section 66E of the Finance Act, 1994 read with Rule 2C of the Service Tax Valuation Rules.
6. I may point out that the competence of the Parliament to levy service tax on restaurants was challenged before two different High Courts. While Hon. Kerala High Court has held in the case of **Kerala Classified Hotels and Resorts Association v/s Union of India (2013) 64 VST 462 (Ker.)** that Parliament does not have competence to levy service tax on restaurants, a contrary view has been recently taken by Hon. Bombay High Court in the case of **Indian Hotel and Restaurant Association v/s Union of India (2014) 71 VST 386 (Bom.)**.
7. I am of the opinion that even while holding that Parliament has competence to levy service tax on restaurants, Hon. Bombay High Court has proceeded on the assumption all supplies of food by restaurants are by way of or as part of service. It has not been noticed by Hon. Bombay High Court that Hon. Supreme Court while dismissing the review petitions in the case of Northern India Caterers Ltd. (supra) specifically observed that its decision would not affect taxability of transactions wherein customer has right to take away unconsumed food since in such cases the dominant nature of the contract would be sale of food.
8. Therefore in my opinion, although fraught with litigation, the contention that service tax cannot be levied on restaurants where customers have a right to take away unconsumed food since in such cases food is not supplied by way of or as part of service still survives.
9. Even for restaurants that do supply food as part of service, reliance may be placed on para 9 of the decision of Hon. Supreme Court in the case of K. Damodarasamy Naidu (supra) which is reproduced herein above to contend that while the Parliament may have a right to levy service tax on restaurants, Hon. Supreme Court has categorically held that if a customer pays Rs. 50 for a cheese sandwich in a restaurant, the entire amount is paid for supply of food and thus no consideration is received towards other services. Such contention would however necessarily require challenge of the vires of Rule 2C of the Service Tax Valuation Rules.
10. In the alternative it may be pleaded that if it is concluded that there is consideration received from customers for services other than for supply of food and such amount is exigible to service tax, then such consideration cannot be included in the sale price of food and hence it does not form part of the turnover of sales for the purpose of payment of lump sum tax under Section 14D of the Vat Act.
11. Reference may be invited in this regard to the decision of Hon. Supreme Court in the case of **Bharat Sanchar Nigam Ltd. v/s Union of India (2006) 145 STC 91 (SC)** wherein it has been specifically observed in para 45 that catering contracts involve sale as well as service and therefore they have been allowed to be split up by Constitutional Amendment. If this be so, then according to me, tax is payable under the Vat Act on consideration towards supply of food and service tax is payable on consideration, if any, towards other services.
12. Thus while according to me Hon. Supreme Court has clarified in the case of K. Damodarasamy Naidu (supra) that the customer pays the entire amount to the restaurant towards supply of food and thus there is no consideration as such for any other service, if at all in future the Court confirms that the transaction also involves other services for which consideration is received and hence service tax is leviable on such consideration, then it can be contended that such consideration is not towards supply of food and therefore not forming part of sale price under the Vat Act. I may caution that this is a grey area and hence it is fraught with uncertainty.

**VI.5 Restrictions on hotels, restaurants, etc who have opted for composition**

1. The following additional restrictions have been stipulated under Rule 28C for hotels, restaurants, etc that have opted for composition under Section 14D of the Vat Act:
2. The dealer cannot import from outside India or purchase from outside the State of Gujarat any eatables or raw materials in any form.
3. The dealer cannot receive eatables or raw material from branch or consignment agent outside the State of Gujarat.
4. The dealer has to display conspicuously at each place of his business including branches a notice with the phrase “Tax is not charged separately”.
5. Input tax credit relating to the goods held in stock will be required to be reversed and if such input tax credit has already been utilized then such amount will be required to be paid.

**CHAPTER VII – PROCEDURES FOR APPLICATION, APPEAL AND RETURN FILING**

**VII.1 Application for Composition**

1. The procedure and time limits for making application for composition under the various provisions of the Vat Act read with the Vat Rules is summarized in the table below:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Composition provision | Relevant Rule | Form Number | Time limit for filing application | Effective date of permission |
| 14 | 28 | 210 | On or before 30th April of the year | Beginning of the year (see para 147) |
| 14A | 28(8) | 214 | Within 30 days from beginning of contract | Beginning of the contract |
| 28(8)(bb) | 214A | Within 30 days before commencement of year i.e. before 1st March of the previous year | Beginning of the year |
| 14B | 28A | 210A | At any time during financial year | Tax period subsequent to month of application |
| 14C | 28B | 210B | At any time during financial year | Tax period subsequent to month of application |
| 14D | 28C | 210C | Within 30 days before commencement of year in any other case | Beginning of the year |

1. Although the effective date of permission for composition is not expressly mentioned in Rule 28, sub-rule (2) provides that application is to be made on or before 30th April for any year subsequent to the year 2006-07 ‘in respect of which’ permission is sought. Thus the Rule contemplates grant of permission for a particular year and hence it can be concluded that the permission will be effective from the beginning of the year.

**VII.2 Time limit and effective date for new dealers**

1. Additionally, in respect of new dealers, Rule 28, Rule 28(8)(bb) and Rule 28C provide that application for composition needs to be made within 90 days of the effective date of registration. Now Rule 5 of the Vat Rules provides that the Commissioner needs to grant registration within 30 days of the effective date of registration and the registration will be effective from the date of application.
2. An issue may arise however if the application for registration is rejected for any reason. Suppose the dealer does not apply for composition since he is yet to be given registration. Suppose rejection of registration is challenged by the dealer by way of appeal and the appeal is allowed say after 4 months and thus registration is made effective from the date of application. Now if the dealer makes an application for composition, the officer may reject the application on the ground that it has been made beyond 90 days of the effective date of registration.
3. In order to avoid such technical controversies, I am of the view that if the dealer intends to challenge the rejection of registration and the dealer also intends to opt for composition, then the dealer should apply for composition notwithstanding the fact that his application for registration has been rejected. Request should be made to keep such application pending till the appeal relating to registration is decided. If such course is adopted and if suppose the appeal of the dealer relating to registration is subsequently allowed, then the dealer will automatically have complied with the requirement of filing application for composition within 90 days of the effective date of registration.
4. Another issue is the effective date of permission for composition for new dealers. In some cases the department is taking a stand that permission for composition can be made effective only from the date of application for composition. However in my view such a stand is on an erroneous reading of the Vat Rules. Rule 28 of the Vat Rules allows a new dealer to apply for composition within 90 days of the effective date of registration. In light of such provision I am of the opinion that the permission for composition has to be and should be granted from the effective date of registration itself particularly because the Scheme of composition permission generally is to provide permission for composition on yearly basis.

**VII.3Delay in filing application for composition cannot be condoned**

1. It has been held by Hon. Gujarat Value Added Tax Tribunal in the case of **Ankur Traders v/s State of Gujarat 2010 GSTB 677** that there is no provision under the Vat Act or Vat Rules which empowers the officers to condone delay in filing application for composition under the Vat Act. Officers are not ‘courts’ and therefore delay cannot even be condoned under Section 5 of the Limitations Act, 1963. It was thus held that the officer had rightly refused to condone delay in filing application for composition. Similar view was taken in the case of **Laxmi Steel Centre v/s State of Gujarat Oct 2009 STR 729.**
2. However in a similar case before Hon. Tribunal in **Jyoti Ply Corner v/s State of Gujarat Nov 2009 STR 810** it was pointed out by the appellants that in other cases delay in filing application for composition was being condoned by the departmental officers. Hon. Tribunal held that appellant should also be eligible for similar treatment and therefore the matter was remanded to pass appropriate orders after taking into consideration orders passed in similarly situated cases.
3. The fact remains that the Vat Rules do not contain any provision for condonation of delay in filing application. Composition is only an alternative method of payment of tax and that too at the option of the dealer. Therefore it is advisable to either apply for composition within the prescribed time limit or otherwise pay tax under the normal provisions for the time being and apply in the next year rather than litigating on the issue of condonation of delay in filing application for composition.

**VII.4Application for composition whether deemed to be granted if no order passed in this regard?**

1. Hon. Karnataka High Court has held in the case of **B.Damodara v/s Additional Assistant Commissioner of Commercial Taxes (2005) 142 STC 454 (Kar.)** that the Karnataka Sales Tax Act, 1957 contemplated passing of order accepting the application for composition and therefore in the absence of a positive order the application could not be deemed to have been granted. Even if the Act provided a time limit for passing of such order and the officer did not pass any order within such time limit, it was for the department to peruse the reason for inaction of the officer. However in so far as the assessee was concerned the composition permission became functional and operative only on passing of positive order. Similar view has been taken by Hon. Kerala High Court in the case of **A.V.J. Emporium v/s Assistant commissioner (2009) 24 VST 422 (Ker.).**
2. A contrary view has been taken by Hon. Gujarat Value Added Tax Tribunal in the case of **Shah Manilal Bapulal v/s State of Gujarat 2009 GSTB 61** wherein it was held that since application was made by the dealer and no response was received from the authorities, permission was deemed to have been granted. Thus in so far as the Vat Act is concerned, the legal position is that if no order is passed granting or rejecting application for composition, permission may be deemed to be granted.

**VII.5 Rejection of application in one year not a bar for application in succeeding years**

1. Except for contract-wise permission under Section 14A of the Vat Act all other permissions are given on a yearly basis. I may clarify that Provisos have been inserted in Rule 28 and other rules from 1.4.2008 providing that once a dealer has been given permission for composition, he will not be required to file application every year. However according to me this Proviso has been inserted to avoid unnecessary procedures of filing applications every year. In fact it shows that the permission is granted on a yearly basis and but for the proviso application would have been required to be filed every year.
2. Therefore if for a particular year application for composition permission is rejected, this does not bar filing application for composition in succeeding year. Reference is invited in this regard to a decision of Hon. West Bengal Taxation Tribunal in the case of **Lakshmi Procon Ltd. v/s Senior Joint Commissioner of Commercial Tax (2012) 51 VST 78 (WBTT)** wherein it has been held that each tax year is separate and disqualification of a dealer for one particular year would not mean disqualification for all years to come. Similar decision was taken by the same Hon. Court in the case of **Alok Patra v/s Deputy Commissioner of Commercial Taxes (2010) 35 VST 428 (WBTT).**

**VII.6 Delay in granting permission for composition by the Officer**

1. Although the Vat Rules provide that the Officers should grant permission for composition within 15 days of the application, in my opinion this may not debar the Officer from giving permission at a later date.
2. I may point out that in the case of **State of Kerala v/s T.S. Kalyanaraman (2009) 26 VST 661 (Ker.)** it was held that the assessing officer could grant permission for composition even in the assessment order itself. Similar view was taken in the case of **Hotel Zodiac Uzhavoor v/s State of Kerala (2010) 27 VST 382 (Ker.)**. However in both these cases it was held that interest could not be levied on arrears arising as a result of grant of permission for composition particularly because the delay in granting permission was not attributable to the dealer.

**VII.7 Order rejecting application for composition is appellable**

1. Section 73 of the Vat Act provides that an appeal shall lie against every original order which is passed under the Vat Act or the Vat Rules other than an order mentioned in Section 74 of the Vat Act. Order rejecting application for composition is not a non-appellable order as per Section 74 of the Vat Act and therefore a dealer can file appeal against order rejecting composition under Section 73 of the Vat Act.
2. Thus if the order is passed by Assistant Commissioner or Commercial Tax Officer then the appeal will lie to the Deputy Commissioner. If the order is passed by the Deputy Commissioner then the appeal will lie to the Joint Commissioner. If the order is passed by Joint Commissioner, Additional Commissioner or Commissioner, then appeal will lie to the Tribunal. If the first appeal order is passed by the Deputy Commissioner or Joint Commissioner then second appeal shall lie to the Tribunal. All appeals need to be filed within 60 days of the communication of the impugned order.

**VII.8Return filing**

1. Rule 19(3) of the Vat Rules require every dealer who has opted for composition to furnish quarterly return in Form 202 with the list of purchases in Form 202A appended to it within 30 days from the end of the quarter to which the return relates.
2. A dealer who has opted for composition under Section 14B of the Vat Act will however be required furnish list of retail invoices in Form 202B and details of purchases in Form 202C along with Form 202. He will not be required to furnish Form 202A.
3. A dealer whose taxable turnover in the previous year or during the year has exceeded Rs.50 lakhs or who is registered under the Central Sales Tax Act, 1956 or who deals in specified commodities that is to say timber, ceramic tiles, scrap of iron and steel, tobacco and tobacco products excluding unmanufactured tobacco and specified major minerals is mandatorily required to furnish the returns in the prescribed forms by way of uploading on the web-site of the department duly authenticated by the dealer himself or by persons declared as managers under Section 65 of the Vat Act. Such dealer shall not be required to furnish hard copy of the returns or information.
4. It may be noted that while under Rule 19(2) it is clarified that those dealers who voluntarily file e-returns will not be required to furnish hard copy of the return, under Rule 19(3) such clarification is made only in respect of dealers who are mandatorily required to file e-returns. Thus a question may arise as to whether dealers who voluntarily file e-returns are required to furnish hard copy of returns. In my opinion although there is no express provision as such in this regard, if at all a dealer does not furnish hard copy of returns on the ground that he has filed e-returns, then at the most it can be considered to be a technical discrepancy which cannot and should not have any consequences by way of interest or penalty.
5. Rule 20(3) of the Vat Rules requires dealers who have opted for composition to furnish annual returns in Form 202. The annual return needs to be furnished to the Commercial Tax Officer within whose jurisdiction the chief place of business as mentioned in certificate of registration is situated. The annual return should be duly signed by the registered dealer or a person authorized by him and it shall be furnished within 3 months from the end of the year to which the annual return relates. If total turnover of the dealer exceeds Rs. 1 crore, then he has to mandatorily file e-return and he also needs to furnish annual accounts containing trading account, Profit & Loss account and balance sheet within 6 months from the end of the year to which the annual return relates.

**CHAPTER VIII – MISCELLANEOUS ISSUES RELATING TO COMPOSITION**

**VIII.IWhether a dealer can opt out of composition?**

1. A question that may practically arise is whether a dealer who has opted for composition can switch over to pay tax under the normal provisions of the Vat Act or whether the dealer has to mandatorily keep paying lump sum tax.
2. In so far as composition permission under Section 14 of the Vat Act is concerned, Rule 28(7) of the Vat Rules specifically provides that of a registered dealer to whom such permission was granted elects not to have such permission, then such dealer shall intimate accordingly to the authority with whom he files the returns and the authority shall cancel the permission. Such dealer shall be liable to pay tax under the Vat Act from the month immediately succeeding the month during which permission to pay lump sum tax has been cancelled on the basis of the application. Rule 28A(7), Rule 28B(7) and Rule 28C(8) of the Vat Rules are also similarly worded in respect of composition permissions granted under Sections 14B, 14C and 14D of the Vat Act.
3. Therefore in view of the express rules in this regard, small scale dealers, commission agents of agricultural produce, dealers effecting transfer of right to use goods and hotels, restaurants& caterers can opt out of composition permissions granted under Sections 14, 14B, 14C and 14D of the Vat Act by intimating the authorities in this regard.
4. However in so far as composition permission for works contract under Section 14A of the Vat Act is concerned, Rule 28(8)(i) of the Vat Rules provides that the option exercised under that rule is final and is irrevocable.
5. Thus if a contractor opts for composition under Section 14A of the Vat Act for a particular works contract, then mid-way he cannot switch over to paying tax under the normal provisions of the Vat Act. Reference may be made to a decision of Hon. Karnataka High Court in the case of **T.Shivakumar v/s Commissioner of Commercial Taxes (2010) 31 VST 261 (Karn.)**. In this case the question was whether a dealer could opt out of composition once the permission had been granted. A specific Rule had been enacted providing that application filed for electing to compound the tax shall not be permitted to be withdrawn by the dealer. Hon. High Court held that this was a procedural rule and clarificatory in nature and therefore it was applicable retrospectively. The dealer was thus not allowed to opt out of composition. Similar view has been expressed by Hon. Karnataka High Court in the case of **Deputy Commissioner of Commercial Taxes v/s B.V. Subba Reddy (2010) 31 VST 530 (Kar.)** wherein its earlier decision in the case of **Karnataka State Construction Corporation Ltd. v/s State of Karnataka (2004) 138 STC 75 (Karn.)** has been followed.
6. However if permission is taken by the contractor on a yearly basis under Rule 28(8)(bb) of the Vat Rules then I am of the opinion that the dealer can opt out of composition after completion of a year. Although Rule 28(8)(i) of the Vat Rules does provide that the option once exercise is final and irrevocable, I am of the view that since each year is a separate year for the purpose of tax, dealer can opt out of composition on completion of the year.
7. I may point out that once a dealer has opted for composition under any of the provisions of the Vat Act viz. 14, 14A, 14B, 14C and 14D and he has not intimated the authorities that he intends not to have such permission, in such circumstances the dealer cannot plead for assessment under the normal provision of the Vat Act for the period in which composition permission was in force.
8. Reference may be made to the decision in the case of **Ramky Infrastructure Ltd. v/s State of Andhra Pradesh (2012) 48 VST 231 (AP)** wherein it was observed by Hon. Andhra Pradesh High Court that permission for composition of tax under the Andhra Pradesh General Sales Tax Act, 1957 was granted for each year. Therefore once a dealer had opted for composition for a particular year he was not allowed to seek assessment under the regular provision for a part of the year on the ground that the regular provision was more beneficial to him. It was held that a hybrid procedure allowing composition of tax for some time and regular assessment for some time in the same assessment year was not contemplated.
9. Hon. Kerala High Court has also held in the case of **Udaya Traders v/s Sales Tax Officer (1995) 99 STC 41 (Ker.)** that once a dealer has opted for composition he cannot opt out of it and request for assessment under regular provisions. Similar views have been expressed by Hon. Kerala High Court in its decision in the cases of **State of Kerala v/s Panchami Jewellers (2012) 50 VST 291 (Ker.)**., **A.M. Abdul Majeed v/s State of Kerala (2007) 6 VST 417 (Ker.)** and **Raju Jacob v/s Sales Tax Officer (2007) 6 VST 515 (Ker.)**

**VIII.2 Permission for composition can be cancelled only after giving opportunity of being heard**

1. Rule 28(6) of the Vat Rules as well as other similar rules expressly requires giving opportunity of being heard before cancelling permission for composition already granted to a dealer. Even otherwise based on the principle of natural justice such opportunity to be given. Order cancelling permission for composition was quashed and set aside by Hon. Gujarat High Court in the case of **BSCPL Infrastructure Ltd. v/s Commercial Tax Officer (2013) 63 VST 1 (Guj.)** on the ground that reasonable opportunity of being heard was not given to the dealer.

**VIII.3 Permission can be cancelled retrospectively if order giving permission was void ab inito**

1. While the authorities cannot retrospectively cancel permission for composition which was validly granted, if the order giving permission for composition is itself held to be void ab initio, then permission for composition can be cancelled retrospectively. Reference may be made in this regard to a decision of Hon. Andhra Pradesh High Court in the case of **KEC International Ltd. v/s State of Andhra Pradesh (2012) 53 VST 373 (AP)**. For instance if permission for composition is given under Section 14B of the Vat Act to a Commission Agent and later on it is found that the Agent was engaged in other businesses and therefore not eligible for permission, then the permission for composition is void ab initio and it can be cancelled retrospectively.

**VIII.4 Assessment cannot be made under the normal provisions while permission for composition is still in force**

1. The Commissioner does have power under the Vat Rules to cancel permission for composition after giving an opportunity of being heard to the dealer. However assessing officer cannot assess a dealer under the normal provisions of the Vat Act until and unless the permission for composition has been cancelled by the concerned authority. The assessing authority cannot inquire into the validity of the composition permission granted to dealers. Attention is invited to a decision of Hon. Karnataka High Court in the case of **Ideal Traders Cream Parlour Pvt. Ltd. v/s Additional Commissioner of Commercial Taxes (2013) 59 VST 459 (Karn.).** In this case the dealer had opted for composition and he had been assessed accordingly. The assessment order was however revised on the ground that the dealer was not eligible for composition. Hon. High Court quashed and set aside the revision of the order on the ground that certificate of composition had not been cancelled by the competent authority and so long as the certificate was in force no tax could be levied under the normal provisions.

**VIII.5 Whether a dealer who has opted for composition can do other business?**

1. In so far as Section 14 of the Vat Act is concerned, permission for composition is admissible to small-scale dealers having regard to their total turnover of sales. Therefore there is no question of such dealers doing some other business and paying tax under the normal provisions of the Vat Act in respect of such business. Similarly Section 14B specifically stipulates that permission for composition can only be given to commission agents who are exclusively carrying on business of agricultural produce. Therefore such agents are also barred from doing any other business.
2. However in so far as composition permission under Section 14A, 14C and 14D of the Vat Act are concerned, these provisions are relating to a particular type of transactions. There is no express bar in the provisions against such dealers from doing other business. Therefore I am of the opinion that dealers who have opted for composition under Section 14A, 14C and 14D of the Vat Act for works contract, transfer of right to use goods and hotels, restaurants, etc can do other business and pay tax under the normal provisions of the Vat Act in respect of such business.
3. I am of the opinion that the problem in the case of restaurants in the context of alcoholic beverages which was rectified by retrospective amendment was that such beverages are expressly included in the definition of “eatables” in the Section itself. Thus alcoholic beverages were covered by the permission for composition and therefore hit by the restrictions of Rule 28D of the Vat Rules. Hence retrospective amendment of the Vat Rules was required for clarity on the matter.
4. However in so far as goods and/or transactions not covered by the composition permission under Section 14A, 14C and 14D of the Vat Act, in my view the dealer is not barred from doing other business and paying tax under the normal provisions in respect of such business.

**VIII.6No Additional tax or surcharge liability if dealers opt for composition under Section 14, 14A, 14B, 14C or 14D of the Vat Act**

1. There has been considerable dispute in many States as to whether a dealer whohas opted for composition is liable to pay additional tax or surcharge in addition to the amount of lump sum tax. Recently Hon. Supreme Court has held in the case of **Bhima Jewellery v/s Assistant Commissioner (2014) 71 VST 110 (SC)** that additional tax or surcharge was not payable by dealers who had opted for composition under the Kerala General Sales Tax Act, 1963. The ground on which Hon. Supreme Court has taken this decision is that the charging provision for additional tax under the Kerala Act provided that the tax payable under “Section 5 and Section 5A” shall be increased by an additional sales tax. However lump sum tax was payable under Section 7 of the Kerala Act and therefore the charge of additional sales tax was not attracted in such case.
2. Similar decision was rendered by Hon. Allahabad High Court in the case of **Systematic Conscom Ltd. v/s State of Uttar Pradesh (2009) 23 VST 520 (All.)**. However in the context of Orissa Sales Tax Act, 1947 it was held by Hon. Orissa High Court in the case of **Baladev Sahu & Sons v/s State of Orissa (2009) 22 VST 386 (Orissa)** that even dealers who have opted for composition are liable to pay surcharge.
3. However in so far as the Vat Act is concerned, in my opinion the provision is quite unambiguous. Additional tax is leviable under sub-Section (1A) of Section 7 of the Vat Act itself and that too on turnover of sales of goods. All the Sections relating to composition viz. 14, 14A, 14B, 14C and 14D of the Vat Act empower the Commissioner to give permission to pay lump sum tax in lieu of “tax” leviable under the Vat Act. Section 2(27) of the Vat Act defines “tax” to include any tax leviable and payable under the Vat Act on sales or purchase of goods. Thus evidently additional tax is also a tax for the purpose of the Vat Act. Therefore there can be no doubt that lump sum tax is payable in lieu of normal tax as well as additional tax and dealers who have opted for composition are not required to pay additional tax separately.
4. This is more so because Section 14(1)(b), Section 14B(6), Section 14C(3) and Section 14D(3) of the Vat Act also specifically provide that in case of breach of provisions, a dealer who has been given permission for composition will be liable to pay tax under Sections “7 and 9”. Additional tax being a part of Section 7 of the Vat Act, it becomes clear that payment of tax with additional tax under Section 7 of the Vat Act is contemplated only if there is a breach committed by the dealer.

**VIII.7Whether conditions can be subsequently introduced in composition provisions with retrospective effect?**

1. Under the Karnataka Value Added Tax Act, 2003, section imposing purchase tax on purchases from unregistered dealers for dealers who had opted for composition in addition to lump sum tax liability and that too with retrospective effect was challenged before Hon. Karnataka High Court in the case of **Mysore Construction Co. v/s State of Karnataka (2009) 24 VST 250 (Karn.)**. While the constitutionality of the provision was upheld by Hon. Karnataka High Court, its retrospective effect was struck down by the Court as being arbitrary and violating Article 14 of the Constitution of India.
2. In the absence of retrospective rule making power being available with the State Government, retrospective increase in the rate of lump sum tax was struck down by Hon. Punjab and Haryana High Court in the case of **Ranbir Singh Ram Gopal v/s State of Haryana (2002) 125 STC 326 (P&H)** which was followed in the case of **Rathi Bhatta Company v/s State of Haryana (2004) 134 STC 51 (P&H).**
3. Thus while it is difficult to challenge the validity of prospective introduction of new conditions, there is scope for challenging retrospective insertion of such conditions if they are detrimental to the interest of the dealers.

**VIII.8 Composition provisions are valid even if they provide a cut off date**

1. It is also open for the legislature to introduce composition provisions with a cut-off date. Hon. Bombay High Court has held in the case of **Builders Association of India v/s State of Maharashtra (2012) 55 VST 504 (Bom.)** that composition provisions which are introduced with a cut off date cannot be struck down as arbitrary. The Court could also not direct the legislature to give composition option to agreements entered into prior to the cut off date as this was a legislative function. It was held that legislature and its delegate had a wide degree of latitude in enacting laws and subordinate legislations and concessions need not be granted to everyone.

**VIII.9 Composition permission to new industries enjoying incentives**

1. A question arose under the Sales Tax Act as to whether composition permission can be granted to new industries enjoying incentives. It was held by Hon. Gujarat Value Added Tax Tribunal in the case of **Larsen and Toubro Ltd. v/s State of Gujarat 2011 GSTB 1167** that composition permission could be granted to new industries. In so far as curtailment of incentive limit is concerned, it was held that lump sum tax is also a tax and the incentive limit is to be curtailed by tax otherwise payable by the eligible unit. It was therefore held that incentive limit was to be curtailed by the composition amount which would have been otherwise payable.
2. It may be noticed that while this decision is rendered in special cases of new industries, there are decisions to the effect that a dealer who opts for composition will not be entitled to take benefit of general exemption notifications. Reference may be made in this regard to a decision of Hon. Kerala High Court in the case of **Pioneer Industries v/s Additional Sales Tax Officer (2003) 129 STC 84 (Ker.)** and the decision of Hon. Madras High Court in the case of **Ramasamy Nadar v/s Special Commissioner (2003) 132 STC 109 (Mad.).**

**CONCLUSION**

Thus although composition provisions are meant for simplification and hassle free computation, there is scope for numerous controversies and complications in the practical implementation of the provisions. Therefore a thorough understanding of the provisions is valuable to avoid unnecessary litigation. I have made an effort to express my views on certain contingent issues relating to Composition provisions of the Vat Act. Contrary opinions are also possible. The purpose of this paper is to invite debate and discussion on such issues. I hope that this paper will be useful to all concerned. Feedback on the same may please be emailed to uchit@uchitsheth.com.