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Negative Blues – XIV

Never ending woes of construction industry

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History: Service tax was imposed on construction of residential complexes from 16.06.2005. Broadly, there are two models followed in the industry.

Model - I. The landowner / builder would first sell the undivided share of land (UDS) to the prospective buyer, by executing a sale deed, thus making the flat buyer as the owner of the land. Then a construction agreement would be entered into between the builder and the flat buyer. In this case, the builder is apparently providing a service and would prima facie be liable to pay service tax (without going into any other defences).

Model II: An agreement to sell a flat would be entered into between the builder and flat buyer and against the same various installments of money would be paid by the flat buyer to the builder. After completion of construction, the entire flat would be sold to the flat buyer, through a sale deed. This is a transaction of sale of immovable property and hence could not be subjected to service tax.

This position has also been conceded by the CBEC in its circular 108/2/2009 Dated 29.01.2009, though such clarification has created lot of confusion in the field as to the liability under Model – I also. To quote,

Generally, the initial agreement between the promoters/builders/developers and the ultimate owner is in the nature of 'agreement to sell'. Such a case, as per the provisions of the Transfer of Property Act, does not by itself create any interest in or charge on such property. The property remains under the ownership of the seller (in the instant case, the promoters/builders/developers). It is only after the completion of the construction and full payment of the agreed sum that a sale deed is executed and only then the ownership of the property gets transferred to the ultimate owner. Therefore, any service provided by such seller in connection with the construction of residential complex till the execution of such sale deed would be in the nature of 'self-service' and consequently would not attract service tax.

The existence of these two models thus created disparity in the matter of transaction. Hence, the following Explanation was inserted in Section 65 (105) (zzzh) – dealing with taxable service of construction of complex, with effect from 1st July 2010.

Explanation. — For the purposes of this sub-clause, construction of a complex which is intended for sale, wholly or partly, by a builder or any person authorised by the builder before, during or

after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer.

The purpose of introducing the said Explanation has also been explained in CBEC's letter F.No. 334/1/2010 Dt. 26.02.2010.

8. Service tax on construction services

8.1 The service tax on construction of commercial or industrial construction services was introduced in 2004 and that on construction of complex was introduced in 2005.

8.2 As regards payment made by the prospective buyers/flat owners, in few cases the entire consideration is paid after the residential complex has been fully developed. This is in the nature of outright sale of the immovable property and admittedly no Service tax is chargeable on such transfer. However, in most cases, the prospective buyer books a flat before its construction commencement/completion, pays the consideration in installments and takes possession of the property when the entire consideration is paid and the construction is over.

8.3 In some cases the initial transaction between the buyer and the builder is done through an instrument called 'Agreement to Sell'. At that stage neither the full consideration is paid nor is there any transfer in ownership of the property although an agreement to ultimately sell the property under settled terms is signed. In other words, the builder continues to remain the legal owner of the property. At the conclusion of the contract and completion of the payments relating thereto, another instrument called 'Sale Deed' is executed on payment of appropriate stamp duty. This instrument represents the legal transfer of property from the promoter to the buyer.

8.4 In other places a different pattern is followed. At the initial stage, instruments are created between the promoter and all the prospective buyers (which may include a person who has provided the vacant land for the construction), known as 'Sale of Undivided Portion of The Land'. This instrument transfers the property right to the buyers though it does not demarcate a part of land, which can be associated with a particular buyer. Since the vacant land has lower value, this system of legal instrumentation has been devised to pay lesser stamp duty. In many cases, an instrument called 'Construction Agreement' is parallel executed under which the obligations of the promoter to get property constructed and that of the buyer to pay the required consideration are incorporated.

8.5 These different patterns of execution, terms of payment and legal formalities have given rise to confusion, disputes and discrimination in terms of Service tax payment.

8.6 In order to achieve the legislative intent and bring in parity in tax treatment, an Explanation is being inserted to provide that unless the entire payment for the property is paid by the prospective buyer or on his behalf after the completion of construction (including its certification by the local authorities), the activity of construction would be deemed to be a taxable service provided by the builder/promoter/developer to the prospective buyer and the Service tax would be charged accordingly. This would only expand the scope of the existing service, which otherwise remain unchanged.

The validity of this Explanation has also been upheld by the Hon'ble High Court of Bombay in the case of Maharashtra Chamber of Housing Industry (2012-TIOL-78-HC-MUM-ST).

Under this model, no separate value would be identified for the UDS land which is also being transferred to the flat buyer. Hence, a higher abatement of 75 % has been introduced with effect from 01.07.2010 by amending Notification 1/2006 ST Dated 01.03.2006, vide Notification 29/2010 ST Dated 22.06.2010. This is subject to a condition that "This exemption shall not apply in cases where the cost of land has been separately recovered from the buyer by the builder or his representative". Further, this Model II cannot fall under works contract also, as it is a transaction of sale of immovable property and no transfer of property in goods is involved in this mode. Hence, it is very clear that this 75 % abatement is intended only for Model II, where separate land value is not available and not for Model I, where separate value is available for land (Though many under Model I also have chosen to claim 75 % abatement by including land value). There was also a 67 % abatement under notification 1/2006, which could apply to Model I cases. But, all these abatements are not relevant if the activity is "works contract", after 01.06.2007 (Though many have been claiming these abatements even after 01.06.2007, even though the activity amounted to works contract).

Now, when the new regime of service tax was introduced with effect from 01.07.2012, the above Explanation under Section 65 (105) (zzzh) finds its place in the Declared service under Section 66 E (b) of the Act, in the following words,

Construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration is received after issuance of completion certificate by the competent authority.

It may be noted here that the above provision goes far beyond the earlier explanation and covers even "construction of a complex, building, civil structure or a part thereof". The erstwhile Explanation is covered by way of inclusion.

Now, to the crux of this article. Maharashtra is one State, where Model II is followed. The Maharashtra Government has enacted provisions in its VAT Act, in 2010, with retrospective effect from 2006, to deem a transfer of property in such Model II cases also. The legislative amendments made by the Government of Maharashtra were also upheld by the Hon'ble Bombay High Court in the case of Maharashtra Chamber of Housing Society (Pity – the society lost its service tax case as well as VAT case!). An optional composition rate of 1 % has also been prescribed.

Once the Model II transaction are thus recognized for the purpose of levy of VAT and transfer of property in goods is deemed by the State Government for levy of VAT, it will also constitute "works contract" as defined in the Finance Act, 1994.

Now the moot questions:

- (i) Under Model – II, where it was not recognized as works contract, 75 % abatement is admissible. Now, in cases like Maharashtra, where transfer of property in goods is also deemed in such cases, can the benefit of 75 % abatement still be claimed or the valuation should be based on Rule 2 A of Service Tax (Determination of Value) Rules, 2006 only? From the wordings of Notification 26/2012, since the complex in this case is "intended for sale" it appears, despite having been treated as works contract, still the 75 % abatement option is available for Model I cases. On the contrary, if it is held that once an activity is works contract, it has to be valued only in terms of Rule 2 A above, the 75 % abatement is available only in those states, where no VAT is levied on such Model I cases.
- (ii) Even under Model – I, is there an option for the service provider to claim 75 % abatement? Such service provider can claim that there activities are also covered as a declared service under Section 66 E (b) (which is now wider in its ambit than the erstwhile explanation). The answer seems to be a NO, in as much as the wordings of Notification 26/2012 covers

only "Construction of a complex, building, civil structure or a part thereof, **intended for a sale** to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority".

- (iii) If that be so, is it not another anomaly in the measure of levy?

