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This is not fair - CBEC

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Service tax on residential construction activities was imposed from 16.06.2005. Ever since its introduction, the levy is mired deeply in controversies and confusions, thanks to improper understanding of the field realities while drafting the law. The various circulars and instructions issued by the CBEC has further contributed to the myriad litigation. The most contentious issue is valuation of service provided to landowners, which is the topic of this article. Joint Development of residential projects, by Builders and Landowners is a common phenomenon. The landowners having land would join hands with the builder, who would obtain all approvals, undertake construction and marketing. The total number of flats constructed would be shared between the builder and the landowner in agreed proportion. The individual flats would be sold to various buyers. Each flat is entitled to an Undivided Share of Land (UDS), which would be registered in favour of the buyer. For example, in a land of 10000 Square Feet, 20 flats of each 1,500 Square feet is constructed (total constructed area of 30,000 Sq. Feet), each flat is entitled for 500 Sq. Feet of UDS land. The UDS land would be registered in favour of the buyer through a sale deed (executed either by the landowner directly, or by the builder, authorised through Power of Attorney by the landowner). This fundamental model has various variants. Let us continue with the above example to understand it better.

"L" a landowner and "B" a builder have entered into a Joint Development agreement, whereby, in the land owned by L, B would construct a residential apartment complex, comprising 20 apartments. B would be entitled for 10 flats and L would be entitled for 10 flats, which would be handed over to L, who may either sell it, occupy it or rent it out. The 10 flats of B, would be sold by B to various buyers identified by him.

In the above example, B is providing a service to his 10 buyers. He is also providing service to L, by way of constructing 10 flats for L. Let us assume that each of the 10 flats of B are sold for Rs.50 lakhs each, out of which Rs.10 lakhs is the value of proportionate UDS land and Rs.40 lakhs is the value of construction undertaken by B, for which a construction agreement would normally be entered into by B with the buyers. The value of UDS sold per flat is Rs. 10 lakhs and the value of service provided to the buyer is Rs. 40 lakhs. In respect of the service provided by B to his buyers, B would be paying service tax on Rs. 40 lakhs X 10 flats (Rs.4 Crores), as per law subject to abatements, etc. Now the question is what is the value of service provided by B to L, by way of constructing 10 flats in the complex, for L. It may be noted L would not be paying any amount to B as consideration for construction of these flats. Instead, L has allowed B, to sell B's share of 10 flats, along with proportionate share of UDS land. The entire land is owned by L, where 20 flats are being constructed and these 20 flats are entitled for its proportionate share in UDS land. When B is

selling his 10 flats, proportionate share of UDS land for these 10 flats would also be sold and this amount would be retained by B. Though the land is owned by L, he has allowed B to sell the same, in proportion to B's share of flats and appropriate the proceeds. So the value of land, pertaining to B's share of flats is the consideration for the services provided by B to L, i.e. value of service provided to L. In our example, B would sell the UDS land pertaining to his share of 10 flats for Rs.10 lakhs per flat, i.e total Rs.1 Crore. B is getting the right to sell Rs. 1 Crore worth of UDS land and appropriate the proceeds and this is the consideration for the service of constructing 10 flats for L. It may be noted that when each flat is sold for Rs.50 lakhs, Rs.40 lakhs suffers service tax as the value of service provided to the buyers and Rs. 10 lakhs also suffers service tax, as the value of service provided to L. Apart from Rs. 50 lakhs per flat, B is not getting any further amount and the entire amount is thus taxed.

The gap between these values, when similar flats are constructed by B for his buyers and L is an eyesore for the department. The fact is that the cost of construction of 10 flats for L, is also loaded by B in the value of his 10 flats indirectly, which value suffers service tax.

The department used to contend that Rs. 40 lakhs per flat shall be considered as the value of service provided to L also and demand service tax on Rs. 4 crore (Rs. 40 lakhs X 10). B is already paying service tax on Rs. 4 Crore, when he sells his 10 flats. So, the total value of service involved in constructing 20 flats is Rs.
8 Crores, according to the department, where B, the service provider, realises only a total of Rs. 5 crores (Rs. 50 lakhs X 10) in the entire episode. This stand of the department was eminent in its Circular No. 151/2/2012 ST Dt. 10.02.2012. To quote,

> *Value, in the case of flats given to first category of service receiver, 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*

Then came the negative list based service tax law, with a voluminous Education Guide, explaining the new dispensation. The following observation in the Education Guide came as a reprieve.

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.

Now, the CBEC turns volte facie and says Education Guide is wrong and the Circular is right. If the Education Guide is wrong, what is the purpose of issuing such a voluminous document and all concerned have wasted so much of their mid night oil in reading it time and again, when a great reform in Service tax was introduced from 01.07.2012. The CBEC has the audacity to say,

The Circular dated 10.2.2012 is in accordance with the provisions relating to valuation as laid down in the Finance Act, 1994 and the Service Tax (Determination of Value) Rules, 2006. As regards the Education Guide, it has been clearly stated in the Education Guide, 2012 that it is merely an educational aid based on a broad understanding of a team of officers on the issues. It is neither a "Departmental Circular" nor a manual of instructions issued by the Central Board of Excise and Customs. To that extent it does not command the required legal backing to be binding on either side in any manner. The guide was released purely as a measure of facilitation so that all stakeholders could obtain some preliminary understanding of the new issues for smooth transition to the new regime. Hence, Circulars such as the present one would prevail over the Education Guide, 2012.

Then why at all it was issued?

Further, in the instant case, the consideration for the service provided by B to L is not flowing from L to B, but L has authorised B to sell proportionate UDS when B's share of flats are sold. The said UDS is not registered in favour of B immediately, so as to make it as a consideration in kind. As and when such UDS land is sold by B along with his 10 flats, the value of service provided to L is being realised by B. Is it not simple logic and simple mathematics? Somebody should pay tax on Rs. 8 crores, when he gets only Rs. 5 crores?

CBEC seeks to rely on Rule 3 of the Service Tax (Determination of value) Rules, 2006. To quote,

RULE 3. Manner of determination of value. — *Subject to the provisions of section 67, the value of taxable service,* ***where such value is not ascertainable****, shall be determined by the service provider in the following manner :-*

(a) the value of such taxable service shall be equivalent to the gross amount charged by the service provider to provide similar service to any other person in the ordinary course of trade and the gross amount charged is the sole consideration;

(b) where the value cannot be determined in accordance with clause (a), the service provider shall determine the equivalent money value of such consideration which shall, in no case be less than the cost of provision of such taxable service.

But, who said that the value of service provided to L is not ascertainable? As and when B sells his flat and realises the value of proportionate UDS land, the same is very much ascertainable from the sale deed for sale of such proportionate UDS. So, there is no need to take recourse to this rule and value as defined under Section 67 is very much available. To quote,

> ***SECTION 67. Valuation of taxable services for charging service tax.*** *— (1) Subject to the provisions of this Chapter, where service tax is chargeable on any taxable service with reference to its value, then such value shall, —*
>
> *(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;*
>
> *(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;*
>
> *(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.*

In this case, the consideration for the services provided by B to L is in money only and the same is flowing from the buyers of B's share of flats, in the form of value of UDS land. L has authorised B to do so and appropriate such proceeds.

Further, the same would be our stand even if the apartment complex is in a posh area and the value of land is more than the value of construction. Perhaps CBEC may have a different criteria for such cases.

Good that there is still judiciary left in our country.