

Can MVAT liability determination be 'fair' on basis of "Fair Market Price"?

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The concept of Fair Market Price (FMP) has been recently introduced under the Maharashtra Value Added Tax Act, 2002 ("the MVAT Act") so as to confer the power on the Commissioner to determine the tax liability of a dealer, for a prescribed class of dealers, on the basis of the fair market price (FMP) for a commodity, purchased or sold below the prescribed FMP, resulting in payment of tax less than the tax which would have otherwise become payable.

While experts and legal luminaries on sales tax law in the State of Maharashtra are still evaluating the prudence of the State legislature in introducing this basis for checking tax evasion, it will be worth the effort to examine whether introducing such a concept for determination of tax liability can indeed pass

judicial scrutiny as well as reap the benefits that the State Government hopes for. This piece intends to achieve just that.

Concept of FMP is not new to Tax jurisprudence in India

Tax laws in India are not alien to the concept of 'Fair Market Value' or FMV. Right from the many decades old Income Tax Act and the Central Excise Act to the more recent Service Tax law and the State VAT laws, the Courts in India have had plenty of occasions to impose adequate checks and balances on the measures to be adopted by Revenue Authorities while arriving at the FMV.

Given that the very idea of imposing an artificial value on a given transaction as against the value agreed between the buyer and seller for the transfer of property militates against the fundamental principles of taxation in a free market economy, the Courts in India generally and the Supreme Court in particular have very often intervened to lay down an acceptable basis for measuring the FMV in a given transaction.

Under Income Tax law

Under the Indian Income Tax Act, the FMV concept is associated with determination of tax liability in transactions concerning immovable property. However, some of the measures suggested by the Courts in arriving at the FMV are thought provoking and indeed applicable even in the context of sales tax/ VAT laws.

In **CIT vs. Arun Mehra [157 ITR 308]**, it was held that "when the initiation of proceedings depends on the market value of the property, such initiation should not depend on a theoretical calculation of such value. What has to be seen is the market value, in the market and not the value calculated in an abstract manner applying a multiplier with reference to some unknown sale.

Further, in **Joseph Valooran's case [108 ITR 544]** it was held that FMV is linked with the "price" the property would ordinarily fetch in the open market; i.e., the price a willing purchaser would pay to a willing seller for a property, having due regard to its existing condition, existing advantages and its potential possibilities when laid out in its most advantageous manner.

Thus, from the above, it would not be incorrect to infer that the determination of FMV depends on the factors and circumstances of each case and ultimately on the commodity itself, and the surrounding circumstances, advantages and disadvantages, which would govern the factors in the determination of the value (also refer **CIT vs. Panchanan Das [116 ITR 272]**).

Under Central Excise law

Incidentally, the Central Excise Act doesn't mention FMP. Valuation of goods involved in a transaction of purchase and sale between unrelated parties is generally done on the basis of Transaction Value (TV) under the Central Excise Act.

Until July 2000, the concept of 'Normal Price' was in vogue in central excise law. The Fair Market price concept was discussed by the Supreme Court of India in **Ashok Leyland Ltd. vs. Collector of Central Excise, Madras [(2002) 10 SCC 344]**, wherein, it observed that "the Normal Price would be the price at which the goods are sold in the market in the wholesale trade. Generally speaking, the normal price is the one at which goods are sold to the public".

In the said Ashok Leyland case (*supra*), the Court further held: "The price of that commodity will remain the normal price at which those goods are ordinarily sold by the assessee to the public, in other words, the price at which they are sold in the market."

The TV concept was first introduced in July 2000 in Central Excise law. Under the new dispensation on Valuation, TV was always to be accepted in transactions between unrelated parties, where price is the sole consideration for the goods, for the purpose of payment of duty. Thus TV could be discarded and recourse could be taken to the Central Excise (Determination of Value) Rules, 2000 ('Excise Valuation Rules') for determining the assessable value (AV) of the goods only when circumstances so established that price actually paid or payable is not the sole consideration for the goods in respect of sale to unrelated parties.

However, the recent decision by the Supreme Court in Fiat India's case changed the entire discourse on valuation of goods in transactions between unrelated parties under central excise. In **Commissioner of Central Excise, Mumbai Vs. M/s. Fiat India (P) Ltd. & ANR. [2012 (283) ELT 161 (SC) = [TS-3-SC-2012-EXC](#)]**, upholding the stand of the Revenue, the Supreme Court held that if the TV is less than the cost of production of the goods, then it will be open for the Revenue to determine on the basis of evidence whether a particular transaction is one where extra-commercial transaction has entered and if so, TV will not be the AV. In such cases, the AV will have to be arrived at under the Excise Valuation Rules.

In the Fiat India case (*supra*), the Central Excise officers had prima facie found that the wholesale price declared by the assessee is much less than the cost of production and, therefore, they formed a view that the price so declared by Fiat India could not be treated as a normal price for the purpose of quantification of assessable value under Section 4(1)(a) of the Central Excise Act and for levy of excise duty as it would amount to short payment of duty.

However, to undo the potential that the above cited decision in Fiat India's case had to inflict damage on the industry, the law was amended in July 2014, subsequent to this decision of the Apex Court, to incorporate in the Excise Valuation Rules, a proviso under Rule 6, specifically stating that "*where price is not the sole consideration for sale of such excisable goods and they are sold by the assessee at a price less than manufacturing cost and profit and no additional consideration is flowing directly or indirectly from the buyer to such assessee, the value of such goods shall be deemed to be the transaction value*". In other words, post the amendment to Excise Valuation Rules necessitated by the Fiat India judgment, Excise Authorities cannot now take recourse to the Excise Valuation Rules to take the shelter of FMP and demand differential excise duty on goods which have been sold by the assessee to an unrelated buyer at a price that is less than manufacturing cost and no other consideration has flown from the buyer to him.

Under Service Tax law

Even the Service Tax statute (the Finance Act, 1994 read with the Service Tax (Determination of Value) Rules, 2006 ('Service Valuation Rules')) deals with the concept of 'Fair Market Value', though in a very limited way and only in the context of Works Contract Service.

The said concept is imbibed in Rule 2A(ii) of the Service Valuation Rules in so far as it deals with determining the portion of the contract value ("total amount") for purpose of levy of service tax.

It is pertinent to note that neither the Service Valuation Rules nor any Department Circular offer much guidance on how this Fair Market Value needs to be arrived at. This aspect was very obliquely dealt with by the Tribunal in the landmark case of **Bhayana Builders vs. CST, Delhi [2013 (32) S.T.R. 49 (Tri.-LB.) = [TS-140-Tribunal-2013-ST](#)]**.

In the Bhayana Builder case (*supra*), even though the Tribunal was not offered any opportunity to deal with the

issue of how the FMV of goods or services need to be determined, it was vaguely discussed therein that for determination of FMV, the value mentioned in the duty paying documents of such goods should be relied upon, which more or less brought the issue back into the realm of central excise / customs valuation and did not offer much guidance of its own.

Under the VAT laws

It is not uncommon to find the term FMP or 'prevailing market price' in the VAT Statues of most of the States in India. Gujarat has it, Tamil Nadu too, so do Karnataka and Haryana and many others. The intention behind incorporating this concept in the VAT law also appears to be in common – that is, to tax the value, purportedly suppressed at the time of purchase or sale of the goods, as the case may be. However, one doesn't yet find too many instances of disputes between the VAT Dealers and the Commercial Tax Authorities on this issue.

A few disputes which have managed to find their way into the corridors of the State High Courts have been decided and disposed of on other technical grounds and not really on the basis of the legal sanctity of the FMP concept under Sales Tax law. For instance, in **State Of Andhra Pradesh vs Arihant Enterprises [(2008) 11 VST 341 AP]**, which is one of the first reported cases on the topic under the recent VAT laws, the jurisdictional Commercial Tax Officer (CTO) noticed that the turnovers, reported by the respondent-dealer in its returns, were too low and were not matching with the huge quantities of goods the dealer was purchasing and selling, therefore, it was suspected that the dealer was suppressing the values of its purchases and sales by under-invoicing and the values recorded by the dealer in the purchase/sales invoices and books of account are far less than fair market value of the goods. Therefore, the CTO stated to have gathered certain information, and thereafter he felt that there was variation of more than 100 per cent less than the fair market value compared with the sale price recorded in the sale invoices, while the variation was noted at 200 per cent in respect of the fair market value and the purchase prices, and therefore, initiated acquisition proceedings as contemplated under Section 28A of the Andhra Pradesh VAT Act.

The Dealer, in his defence, contended that the VAT Authority did not have the price either with reference to the goods of the Respondent-Dealer nor the Authority had acquired information as to the prices of the respective varieties of goods. When the authority failed to ascertain the sale value of similar goods by any other dealer in the market, the Respondent-Dealer contended that it was impossible for the authority to have come to the conclusion that there is either undervaluation or over valuation, as the case may be, of any of the goods purchased/sold.

The High Court held that the learned Commercial Tax Officer failed to ascertain the fair market price as defined under the Act and instead he not only adopted wrong methods for ascertaining the fair market price but also adopted a different fair market price at different stages.

The Court further held that there were no circumstances for the competent authority to initiate proceedings under Section 28A of the Act. It concurred with the majority view of the Tribunal that categorical findings have been recorded and that the material does not show that the case would attract the provision of Section 28A of the Act.

To conclude...

It is pertinent to understand that the provision under Section 28A of the MVAT Act on the FMP as it is currently worded, makes it mandatory for the State Government to first notify the class of dealers, commodities and corresponding FMP. Thus, prima facie, the way the provision on FMP under the MVAT Act seems to be worded, it does not allow any leeway to the Commissioner to determine the tax liability on the basis of the FMP by resorting to arbitrary or adhoc basis for estimation of the FMP. Therefore, till such time that the jury of experts give their verdict on the legal prudence of introducing this new measure for valuation of goods under the MVAT Act, in this author's humble view, the provision has minimal potential to cause indiscriminate damage to innocent dealers.

At best, the new provision on FMP can be seen as another tool in the hands of the State Government to garner more funds to the Government kitty to salvage the beleaguered economy of drought affected State.