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## JVs in construction

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It is a common practice in the construction industry for the landowners and the builder / developers to enter into a joint venture agreement and the total constructed area would be shared between the land owners and builder / developers in agreed proportion. For example, if 20 flats are to be constructed in a land, the landowner on the one hand and the builder / developer on the other hand, may agree to retain 10 flats each for them. The builder / developer can sell his portion of 10 flats to individual buyers. While selling so, the Undivided Share of land pertaining to these 10 flats would first be sold and construction agreement would be entered into with the buyers. Or in some States, an agreement to sell would be entered first and then the flat would be registered in the name of the buyer for the whole value. It may be noted that when the builder / developer thus sells his portion of 10 flats to individual buyers, the amount attributable to the value of UDS land sold to the buyer, actually belong to the landowner as he is only the owner of the land. But, the builder / developer is allowed to retain this sum, in consideration of constructing and handing over 10 flats to the landowner. The landowner may deal with his 10 flats in whatever manner he wants. Let us assume that the builder / developer is selling his portion of the flats at Rs.50 lakhs, out of which Rs.10 lakhs is towards sale of UDS and Rs.40 lakhs is towards construction cost. In the normal course, the builder / developer would be liable to pay service tax on Rs. 40 lakhs for the services provided to the buyers.

The next question is whether the builder / developer is providing any service to the landowner when he constructs and hand over 10 flats to the land owner. Though it is being argued that this is a business venture for share of profits in the form of constructed area, and there is no relation of service provider and service recipient relationship between the builder / developer and landowner, by and large, the builder / developer is liable to pay service tax for the 10 flats handed over to the landlord. But, it may be observed that the landowner will not be making any payment to the builder / developer, for constructing this 10 flats. Instead, the builder / developer can sell the UDS portion pertaining to his share of 10 flats (Rs. 10 lakhs X 10 flats) and retain the same. Such sale will happen over a period of time, as and when the builder / developer is identifying buyers for his share of 10 flats. Hence, the consideration for constructing 10 flats for the landowner is not readily ascertainable and recourse has to be made to Rule 3 of the Service Tax (Determination of Value) Rules, 2006. The following questions are normally raised in this regard.

- (i) What is the value to be adopted for the construction of 10 flats for the landowner?
- (ii) When service tax has to be paid for the said 10 flats handed over to the landowner?

Normally, the department adopts the value charged by the builder / developer to his share of buyers towards construction, as the value for the purpose of flats being handed over to the landowner also. From the example, the value of Rs.40 lakhs per flat will be adopted for the 10

flats handed over to the landlord also. As and when the builder / developer is receiving money from his sale of his share of the flats, corresponding demands were also being made towards the 10 flats meant for landowners. In this connection, reference can also be drawn to CBEC's circular 151/2/2012 Dt. 10.02.2012, wherein it has been clarified as below, with regard to valuation:

Value, in the case of flats given to first category of service receiver (landowner), is determinable in terms of section 67(1)(iii) read with rule 3(a) of Service Tax (Determination of Value) Rules, 2006, as the consideration for these flats i.e., value of land/development rights in the land may not be ascertainable ordinarily. Accordingly, the value of these flats would be equal to the value of similar flats charged by the builder/developer from the second category of service receivers. In case the prices of flats/houses undergo a change over the period of sale (from the first sale of flat/house in the residential complex to the last sale of the flat/house), the value of similar flats as are sold nearer to the date on which land is being made available for construction should be used for arriving at the value for the purpose of tax. Service tax is liable to be paid by the builder/developer on the 'construction service' involved in the flats to be given to the land owner, at the time when the possession or right in the property of the said flats are transferred to the land owner by entering into a conveyance deed or similar instrument (eg. allotment letter).

Two issues have been clarified in the above circular, viz. (i) value of service provided to landowner shall be based on comparable value of service provided to other buyers; (ii) Service tax for services rendered to landowner has to be paid when the flats are handed over to the landowner.

It was always being argued when the builder / developer is getting the right to develop and sell his share of UDS immediately on entering into of the Joint Development agreement, when no sale to individual buyers would have happened, it would be more appropriate to treat the value of UDS portion of land pertaining to the builder/ developer's share of 10 flats, on the date of Joint Development agreement as the value of services provided to the landowner. In other words, the value of service provided to the landowner in the above example should be Rs. 10 lakhs X 10 flats and not Rs.40 lakhs X 10 flats.

Now, the guidance note issued in the context of negative list seems to have accepted this argument. To quote from para 6.2.1,

**6.2.1 What would be the liability to pay service tax on flats/houses agreed to be given by builder/developer to the land owner towards the land /development rights and to other buyers. If payable, how would the services be valued?**

Here two important transactions are identifiable: (a) sale of land by the landowner which is not a taxable service; and (b) construction service provided by the builder/developer. The builder/developer receives consideration for the construction service provided by him, from two categories of service receivers: (a) from landowner: in the form of land/development rights; and (b) from other buyers: normally in cash.

Construction service provided by the builder/developer is taxable in case any part of the payment/development rights of the land was received by the builder/ developer before the issuance of completion certificate and the service tax would be required to be paid by builder/developers even for the flats given to the land owner.

**Value, in the case of flats given to first category of service receiver will be the value of the land when the same is transferred and the point of taxation will also be determined accordingly.**

The following probable conclusions can be drawn in this connection.

**Conclusion I.** As per the above, the value on which service tax is payable for the flats handed over the landowner would be the value of land transferred to the builder towards the builder / developer's share of flats at the time of such transfer. It may be noted that the land will not be registered in the name of the builder / developer and he will only be the given the right to develop and sell by the Joint Development agreement. If the "transfer" contemplated above is such transfer then the value prevalent on the date of giving such development right to the builder / developer (guideline value) will be the value and service tax also has to be paid immediately on receipt of such right, i.e. date of entering into the development agreement. In the given example if the value of UDS portion of land pertaining to 10 flats belonging to the builder / developer, on the date of Joint Development agreement is Rs.50 lakhs, service tax has to be paid by the builder / developer immediately on Rs.50 lakhs. Further it may also be noted that on the date of such transfer no individual buyer would have been identified and no comparable construction value would be available.

**Conclusion II.** As the land will not be transferred in the name of the builder / developer, he is not at all receiving any consideration on signing of the Joint Development agreement. He would be receiving money only when his portion of UDS is sold to the buyers. So as and when he sells his portion of 10 flats, he would be pay service tax both on value attributable to UDS portion (treating it as consideration for the services provided to the land owner and also on the value attributable to construction cost (treating it as the consideration for the services provided to the buyers). In the above given example, he would pay service tax on the entire Rs.50 lakhs received from the buyers as and when the same is received, on Rs. 10 lakhs X 10 flats as consideration for the services provided to the landowners and on Rs.40 lakhs X 10 flats as consideration for the services provided to the buyers.

There may be another situation. Instead of taking possession of the 10 flats, the landowner may ask the builder / developer to sell those flats also and remit the proceeds to him. In such case, the builder / developer would be selling all the 20 flats by selling UDS portion of land and entering into construction agreement (assuming for Rs.10 lakhs and Rs.40 lakhs respectively). The proceeds in respect of builder / developer's share of 10 flats would be retained by him and the proceeds in respect of the landowners share of 10 flats would be remitted to the landowner. In such case, he is providing services only to the buyers and not to the landowner. The builder / developer would be paying service tax on Rs.40 lakhs X 20 flats as and when they are sold / amounts received.

