Service tax on commercial rentals – no solution in sight as litigation continues! – JUNE 29, 2010

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By S Sivakumar, CA

THE Central Government's attempts to legalize the levy of and collection of service tax on commercial rentals, on a retrospective basis, from June 1, 2007, would seem to have met with some judicial resistance, at least, in so far as the retrospectivity of the levy is concerned. While the Delhi High Court has given a stay in the *Home Solution Retail Ltd v. Union of India and others* 2010-TIOL-341-HC-DEL-ST, the AP High Court, in *Trent Limited v. Union of India and Others* 2010-TIOL-402-HC-AP-ST, has stayed the recovery of service tax for the period June 1, 2007 to March 31, 2010. The issue before the Delhi High Court was, whether, the amendment brought about by the Government, by the introduction, through the Finance Act, 2010, in the place of the words "in relation to renting of immovable property" appearing in Section 65(105)(zzzz), the words " by renting of immovable property or any other service in relation to such renting", was valid in law. The same High Court, in an earlier case involving the same petitioners, had on 18-4-2009 that the activity of renting could not be held to be a taxable service **(**2009-TIOL-196-HC-DEL-ST**)**. The Delhi Court had, in this earlier decision held (in Para 35) that, if any other service such as air-conditioning was provided, along with the renting service, such a case would be covered by the levy of service tax under Section 65(105)(zzzz). This part of its earlier decision has not been touched upon, in the subsequent petition filed before it, in 2010, post the retrospective amendment.

Though its attention was drawn to the decision of the Delhi High Court in the Home Solution case delivered in 2009, the AP High Court has taken a different stand by only staying the recovery of tax in respect of the period June 1, 2007 to March 31, 2010, without toeing the line of the Delhi High Court which had held that, if additional services are provided along with renting, service tax was attracted.

A combined reading of these decisions could possibly lead to the following conclusions…

- the constitutionality of the levy has not been touched. It is now up to the Supreme Court to decide on whether renting, as an activity, would constitute a service. Of course, as aforesaid, the Delhi High Court had held that, when additional services are provided along with renting, service tax was very much attracted.
- The AP High Court, it seems, has no problems about service tax being levied on renting even without any additional service being provided, post April 1, 2010. In a way, it seems to justify the levy of service tax on renting, as an independent service, post April 1, 2010.
- The Supreme Court is already hearing the SLP filed by the Government against the decision of the Delhi High Court, in the Home Solution case delivered in 2009. It has been reported that the Government is in the process of filing a fresh appeal/SLP before the Supreme Court against the latest decision of the Delhi High Court in the Home Solutions case.

Be that as it may…… what would be the impact of these decisions in respect of cases situated outside of Delhi and AP? Could these decisions constitute as a binding precedent for the whole of India?

The Supreme Court has, in the last few years, has come out with three judgments on jurisdictional issues concerning the decisions of the High Courts. In *Kusum Ingots and Alloys Ltd. v Union of India* 2004-TIOL-117-SC-CX-LB, a three member Bench had held that " an order passed a High Court on a writ petition questioning the constitutionality of a parliamentary Act whether interim or final keeping in view the provisions contained in clause (2) of Article 226, will have effect throughout the territory of India subject of course to the applicability of the Act." In the Home Solutions case decided in 2009, the Delhi High Court had not had not struck down the constitutionality of the levy of service tax on renting and consequently, its decision cannot be made applicable to cases falling beyond its jurisdiction.

In 2007, in the case of *Ambica Industries Vs Commissioner, Central Excise*, 2007-TIOL-97-SC-CX, the Supreme Court had held that "the decision of the high court shall be binding only on the authorities which are within its jurisdiction."

In a recent case, in the case of Durgesh Sharma v. Jayshree, in the case of CIVIL APPEAL NO.5857 OF 2008, the Supreme Court has categorically held that "s o far as a high court is concerned, its jurisdiction is limited to territory within which it exercises jurisdiction and not beyond it.

"The jurisdiction of a high court has territorial limitations. The writs issued by a high court cannot run beyond the territory subject to its jurisdiction and the person or authority whom the HC is empowered to issue such writs must be within those territories which clearly implies that they must be amenable to its jurisdiction," the SC had clarified.

It is then very clear that, the impact of the decisions of the Delhi High Court and the AP High Court would be restricted to cases falling within their respective territories and cannot be made applicable to cases falling beyond their jurisdiction.

Now, coming back to the retrospective amendment carried by the Government of India in Section 65(105)(zzzz) in the Finance Act, 2010 in terms of redefining the taxable service so as to cover the "renting of immovable property or any other service in relation to such renting"…. can this amendment, aimed to scuttle the decision of the Delhi High Court in the Home Solutions case of 2009 against which an SLP has already been admitted by the Apex Court, stand judicial scrutiny? I am reminded of the concept of 'deemed manufacture' under the central excise law, under which, an activity, which cannot be strictly termed as manufacture, can still be treated as manufacture by the Parliament, for purposes of levy of central excise duty. The Government, perhaps, is doing the same thing here, by statutorily holding that, the activity of renting, would constitute a service.

In Commissioner of Customs and Central Excise v. PHIL CORPORATION Ltd, in a case involving the concept of 'deemed manufacture', reported by **TIOL** in **2008-TIOL-16-SC-CX**, the Supreme Court had held that " it will have make serious endeavour to ascertain the spirit and intention of Parliament in enacting such provisions and once legislative intention is properly gathered, then the bounden duty and obligation of Courts is to decide the cases in consonance with legislative intention of the Parliament ". One could possibly draw a parallel here in as much as, in the latest attempt of the Parliament to deem 'renting' as a service. As we know, the concept of 'deemed service' has already come into the service tax statute, in terms of the amendments incorporated to the 'Construction of Complex' services, in the Finance Act, 2010.

There is little doubt that the decisions of the Delhi and the AP High Courts, have, once again, set the ball of litigation rolling, in so far as the levy of service tax on renting is concerned. We could now see fresh writs being filed before the various other High Courts and it is good times for Advocates and Consultants.

Before parting….

I would believe that the Courts could grant stay only on the retrospective amendment brought about by the Government, and not on the prospective applicability of the statutory provisions, as rightly held by the AP High Court in the Trent Limited case. Moreover, stay orders could get issued only in cases involving the levy of service tax on the activity of renting, without additional services being provided by the Developers/Lessors/landlords.

Developers/Landlords/Lessors would be well advised to appreciate that the constitutional validity of the levy of service tax on commercial rentals has not been touched upon either by the Delhi High Court or the AP High Court. The High Courts have only a stay on the recovery of the service tax by the Department and the service tax along with the mandatory interest @ 13% would become payable once the stay is lifted. Of course, in my view, the Department cannot impose penalties, as the matter is sub-judice .

In so far as the Developers/Landlords/Lessors are concerned, they should bear in mind that, without a specific stay from their jurisdictional High Courts, in terms of a writ to which they are made parties, they cannot withhold payment of service tax, irrespective of whether their tenants pay service tax or not. Developers/Landlords/Lessors would be well advised to ensure that their rental contracts or agreements with their tenants clearly provide for service tax to be collected from such tenants.

At the cost of repetition, I would reiterate that the decision of the Delhi High Court, in the first Home Solutions case, rendered in 2009, it had been categorically held that when additional services like air-conditioning are provided along with renting, service tax is attracted. Hence, a distinction would need to be made between cases involving renting of the bare shells as the only activity and providing of additional services to the tenants along with renting of the bare shells. In the latter case, there is no question of the service tax liability being denied, while in the first case, the stay given by the Delhi High Court is applicable to properties situated within its jurisdiction.

It is interesting to know that, the entire litigation on the subject matter is being driven by the big players in the retail sector, where the landlords/lessors/developers follow the normal practice of letting out only the bare shell/building, with the fitouts and other accessories being handled by the retailers themselves. In sheer contrast, in the case of commercial and industrial complexes, developers and lessors provide premises with additional facilities like fitouts, air-conditioning etc. I have not come across software companies and other industrial companies refusing to pay service tax on rentals.

With a statutory retrospective amendment in place, I for one, would strongly believe that, ultimately, the Courts would have no choice but to uphold the levy of service tax on commercial renting with effect from June 1, 2007.

I would presume that, once the GST comes into force, most of the issues concerning the levy of service tax on rentals would die a natural death, as all commercial activities including, or of course, renting, would come into the net. Even the retail sector would get comprehensively covered under VAT. Much of the current problems arise due to the fact that the retail players will not be able to avail of cenvat credit, on the service tax paid by them on rentals, as they don't render any output services. This would change under GST, as aforesaid. The GST should then, be the solution for the issues concerning the service tax levy on commercial rentals.