

Part-II-GST on flats allotted to Landowner-Promoter & on development rights in case of Joint Development Agreement is illegal

In Part-I it was stated that the concept of joint venture, the facts, observations and decision of CESTAT in case of Mormugao Port Trust v/s Commissioner of Customs, Central Excise & Service Tax- Goa, dated 07/10/2016 will be described in detail in the next part.

Concept of Joint venture: A joint venture is a combination of two or more persons in a specific venture, where profit is jointly sought without any actual partnership or corporate designation. It is a common enterprise for profits with a joint control over strategic financial and operative decisions. The relation between the co-venturer and joint venture is akin to that of a partner in a partnership firm. The partner contributes into a common pool, resources required for running the joint enterprise. If the venture is successful, the returns that he gets from the same, is his profits and not a consideration, for any specific service rendered. Likewise a co-venturer does not render any service to the joint venture for a consideration.

Facts: Mormugao Port Trust (Mormugao) was rendering Port Services from its own land and was registered with the service tax authorities. Mormugao leased out/rented out the said land to M/s. South West Port Ltd. (SWPL) for the purpose of carrying out the business of providing the service of loading and unloading of cargo to ocean going vessels. SWPL constructed a jetty on the said land for the aforesaid business. Mormugao received license fee and royalty from SWPL. Mormugao paid service tax on the license fee, but not on royalty. The Commissioner of Central Excise, issued the notice to Mormugao, proposing to levy service tax on royalty, under the head of Renting of Immoveable Property services. Mormugao replied to the Notice submitting that service tax cannot be levied, as there was no renting of land. The royalty earned by it was infact its share of revenue from services which were jointly rendered by Mormugao and SWPL. The principal-client relationship which is the basic tenet for applicability of service tax, was not existing between the Mormugao and SWPL. Being not satisfied with the aforesaid submissions, the order was passed to levy service tax. On appeal before CESTAT, Mormugao argued that the impugned order has been passed without appreciating the true nature of agreement existing between the Mormugao and SWPL. The assumption that Mormugao had leased the land and the water front was erroneous and contrary to facts. Infact the arrangement between the Mormugao and SWPL was one where both parties were jointly rendering port services for earning profits. Both the parties were jointly controlling the operations of the two cargo handling berths. The relation between the Mormugao and SWPL was not that of a service provider and service recipient but was that of a co-venturer in a joint venture.

Observation & Judgment: Hon'ble CESTAT observed that the issue to be decided by us is whether the amount received by Mormugao from SWPL, under the nomenclature of royalty, was a consideration for the renting/leasing of the land and the waterfront and accordingly liable to tax under the head of Renting of Immoveable Property services. After going through the licence agreement dated 11-4-1999 between the two parties, we find that the Commissioner was wrong in holding that Mormugao had merely leased out the land and water area to SWPL, and had done nothing else besides that. The agreement shows that

besides leasing out the land and water area to SWPL for which a specific consideration by way of licence fees is charged by Mormugao (this licence fee is not subject matter of dispute in this appeal), Mormugao had also granted a permission to SWPL to conduct port operations. This permission was necessary for SWPL, as the right to exploit the water front by operating a port at Mormugao waterfront was by law, vesting only with Mormugao. Therefore, besides leasing out the land and the water area to SWPL, the other facility/right given to SWPL, is the right to conduct port operations at Mormugao waterfront. As per the licence agreement, licence fee is the consideration agreed for the specific activity of leasing/renting of land and water area. Royalty on the other hand is the reward that Mormugao earns as his share of revenue from a joint port business enterprise run by the two parties in lieu of the various facilities, rights and resources contributed by Mormugao for the joint business. The main contribution of Mormugao, for which it is entitled for Royalty is the grant of permission/licence to carry on business on the water front at Mormugao. This exclusive right to exploit the water front which was available only to Mormugao as per law, was relinquished by Mormugao in favour of the joint venture. In addition to the above contribution, Mormugao was also obliged to do many more things for the smooth running of the port operations. These obligations are such as, providing information about licence premises to SWPL, approval of the provision and maintenance of all general port infrastructure, pilotage and towage on a non-discriminatory basis, overseeing dock-side safety, monitoring air pollution and water pollution at its own cost, compliance of environmental measures, supplying of power and water during construction, assistance for firefighting, obtaining/assisting in obtaining other sanctions and donations, scheduling entry, berthing and sailing of vessels, maintenance, dredging, removal of racks, debris of liquid spillage etc. The arrangement between Mormugao and SWPL is the public-private partnership. In our view this arrangement is in the nature of the joint venture where two parties have got together to carry out a specific economic venture on a revenue sharing model. Such PPP arrangements are common nowadays not only in the port sector but also in various other sectors such as road construction, airport construction, oil and gas exploration where the Government has exclusive privilege of conducting businesses. In all such models, the public entity brings in the resource, over which, it has the exclusive right, whether land, water front or the right to exploit the said land and water front, and the private entities bring in the required resources either capital, or technical expertise necessary for commercial exploitation of the resource belonging to the Government. These PPP arrangements are described sometimes as collaboration, joint venture, consortium, joint undertaking, but regardless of their name or the legal form in which these are conducted. These are arrangements in the nature of partnership with each co-venturer contributing in some resource for the furtherance of the joint business activity. Sometimes, the contracting parties, may conduct such joint venture in the name of a separate legal entity, while at times, such a joint venture is carried out under the individual names of the parties. Such informal arrangements are called by different names either as a consortium, collaboration, joint undertaking, etc. Regardless of the legal form or name that is given to such a Joint Venture, the same are arrangements in the nature of partnership **but without the liabilities being joint and several.**

The meaning of the term joint venture was interpreted by the Supreme Court in the case of *Faqir Chand Gulati v. Uppal Agencies Pvt. Ltd. - (S.C.)* wherein the Apex Court quoted with approval the following extract from the American jurisprudence Second Edition Volume 46 defines Joint Venture to mean that a joint venture is frequently defined as an association of two or more persons formed to carry out a single business enterprise for profit. More specifically, it is in association of persons with intent, by way of contract, express or implied, to engage in and carry out a single business venture for joint profit, for which purpose such persons combine their property, money, effects, skill, and knowledge, without creating a partnership, a corporation or other business entity, pursuant to an agreement that there shall be a community of interest among the parties as to the purpose of the undertaking, and that each joint venture must stand in the relation of principal, as well as agent, as to each of the other coventurers within the general scope of the enterprise. Joint ventures are, in general, governed by the same rules as partnerships. The relations of the parties to a joint venture and the nature of their association are so similar and closely akin to a partnership that their rights, duties, and liabilities are generally tested by rules which are closely analogous to and substantially the same, if not exactly the same as those which govern partnerships. Since the legal consequences of a joint venture are equivalent to those of a partnership, the courts freely apply partnership law to joint ventures when appropriate. In fact, it has been said that the trend in the law has been to blur the distinctions between a partnership and a joint venture, very little law being found applicable to one that does not apply to the other. Thus, the liability for torts of parties to a joint venture agreement is governed by the law applicable to partnerships. A joint venture is to be distinguished from a relationship of independent contractor, the latter being one who, exercising an independent employment, contracts to do work according to his own methods and without being subject to the control of his employer except as to the result of the work, while a joint venture is a special combination of two or more persons where, in some specific venture, a profit is jointly sought without any actual partnership or corporate designation.

An analysis of this judgment shows that in order to constitute a joint venture, the arrangement amongst the parties should be a contractual one, the objective should be to undertake a common enterprise for profit. Joint control over strategic financial and operative decisions was held to be the key feature of a joint venture. The other obvious feature of a joint venture would be that the parties participate in such a venture not as independent contractors but as entrepreneurs desirous to earn profits, the extent whereof may be contingent upon the success of the venture, rather than any fixed fees or consideration for any specific services.

The question that arises for consideration is whether the activity undertaken by a co-venture (partner) for the furtherance of the joint venture (partnership) can be said to be a service rendered by such co-venturer (partner) to the Joint Venture (Partnership). In our view, the answer to this question has to be in the negative inasmuch as whatever the partner does for the furtherance of the business of the partnership, he does so only for advancing his own interest as he has a stake in the success of the venture. There is neither an intention to render a service to the other partners nor is there any consideration fixed as a quid pro quo for any particular service of a partner. All the resources and contribution of a partner enter into a common pool of resource required for running the joint enterprise and if such an enterprise is

successful the partners become entitled to profits as a reward for the risks taken by them for investing their resources in the venture. A contractor-contractee or the principal-client relationship which is an essential element of any taxable service is absent in the relationship amongst the partners/co-venturers or between the co-venturers and joint venture. In such an arrangement of joint venture/partnership, the element of consideration i.e. the quid pro quo for services, which is a necessary ingredient of any taxable service is absent.

In our view, in order to render a transaction liable for service tax, the nexus between the consideration agreed and the service activity to be undertaken should be direct and clear. Unless it can be established that a specific amount has been agreed upon as a quid pro quo for undertaking any particular activity by a partner, it cannot be assumed that there was a consideration agreed upon for any specific activity so as to constitute a service.

In *Cricket Club of India v. Commissioner of Service Tax*, reported in it was held that mere money flow from one person to another cannot be considered as a consideration for a service. The relevant observations of the Tribunal in this regard are extracted below:

Consideration is, undoubtedly, an essential ingredient of all economic transactions and it is certainly consideration that forms the basis for computation of service tax. However, existence of consideration cannot be presumed in every money flow. The factual matrix of the existence of a monetary flow combined with convergence of two entities for such flow cannot be moulded by tax authorities into a taxable event without identifying the specific activity that links the provider to the recipient.

Unless the existence of provision of a service can be established, the question of taxing an attendant monetary transaction will not arise. Contributions for the discharge of liabilities or for meeting common expenses of a group of persons aggregating for identified common objectives will not meet the criteria of taxation under Finance Act, 1994 in the absence of identifiable service that benefits an identified individual or individuals who make the contribution in return for the benefit so derived.

Neither can monetary contribution of the individuals that is not attributable to an identifiable activity be deemed to be a consideration that is liable to be taxed merely because a club or association is the recipient of that contribution.

To the extent that any of these collections are directly attributable to an identified activity, such fees or charges will conform to the charging section for taxability and, to the extent that they are not so attributable, provision of a taxable service cannot be imagined or presumed. Recovery of service tax should hang on that very nail. Each category of fee or charge, therefore, needs to be examined severally to determine whether the payments are indeed recompense for a service before ascertaining whether that identified service is taxable.

We are accordingly of the view that activities undertaken by a partner/co-venturer for the mutual benefit of the partnership/joint venture cannot be regarded as a service rendered by one person to another for consideration and therefore cannot be taxed.

We may mention here that there are situations where a co-venturer or a partner may render a taxable service to the joint venture or the firm. This may happen if, for instance, the partner in

individual capacity enters into a separate contract with the joint venture/partnership for providing a specific service in lieu of a separate specific consideration. Such consideration for specific services provided under an independent contract between a co-venturer/partner and joint venture/partnership can be taxable, as such contracts are executed by the partners not in their capacity of the partners but as independent contractors and such a relationship is governed by a separate contract independent of the partnership/joint venture agreement. To illustrate, a partner in a partnership firm may enter into a separate lease agreement with the firm for renting out his private property to the Partnership firm for a monthly rent. In this situation, the partner will be liable to pay service tax on the renting service rendered by him to the firm. On the other hand, if the partner chooses to grant the firm a right to use his office premises and regards this as his contribution to the hotch-potch of the partnership firm, the reward by way of profits which such partner may earn upon the success of the partnership venture will not be taxable as the profit earned by the partner in such circumstances is not a consideration for the service of renting out the property to the partnership firm. By placing the office at the disposal of the firm to conduct its business the partner agrees to receive only a share of profit which is contingent upon the firm earning profits in the first place. If the venture fails and the firm does not earn any profit, the partner may not receive anything in return for the contribution made by him. On the other hand, if the firms venture is successful, the partner may earn profit which may be much more than the normal rent that he would have earned by simply leasing out the office to the firm for a fixed rent. The profits which the partner will earn in such circumstances is a reward due to an entrepreneur for the risk that he takes and cannot be regarded as a consideration for the renting of the office to the firm.

The Commissioner has tried to support his conclusion to levy tax on Royalty by citing Mormugao's own action of paying service tax on Royalty after April, 2012 when the negative list regime of taxation was introduced. Since there is no estoppels in law, we find this aspect to be totally irrelevant for deciding Mormugao's liability for the past period. In any case, we find that under the negative list regime the most significant change having a bearing on the issue in hand is the insertion of explanation (iii) in the definition of service in Section 65B(44). The said explanation (iii) reads as under:

Explanation 3. - For the purposes of this Chapter, -(a)an unincorporated association or a body of persons, as the case may be, and a member thereof shall be treated as distinct persons; (b)an establishment of a person in the taxable territory and any of his other establishment in a non-taxable territory shall be treated as establishments of distinct persons. In our view all that the explanation stipulates is that an unincorporated association or a body of persons and members thereof, shall be treated as distinct persons. This explanation in our view does not have the effect of rendering the activities undertaken by the partner/co-venturer, which are actually for his own benefit, as being a service rendered by it to the partnership (joint venture). What the partner/co-venturer does is for his own benefit cannot ipso facto be considered as a service rendered to the partnership (joint venture). The mere fact that the partnership (joint venture) may also benefit from the same is irrelevant as there is no contract of service agreed upon or performed by the partner (co-venturer) to the partnership (joint venture). Additionally, there is no consideration agreed upon or provided. In the absence of

there being a quid pro quo the essential requirement of the definition of service is not met with.

The learned AR for the Revenue disputed the contention with regard to the enterprise being a joint venture and Mormugao being a joint venture partner on the ground that the agreement between the two entities in Clause 15.3 states that the duties, obligation and liabilities of the parties under the agreement are intended to be several and not joint or collective and that nothing contained in the agreement shall be construed to create an association, trust, partnership, agency or a joint venture amongst the parties. It has also been contended that there being no sharing of losses provided for, enterprise could not be called a joint enterprise.

In our view none of the two reasons urged by the learned Counsel for the Revenue would lead us to a conclusion that the arrangement between the two was not that of a Joint venture. The true nature of parties relationship has to be decided keeping in view the totality of the agreement by reading the agreement as a whole and not by reading one clause in isolation. If the agreement is read as a whole, it clearly comes out that Mormugao and SWPL were jointly undertaking a common enterprise, the revenue of which was shared between the two. Insofar as the other argument of the revenue that non-sharing of losses militates against the principle of partnership being canvassed by the Mormugao is concerned, firstly the broad principle of partnership of law applies to a transaction between co-venturer and joint venture and not the entire Partnership Act per se. Secondly, even under the Partnership Act there is no stipulation that the partners must necessarily share losses. Infact the Honble Bombay High Court in the case of Raghunandan Nanu Kothare v. Hormasji Bezonji Bamji (1927) 29 BOMLR 207 have categorically held that it is not essential to constitute a partnership that a partner should share the losses. In any case in a joint venture of the present type where jointly controlled operations are being undertaken and one of the venturer brings in the land and the water front and the right to exploit such water front as his contribution while the other venturer brings in money to create infrastructure on the same as his capital, each of the partners is responsible/liable for loss of his capital in case the venture is not successful. Had the Mormugao chosen to give right in the land and the water front by way of auctioning the same, they could have gained substantial fixed amount, irrespective of revenue loss to the person who takes the right under auction. If the venture goes into loss the co-venturer who invested money will loose his money, at the same time the Mormugao will also not get anything being the consideration of the Mormugao is a share in the earning of the joint venture, that way the Mormugao is the looser of intrinsic auction value. Therefore, as per the present arrangement of joint venture, though there is clause that the Mormugao will not share the revenue loss of the business of the joint venture but in fact, they are otherwise the looser of the deemed auction amount, in case of auction which the Mormugao could have opted instead of joint business venture. Therefore, in the present set of arrangement also, it is not correct to say that the Mormugao is not sharing the loss.

We are accordingly of the view that there is no service that has been rendered by Mormugao, much less the taxable service of renting of immoveable property. The money flow to the Mormugao from SWPL, under the nomenclature of Royalty, is not a consideration for

rendition of any services but infact represents the Mormugao's share of revenue arising out of the Joint Venture being carried on by Mormugao and SWPL. Consequently, the appeal is allowed.

Summing up: The GST Act being new, many tax payers and professionals are not ready to take the risk. As a result, there is a rising tendency of the tax payers to assume (i) as something is received, it must be against a supply and (ii) as something is supplied, it must be for a consideration. As the aforesaid judgment is helpful to do away the aforesaid assumptions, I have reproduced, almost the entire judgment. I am of the firm view that any enactment cannot evolve, unless every illegal provision is challenged by someone; may be, after payment of tax under protest. I am the supporter of automation systems for the purpose of filing returns etc. but any illegal provision in the law should not be allowed to be settled automatically, by inaction of the taxpayers.

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