CASE NO.:
Appeal (civil) 684 of 2003

PETITIONER:
Municipal Committee, Patiala

RESPONDENT:
Model Town Residents Asson. & Ors

DATE OF JUDGMENT: 01/08/2007

BENCH:
S. H. Kapadia

JUDGMENT:

J U D G M E N T

with
Civil Appeal Nos. 685/2003, 686/2003, 687/2003, 690-691/2003, 692/2003, 693-694/2003, 695/2003, 696-698/ 2003, 699/2003, 700-702/2003, 703-704/ 2003, 705-706/2003, 710-711/2003, 712/2003, 713-714/2003, 715-717/2003, 718/2003, 719/ 2003, 721/2003, 722/2003, 724/2003, 727-728/2003, 730/2003, 732/2003, 735/2003, 736/2003, 737/2003, 738/ 2003, 740-744/2003, 757/2003, 758/2003, 759/2003, 760/2003, 761/2003, 762/2003, 763/2003, 764/2003, 765/2003, 766/2003, 767/2003, 768-774/2003, 781/2003, 782/2003, 790/2003, 791/2003, 792/2003, 793/2003, 795/2003, 796/2003, 797/2003, 798/2003, 799/2003, 800/2003, 801/2003, 802/2003, 803/2003, 804/2003, 805/2003, 806/2003, 807-808/2003, 825-828/2003, 1425-1433/2003, 4616-4618/2003, 8426/2003, 4329/2004, and
Civil Appeal No. 3387 @ SLP(C) No. 13183 of 2003,
Civil Appeal No. 3388 @ SLP(C) No. 13708 of 2003,
Civil Appeal No. 3386 @ SLP(C) No. 14774 of 2003.

KAPADIA, J.

Leave granted.

2. The short point involved in this batch of civil appeals is whether the High Court was right in holding that Section 3(1)(b) which defines "annual value" and Section 3(8aa) which defines "market value" in the Punjab Municipal Act, 1911 ("the said Act") as substituted by Punjab Amending Act 11 of 1994 suffers from the vice of discrimination and, therefore, they are unconstitutional. We have before us a batch of civil appeals. For the sake of convenience, we reproduce hereinbelow the facts in the case of Civil Appeal No. 684/03 in the case of Municipal Committee, Patiala v. Model Town Residents Asson. & Ors..

3. At the outset, we may state that under Section 71(1) of the said Act the State Government has given exemption to the self occupied residential houses from the payment of house tax. Therefore, the grievance is confined to the payment of house tax by self occupied commercial premises.

4. Before examining the grounds of challenge, we quote hereinbelow the unamended Section 3(1) of the said Act:

"3. Definition.- In this act, unless there is something repugnant in the subject or context-

(1) ’annual value’ means-

(a) in the case of land, the gross annual rent at which it

may reasonably be expected to let from year to year.

Provided that in the case of land assessed to land revenue or of which the land revenue has been wholly or in part released, compounded for, redeemed or assigned, the annual value shall if, the State Government so direct, be deemed to be double the aggregate of the following amounts, namely:

(i) The amount of the land revenue for the time being assessed on the land, whether such assessment is leviable or not; or when the land revenue has been wholly or in part compounded for or redeemed, the amount which, but for such composition, or redemption would have been leviable and

(ii) When the improvement of the land due to canal irrigation has been excluded from account in assessing the land revenue the amount of owner's rate or water advantage rate or other rate imposed in respect of such improvement;

(b) In the case of any house or building, the gross annual rent at which such house or building, together with its appurtenances and any furniture that may be let for use or enjoyment forthwith, may reasonably be expected to let from year to year subject to the following deductions;

(i) such deduction not exceeding 20 per cent of the gross annual rent as the committee in each particular case may consider a reasonable allowance on account of the furniture let therewith;

(ii) a deduction of 10 percent for the cost of repairs and for all other expenses necessary to maintain the building in a state to command such gross annual rent. The deduction under sub-clause shall be calculated on the balance of the gross annual rent after the deduction (if any) under Sub-clause (i);

(iii) where the land is let with a building, such deduction not exceeding 20 percent of the gross annual rent, as the committee in each particular case may consider reasonable on account of the actual expenditure, if any, annually incurred by the owner on the upkeep of the land in a state to command such gross annual rent;

Explanation-I- For the purpose of this clause, it is immaterial whether the house or building, and the furniture and the land let for use or enjoyment therewith, are let by the same contract or by different contracts and if by different contracts whether such contracts are made simultaneously or at different times.

Explanation-II.- The term "gross annual value" shall not include any tax payable by the owner in respect of which the owner and tenant have agreed that it shall be paid by the tenant.

(c) in the case of any house or building, the gross annual rent of which cannot be determined under Clause (b), 5 per cent of the sum obtained by adding the estimated present cost of erecting the building, less such amount as the committee may deem reasonable to be

deducted on account of depreciation (if any) to the estimated market value of the site and any land attached to the house or building;

Provided that-

(i) In the calculation of the annual value of any premises no account shall be taken of any machinery thereon.

(ii) when a building is occupied by the owner under such exceptional circumstances as to tender a valuation at 5 per cent on the cost of erecting the building, less depreciation, excessive a lower percentage may be taken." (emphasis supplied)

5. We also quote hereinbelow the substituted Sections 3(1) and 3(8aa) of the said Act by Punjab Amending Act No. 11 of 1994.

"3. Definitions.- In this Act, unless there is something repugnant in the subject or context.-

(1) 'annual value' means-

(a) in the case of land or building which is in the occupation of a tenant, the gross annual rent at which the land or building has actually been let.

Provided that in the event of increase in the rent, the Committee may make corresponding increase in the annual value;

Provided further that where the land or building has been let by he owner to any of his relations and the Committee is of the opinion that the rent fixed does not represent the true rent, the rent fixed under the agreement of lease shall not be taken into consideration and the annual value shall be determined in accordance with the principles contained in Clause (b);

b) in the case of land or building which is occupied by the owner, the annual value shall be five per cent on the sum obtained by adding the present market value of the land and estimated cost of erecting the building less ten per cent depreciation;

Provided that in the calculation of annual value of any land and building, no account shall be taken of the furniture or machinery thereon;

c) in the case of any land on which no building has been erected but on which a building can be erected, and on any land on which a building is in the process of erection, the annual value shall be fixed at five per cent of the estimated market value of such land;

d) in the case of any land on which no building has been erected but on which a building can be erected, or which is partially built and is being used by erecting tenants, temporary structures for the purpose of accommodating marriage parties, circus shows or for any entertainment purposes or such other purpose as may be specified in this behalf by the committee with the previous sanction

of the state government the annual value shall be twenty per cent of the estimated market value of such land.

(emphasis supplied)

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3(8aa) 'market value' means the market value of the land or the building which is determined in accordance with the principles contained in Section 23 of the Land Acquisition Act, 1894, or as determined in accordance with the provisions of the Registration Act, 1908."

6. At this stage, we may state that the validity of the above Punjab Amending Act 11 of 1994 was challenged on two grounds, namely, regarding competency of the State Legislature to impose tax and on the ground of discrimination being violative of Article 14 of the Constitution. Suffice it to state that the petitions of the assessees on the point of competency of the Legislature to impose the tax has been dismissed by the High Court and, therefore, in the present case, we are concerned only with the question as to whether Punjab Amending Act 11 of 1994 makes an arbitrary classification between self occupied residential houses and self occupied commercial houses in the matter of taxation under the said Act. According to the assessees, the said classification between the above two categories was not only discriminatory but it has no rational basis with the object sought to be achieved and, therefore, the above two sub-sections, namely, Section 3(1)(b) and 3(8aa) violated the assessees fundamental rights under Article 14 of the Constitution.

7. According to the assessees, the distinction made between land or building in occupation of the tenant on one hand and the land or building occupied by the owner, for the purposes of determination of annual value, for imposition of house tax, is per se discriminatory and violative of Article 14 of the Constitution. According to the assessees, the classification of land or building with reference to their occupation by the tenant or owner is wholly arbitrary having no nexus with the object of determination of annual value for levy of house tax under the impugned sections. According to the assessees, by virtue of the impugned amended definition of annual value, two properties having similar area, cost and quality of construction and situation will be subjected to house tax at different rates simply because one is occupied by the tenant and the other is occupied by the owner. It is submitted by the assessees that this differentiation has no rational relation with the object of enactment, namely, determination of annual value for levy of house tax. According to the assessees, Section 3(8aa) was also unconstitutional as the Legislature has not indicated any guidelines for determination of the market value in accordance with the principles contained in Section 23 of the Land Acquisition Act, 1894 or in accordance with the provisions of the Registration Act, 1908. According to the assessees, determination of the market value cannot be left to the sweet will of the municipality and in the absence of said guidelines, the said Section 3(8aa) be declared as unconstitutional.

8. The above contentions have been accepted by the High Court, which has struck down Section 3(1)(b) and Section 3(8aa) of the Punjab Municipal Act, 1911, as amended. The short question which requires consideration is whether Section 3(1)(b) and Section 3(8aa) are violative of the rule of equality in the matter of determination of annual value as basis for imposition of house tax.

9. Before examining the question of constitutional validity, we need to take note of certain concepts under municipal taxation. Value is the function of price. Value is the function of the economy. Valuation is subjective exercise. Valuation involves an element of guess work. Valuation does not involve straight-jacket formula. Broadly, the following methods merit attention in the determination of Fair Market Value ("FMV") they are: (a)

net asset method; (b) multiple based method; and (c) discounted cash-flow method. The word "rate" has acquired a special meaning. It means a tax for local purposes imposed by local authorities. The basis of the tax is the annual value of the land or building on which it is imposed. The annual value is arrived at by three ways, namely, (i) actual rent fetched by the land or building where it is actually let; (ii) where it is not let, rent based on hypothetical tenancy, particularly in the case of buildings; and (iii) where either of these two methods is not available, by valuation based on capital value from which annual value has to be derived by applying a suitable percentage which may not be the same for lands and buildings.

10. In the case of Patel Gordhandas Hargovindas v. Municipal Commissioner, Ahmedabad reported in 1964 (2) SCR 608 the Constitutional Bench of this Court took the view that there was no authority for the proposition that the word "rate" indicated a levy on the basis only of annual value of property. In our country, the words "tax" and "rates" have been used by the Legislatures to indicate the impost and in some cases the Legislature has permitted a local authority to levy "property tax" at a percentage of its (land and building) capital value. In the said judgment, the Constitutional Bench of this Court has held that there were three methods for arriving at rateable value. Where the land or building was actually let, the valuation based on the rent actually charged is the proponent. Where land or building is not let, then there were two methods for finding out the rateable value. The first was to assume a hypothetical tenancy and to find out the rent at which the premises would be let. The second was based on capital value of the premises. However, in the second case the tax is not levied on the capital value itself, the capital value of the house to be assessed by contractors method, in addition to the market value of the land. This second method has been accepted as constitutionally valid in the above decision of this Court in the case of Patel Gordhandas (supra). It is this second method which has been introduced in the Punjab Municipal Act, 1911 by insertion of Punjab Amending Act 11 of 1994. Therefore, the word "rate" has always been construed to mean a tax on the annual value or rateable value of lands or buildings and it is this annual value or rateable value which is arrived at by one of the modes indicated above.

11. Applying the above tests to the present case, we find that prior to the Amending Act of 1994, annual value was defined to mean the gross annual rent at which the house or building could be let from year to year subject to statutory deductions [see unamended Section 3(1)(b)]. Therefore, under the unamended section the tenanted as well as self-occupied premises stood equated in the matter of determination of the gross annual rent. However, even under the unamended Act, vide Section 3(1)(c) it was stipulated that if in a given case it was not possible for the municipality to determine the gross annual rent, then, 5% of the total sum obtained by adding the estimated present cost of construction, less such amount as the Committee may deem fit to be deducted on account of depreciation to the estimated market value of the land (site). Therefore, even under the unamended section, in marginal cases, it was open to the municipality to fix the annual value at 5% of the sum obtained by adding the cost of construction to the market value of the land. It appears that on account of increase in the market price of the land in question that the State Legislature amended Section 3(1) by Punjab Amending Act 11 of 1994 by which it had been stipulated vide Section 3(1)(b) that in cases where land or building is self occupied, the annual value shall be 5% of the sum obtained by adding the present market value of the land and the estimated cost of construction less 10% deduction on account of depreciation. By the said amendment it had been laid down under Section 3(8aa) that the word "market value" of the land or building shall be determined in accordance with the principles in Section 23 of the Land Acquisition Act, 1894 or in accordance with the provisions of the Registration Act, 1908.

12. Analysing the unamended and amended Section 3(1)(b) of the said Act, we are of the view that the Legislature has given a great amount of leeway in the matter of taxation. Article 14 does not prohibit classification. As stated above, in cases where the property is actually let out and it is

possible to decide the annual value on the basis of actual rent then the annual value is equated to the gross annual rent at which the land or building has actually been let [see Section 3(1)(a) as amended]. The difficulty comes in when the land or building is self occupied by the owner and it is not possible to arrive at the annual value in the absence of actual rent and it is in those cases that the Legislature has prescribed the method of calculating the annual value at 5% on the sum obtained by adding the present market value of the land plus the estimated cost of construction of the building minus 10% as deduction on account of depreciation.

13. It had been vehemently urged on behalf of the assessees that there is no rational basis for making the above classification, particularly when both the premises, whether let out or self occupied, are subject to rent restrictions under the Punjab Rent Act.

14. It is urged on behalf of the municipality that Section 3(1)(b), as amended, makes no distinction between self occupied land or building and tenanted land or building. According to the municipality, after the amendment, the annual value in occupation of the tenant has to be determined on the basis of actual rent which the property would fetch whereas if the same property is in occupation of its owner then the rateable value under the amended provisions shall be calculated by applying the rate of 15% of the 5% of the sum determined in accordance with Section 3(1)(b). For example, if the value of the property is Rs. 10 lacs (which comprises of the market value of the land plus cost of construction of the structure) then the annual value in terms of Section 3(1)(b) shall be Rs. 50,000/- at the rate of 5% of the market value. If the property is a commercial property, then the tax shall be 15% of Rs.50,000/- equal to Rs. 7,500/- which comes to .75% of the value (Rs. 10 lacs). At this stage, it may be stated that residential property is exempted from tax, therefore, we are not required to go into those figures. Essentially, in this case we are concerned with commercial property. It is the tax on the scarce resources, mainly the land whose prices are escalating, which provides an intelligible differentia (rational basis) having requisite connection with the object sought to be achieved. There cannot be a straight-jacket formula for determination of the annual value. The State is always entitled to raise resources by way of imposition of tax. As held in the case of Patel Gordhandas (supra) cost of construction plus market value of the land thus constituted the very basis for determination of the annual value, where it is not possible to obtain figures concerning actual rent or hypothetical rent, it is in these circumstances that the cost of construction plus the market value of the land can form the basis for arriving at the annual value.

15. In our view, the classification made between premises occupied by tenants on one hand and those occupied by the owner himself is wholly reasonable and has direct nexus with the object sought to be achieved. In our view, properties occupied by the tenants and properties which are self occupied constitute two separate classes. The amount of tax on the capital value has been recognized valid by this Court in the judgment of Patel Gordhandas (supra). Even according to the municipality the rent actually paid by the tenant does form the basis for assessment of house tax, however, the necessity to amend the Act arose with the growing demand of citizens for modern basic amenities. The data indicates that the increase in the house tax every five year was negligible. The commercial properties earned higher returns. Therefore, it was decided to amend the law by taking into account the present market value of the land and the initial investment made by the owner when he constructed the house. Moreover, under Section 68 of the Act, once the annual value is decided in terms of the amended definition then the same shall be valid for five years and on expiry of five years, the annual value is required to be decided as per the wishes of the owner, who may either opt for the method indicated in Section 3(1)(b) or by increasing it by 10% of the annual value already fixed. On the other hand, in cases where premises are in occupation of the tenant then as per Section 68 of the Act, the formula to revise the annual value has a direct nexus with the rent revision, if any. In the circumstances, the High Court had erred in holding

that the amended Section 3(1)(b) made an invidious discrimination/distinction between premises in occupation of the tenant and premises which are self occupied.

16. In the present case, the High Court has further held that Section 3(8aa) was ultra vires and unconstitutional for want of guidelines which gives wide powers to the officers in the matter of fixing annual value. This finding of the High Court is equally erroneous. Under the amended Section 3(1)(b), as stated above, a formula has been evolved by which in the case of self occupied premises the tax has to be imposed on annual value calculated on the basis of the present market value of the land plus the cost of construction minus 10% deduction on account of depreciation. Section 3(8aa) states that while estimating the present market value of the land the Assessing Officer ("A.O.") will keep in mind the principles mentioned in the Land Acquisition Act, 1894 whereas under the above formula, the A.O. will keep the registered sale instances of buildings before him in order to compare the cost of construction of houses in the same locality, area etc. When it comes to land, the A.O. will gather the market value dependant on the sale instances in the surrounding areas. He will keep in mind the principles of Land Acquisition Act, 1894 for arriving at the market value of the land. On the other hand, under the above formula, which is the composite formula, the A.O. has to take into account the cost of construction. This is because the building might have been constructed ten years ago. In such cases, the A.O. shall keep in mind the cost of construction prevailing in the area when the house was constructed. For such an exercise, the A.O. has to refer to the instances mentioned to properties registered under the Registration Act. As stated above, there is no straight-jacket formula in matters of valuation. Therefore, leeway has to be given to the A.O. for arriving at the market value of the land and the cost of construction by applying apposite principles under the Land Acquisition Act qua the land and by proceeding to arrive at the cost of construction of the houses by invoking the instances of registration on transfer of houses under the Registration Act. Therefore, in our view, the High Court had erred in striking down Section 3(8aa).

17. The central test for permissible classification has to satisfy two conditions. It must be founded on an intelligible differentia which distinguishes persons or premises that are grouped together from others left out of the groups and the differentia must have a rational relation to the object sought to be achieved by the Act in question. A law based on a permissible classification fulfils the guarantee of the equal protection of the laws and is valid whereas a law based on an impermissible classification violates the guarantee and is void. Equality is violated by treating persons similarly situated differently. In the present case, as stated above, that is not the case. If a law deals equally with members of a well defined class, it is not open to challenge such a law on the ground of denial of equal protection. In order to sustain the presumption of constitutionality, the court can take into consideration matters of common knowledge and, at the same time, the court must presume that the Legislature understands and correctly appreciates the need of its own people. In the present case, the Legislature seems to have taken cognizance of the fact that the land prices have been increasing which remains excluded from the composite valuation of an asset, namely, land or building which is self occupied and for which there is no measurable, identifiable and quantifiable data of actual or hypothetical rent.

18. For the aforestated reasons, we uphold the validity of the aforesaid impugned Section 3(1)(b) and Section 3(8aa) of the Punjab Municipal Act, 1911, as amended.

19. On behalf of the assessees, a number of judgments of this Court were cited in the matter of fixation of standard rent. In our opinion, the said citations are not relevant. In this case we are concerned with constitutional validity of the impugned Sections 3(1)(b) and 3(8aa). In the present case, we have held that it is open to the Legislature to introduce the composite scheme for determination of annual value based on cost of construction plus market value of the land, therefore, the judgments of this Court in the matter

of fixation of standard rent has no relevance.

20. Before concluding, we have serious objections to the manner in which direction has been given by the Division Bench of the High Court to the Legislature. In this connection, we quote the last paragraph of the impugned judgment, which is as follows:

"\005 Sections 3(1)(b) and 3(8aa) of the Act are declared unconstitutional and struck down\005. The State shall be free to suitably amend Section 3(1) to provide for levy of house tax by adopting a uniform criteria for determination of annual value of similarly situated properties. The State shall also be free to amend Section 3(1) and lay down a uniform criteria for determination of annual value of properties occupied by the tenants as well as the owners in the light of the judgment of the Supreme Court in Sachidanand Kishore Prasad Sinha's case [(1995)3 SCC 86] and observations made in this order. It is, however, made clear that any such enactment shall not effect the assessments made prior to the amendment of section 3 by Punjab Act No. 11 of 1994 and the old cases, if any pending shall be decided in accordance with the unamended provision\005" (emphasis supplied)

21. In the above judgment, the High Court directs the State Legislature to amend the law relating to determination of annual value by classifying that any such amendment shall not be retrospective. We have serious reservations regarding such a direction. It is not open to the High Court under Article 226 of the Constitution, particularly in the matter of taxation directing it not to amend the law retrospectively. Such a direction is unsustainable, particularly in a taxing statute. It is always open to the State Legislature, particularly in tax matters, to enact validation laws which apply retrospectively. The High Court cannot take away the power of the State Legislature to amend the tax law retrospectively. The basis of the law can always be altered retrospectively.

22. For the aforestated reasons we set aside the impugned judgment. We declare the aforestated Section 3(1)(b) and Section 3(8aa) as valid. Accordingly, we uphold the validity of the said sections. Since we have upheld the validity of the aforestated impugned sections we make it clear that all pending disputed assessments and appeals therefrom shall be decided in accordance with the provisions of Punjab Municipal Act, 1911, as amended. The civil appeals filed by Patiala Municipal Committee as well as the State Government are allowed with no order as to costs.