ST on Renting after Delhi HC decision : A case of misplaced euphoria? – Apr 27, 2009

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THE suspense is over and the full text of the Delhi HC's order dated April 18, 2009 on the levy of service tax on renting of immovable property services is out in TIOL (**2009-TIOL-196-HC-DEL-ST**). At the cost of becoming highly unpopular, I have ventured into writing this urgent piece on this very important development, which would seem to have created a lot of misplaced euphoria amongst the tenants/lessees.

Firstly. *…… what was challenged before the Delhi HC was the legal validity of the exemption Notification No. 24/2007-ST dated May 22, 2007 and the Board Circular No.98/1 /2008-ST dated 04/01/2008. As is well known, the Notification No. 24/2007 deals with exemption in relation to the property tax paid, while computing the taxable value of the service related to renting of immovable property, while the famous (or infamous) Board Circular No. 98/1/2008 deals with the denial of cenvat credit for the landlords/lessors in respect of service tax paid on input service being Commercial or Industrial Construction service. The Supreme Court is yet to pronounce its verdict on whether service tax can be levied on 'renting of immovable property' services, in respect of the 15 odd writ petitions filed before the various High Courts, which have all been transferred to the Supreme Court. The question of the constitutionality of the levy of service tax on renting of immovable property services will be decided by the Apex Court and as such, this was not a subject matter before the Delhi High Court, in any case. Hence, to term that the Delhi HC has struck down the service tax levy on commercial rentals, would be totally incorrect.*

In the instant case, it was alleged before the HC that by virtue of the said notification and the circular a completely erroneous interpretation is placed on Section 65(90a) and Section 65 (105) (zzzz) of the Finance Act, 1994. It was further alleged that because of this incorrect interpretation, service tax is sought to be levied on the renting of immovable property as opposed to service tax on a service provided "in relation to the renting of immovable property". *An alternate plea was also made before the HC that the levy of service tax under the provisions of Sections 65(90a), 65(105)(zzzz) and 66 of the Finance Act, 1994, insofar as they relate to the levy of service tax on renting of immovable property would amount to a tax on land and would therefore fall outside the legislative competence of Parliament inasmuch as the said subject is covered under Entry 49 of List I1 of the Constitution of India and would fall within the exclusive domain of the state legislature. The Delhi HC did not deal with the alternate plea and hence,* per se *, the constitutional validity of the levy of service tax in renting of immovable property services has not been struck down.*

In my view, most of the observations of the Delhi HC vis-a-vis the levy of service tax on renting of immovable property services are more in the nature of *obiter dicta* rather than in the nature of *ratio decidendi* , as these pertain to the question of the constitutionality of the levy of service tax on renting of immovable property services, which was not a subject matter before it.

This is clear from Para 36 of the order reproduced below:

Quote :

36. In view of the foregoing discussion, we hold that Section 65(105)(zzzz) does not in terms entail that the renting out of immovable property for use in the course or furtherance of business of commerce would by itself constitute a taxable service and be exigible to service tax under the said Act. The obvious consequence of this finding is that the interpretation placed by the impugned notification and circular on the said provision is not correct. Consequently, the same are ultra vires the said Act and to the extent that they authorize the levy of service tax on renting of immovable property per se, they are set aside.

Unquote :

Secondly, the Delhi HC has referred to several decisions of the Supreme Court including, notably, the following :

Tamil Nadu Kalyana Mandapam Association v Union of India and Others – 2004-TIOL-36-SC-ST

All India Federation of Tax Practitioners v Union of India – 2007-TIOL-149-SC-ST

Doypack Systems Pvt Ltd v Union of India – 2002-TIOL-389-SC-MISC .

BSNL v. Union of India: 2006-TIOL-15-SC-CT-LB

Commissioner of Income-tax, Bangalore v. B.C. Srinivasa Shetty: 2002-TIOL-587-SC-IT-LB

Union of India v. Inter Continental: 2008-TIOL-83-SC-CUS

Of course, the Delhi HC has distinguished the decision of the Hon'ble Supreme Court in the Tamil Nadu Kalyana Mandapam case, while disposing off the writs in the instant case. To this extent, it looks good, as many practitioners and the Departmental officials have been taking a view that, based on the Apex Court's decision in the Tamil Nadu Kalyana Mandapam case, levy of service tax on services in relation to renting of immovable property services could not be held to be unconstitutional.

In the landmark judgment involving the All India Federation of Tax Practitioners, the Hon'ble Supreme Court discussed, in detail, the concept of service tax being a value added tax. In Para 17 of this judgment, the Apex Court has stated that "service tax is a value added tax which in turn is a general tax which applies to all commercial activities involving production of goods and provision of services". To what extent the latest decision of the Delhi HC would hold water when the case goes to the Hon'ble Supreme Court, in the light of its decision rendered in the All India Federation of Tax Practitioners case, would remain to be seen.

Thirdly *, very interestingly, the Delhi HC has, while dealing with the question as to whether renting of immovable property for use in the course or furtherance of business or commerce by itself is a service, has also held that any service connected with the renting of such immovable property would fall within the ambit of Section 65(105)(zzzz) and would be exigible to service tax. Of course, the HC has specifically held in Para 35 of its order that if there is some other service, such as air conditioning service that is provided along with the renting of immovable property, then it would fall within Section 65(105)(zzzz).*

Now, it is well known that the Landlords/ Lessors do provide a lot of services like letting out of fitouts, furniture, provision of air-conditioning, providing common parking space, providing common facilities, common power supply, etc. as part of an overall package and, in terms of the Delhi HC judgment, all of these services would indeed get covered under 'Renting of Immovable Property' services. In other words, the Delhi HC's judgment holding that 'renting of immovable property' is not a service, is only, qua, *the activity of renting of the immovable property without any additional services being rendered. If any other services get provided by the Landlord or the Lessor, the provisions of Section 65(105)(zzzz) stand automatically attracted, as per the Delhi HC.*

Quite paradoxically, after this decision, it becomes necessary for the Landlords /Lessors who have built commercial or industrial complexes to charge service tax, as invariably, other services of the nature mentioned above, are provided to the tenants in addition to the renting of the immovable property.

***Fourthly** , as aforesaid, the basis on which the Delhi HC would seem to have proceeded in the instant case, is the concept of 'value addition' as being the only pre-requisite for holding that a service is provided. To what extent this point of view finds favour with the Hon'ble Supreme Court, when the Government goes on civil appeal/SLP, would remain to be seen. As such, if one goes by this decision of 'value addition' being the only pre-requisite for levy of service tax being a value added tax, the constitutional validity of the Service Tax (Determination of Value) Rules, 2006 could be called into question, as, under these Rules, 'reimbursements' involving no value addition from the service provider, get included under the gross amount charged and get subjected to the levy of service tax. Moreover, to what extent this view of the Delhi HC would go with the Apex Court's view expressed in the All India Federation of Tax Practitioners case that 'service tax is a general tax on all commercial activities and provision of services' would remain to be seen.*

***Fifthly** ..... how will this decision get implemented at the ground level, especially, in cases, where a composite rent is charged by the Landlord/Lessor for letting out the commercial or industrial property and also for providing common services? As per the Service Tax (Valuation Rules) of 2006, the gross amount charged on which service tax is to be collected, would include the portion of the overall rentals as are attributable to the letting out of the bare/worm shell, which as per the Delhi HC, is not a taxable service. There is no provision in the service tax for an artificial bifurcation to be carried out, to ascertain the portion of the 'rent' as is attributable to the activity of 'letting out of the property' which, as per the Delhi HC, is not a taxable service.*

***Sixthly** .... what are the implications of this order in respect of transactions outside of Delhi? Article 226 of the Constitution places two important limitations upon exercise of the powers of the High Court, viz.*

++ The writ issued by the court cannot run beyond territory subject to its jurisdiction.

++ The authority to which High Court is empowered to issue the writs must be amenable to the jurisdiction of the court either by residence or by location.

It is clear then that the decision of the Delhi HC would not apply to lease/rental agreements entered into, in respect of premises located outside of the jurisdiction of the Delhi High Court, even in respect of the parties who have filed the writs. Thus, even in respect of the petitioners, it is only the properties located within the jurisdiction of Delhi would get covered by the HC decision while, properties outside of Delhi, would still not be covered.

***And, lastly**, where does this decision of the Delhi High Court leave the hapless Developers/Landlords / Lessors? Very unfortunately, the extensive coverage of this judgment in the press has already created an impression that the Delhi High Court has struck down the service tax levy on commercial rentals, which as we saw, is totally incorrect. Now, there would be a clamour from the tenants for service tax not to be charged on the rents paid by them while the Department*

would continue to insist that the landlords/lessors pay service tax on commercial rentals. The Landlords/Lessors could easily get caught in a 'Catch 22' situation.

In my view, the Landlords/Lessors would need to continue to collect and pay service tax, in respect of the rents collected from their tenants till the final word on the levy of service tax on commercial rentals is out, from the Apex Court in respect of the writs filed before the various High Courts, which have now been transferred to the Apex Court. Of course, one must also be prepared for retrospective amendments by the Government to protect its revenue, should the case get decided against the Government at the Hon'ble Supreme Court, if the recent actions of the Government are any indication.

Before parting …

++ It is understandable for the players of the Retail Lobby to have filed the writs, given the fact the service tax element on the rentals becomes an ' expense item' for them, as here is no way for cenvat credit to be taken. In a lighter vein… I only hope that the Government does not levy service tax on 'Sale of Goods' services and bring the Retail Sector into the service tax net, in which case, a logical answer would have been found for the problem.

++ The latest decision of the Delhi High Court would have very limited applicability on the ground level, as aforesaid. As per my understanding, expect for some players of the Retail Lobby and some multiplex owners, who had filed writs before the High Courts, the levy of service tax on commercial rentals has largely been accepted and tenants are indeed paying service tax. The introduction of service tax on Information Technology Software Services with effect from May 16, 2008, would help the IT exporters to claim refund of service tax paid on rentals and hence, the burden of this levy has significantly reduced post may 16, 2008, subject of course, to the issues concerning the Retail Sector. Would it not make sense for the Government to exempt the levy of service tax on commercial properties let out to the Retail Sector, which could result in a largely acceptable solution to this problem.

++ Is it then, a case of misplaced euphoria?