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NEWSALERT

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BOMBAY HIGH COURT UPHOLDS VALIDITY OF SERVICE TAX ON RENTS RECEIVED

The Division Bench (D.Y. Chandrachud and A.V.Mohta, JJ.) of the Bombay High Court has in the case of *Retailers Association v. Union of India*, upheld the constitutional validity of service tax on renting of immovable property.

Brief Facts:

In 1994, the Parliament legislated to provide for the imposition of a service tax decided to levy a tax of 12% "of the value of taxable services". The term "Taxable services" defined under Section 65 includes sub clause (zzzz) under Clause 105, which was initially inserted by the Finance Act of 2007 with effect from 1 June 2007. Sub- clause (zzzz) defined taxable service as "any service provided or to be provided": "to any person, by any other person in relation to renting of immovable property for use in the course or furtherance of business or commerce."

A notification was issued on 22 May 2007 which was followed by a circular dated 4 January 2008 of the Ministry of Finance in the Union Government. The legality of the notification and of the circular was questioned in proceedings before the Delhi High Court. It was contended that as a result of an erroneous interpretation of the provisions of Section 65(105)(zzzz) and of Section 65(90)(a), service tax was sought to be levied on the renting of immovable property as opposed to the levy of service tax on a service provided "in relation to renting of immovable property". This issue was decided by a Division Bench of the Delhi High Court in ***Home Solution Retail India Ltd. vs. Union of India*** on 18 April 2009. The Court held that service tax was a value added tax and there was no value addition which could be discerned from the renting of immovable property for use in the course or furtherance of business.

The view of the Delhi High Court was that Section 65(105)(zzzz) does not make renting out of immovable property eligible to service tax. The Division Bench noted that it was not examining the plea in challenge to the legislative competence of Parliament in the context of Entry 49 of List II of the Seventh Schedule to the Constitution.

Following the decision of the Delhi High Court, the Finance Act, 2010 substituted the provisions of sub clause (zzzz) with retrospective effect from 1 June 2007. As amended, the provision now stipulates that the expression taxable service means any service provided or to be provided: "To any person, by any other person, by renting of immovable property or any other service in relation to such renting, for use in the course or for furtherance of, business or commerce."

Issues Raised:

(i) The impugned levy falls under Entry 49, List II, and was outside the legislative competence of Parliament

(ii) Service Tax can be levied only if there is an element of service involved and hence renting of immovable property cannot attract service tax as no element of service is involved

(iii) Retrospective levy of the tax with effect from June 1, 2007 was unconstitutional

Decision of the Hon'ble Court:

(i) After deliberations, the Hon'ble Court noted that a tax on lands and buildings is a tax on the general ownership of lands and buildings. For a tax to fall under Entry 49 of List II, the tax must be one directly on lands and buildings. Though the tax levy is measured based on the rental income but that does not mean that the tax is on the very land. Hence a tax which is levied on the income which is received from lands or buildings is not a tax on lands or buildings

(ii) Next, turning to the argument that there is no "service" involved in mere renting, the Hon'ble Court held that when Parliament legislates on a matter, it is open to Parliament to make assessments of fact on the basis of which legislation can be drafted. In a comment of far reaching constitutional significance the Hon'ble Court held, "*an underlying assessment of fact by Parliament on the basis of which a law has been enacted cannot be amenable to judicial review absent a case of manifest arbitrariness.*" The only limitation on the exercise of the power is that the Legislature cannot transgress upon a field of legislation reserved to another legislature. Since the Hon'ble Court saw no transgression into List II, the Court held that there was no question of there being any limitation on the power of Parliament to treat renting as a service

(iii) Coming to the challenge on the basis of retrospectivity, the Hon'ble Court noted that the retrospective amendment was intended to bring out the true intent of Parliament which was behind the enactment of the Finance Act 2007.

> The amendment was intended to remove the basis of Delhi High Court's ruling in *Home Retail*, and was a permissible exercise of legislative power

A Full Bench of the Delhi High Court has already heard a batch of writ petitions challenging the amendment to section 65(105)(zzzz) as made by Finance Act, 2010. Judgment in that case has been reserved and is expected shortly.

In cognizance of the contentious nature of the issue, the Hon'ble Bombay High Court has allowed continued operation of the interim orders granting stay, against coercive action for recovery of tax, for four weeks from the date of the order to enable petitioners to seek remedy in appeal.

This judgment assumes significance as the Court has held that judiciary will not invade the province of law making unless there is blatant arbitrariness or transgression of a field of legislation reserved for another legislature. The decision delivered in Home Retail is pending before the Hon'ble Supreme Court and it remains to be seen if the Hon'ble Court endorses the view expressed by the Bombay High Court.

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