

Impact of Finance Bill 2010 on Construction Services

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“**Kanoon Kay Hath Bauat Lambe Hotte Hai**” was a well-known and oft-repeated dialogue of scores of old Hindi masala movies which used to be proudly uttered by a Police Inspector after getting hold of the culprits. I am quite optimistic that the abovementioned dialogue must also have been articulated by Builders’ community after bearing in mind the Service Tax budget proposals in respect of them in Finance Bill 2010.

To begin with, Service Tax is levied on a ‘taxable service’. Various sub-clauses of clause (105) of section 65 define each type of taxable service. Simultaneously, it will not be out of context to specify that service tax is not leviable on a transaction which tantamount to sale of goods and consequently attracts levy of sales tax/VAT. What is more, it has been unequivocally laid down by the Hon’ble Supreme Court in the case of **Bharat Sanchar Nigam Ltd. V. U.O.I. (2006) 145 STC 91 (S.C.)** that the very same transaction cannot attract both service tax and also sales tax, and the very same transaction cannot constitute both the rendering of a service and also a sale of goods. Likewise in case of **Shilpa Colour Lab V CCE (2007) 8 STT 102 (Bang. CESTAT)** it was pointed out that service tax cannot be levied on that portion of the value on which sales tax has been charged. In addition, in **Imagic Creative Pvt. Ltd. V CCT (2008) 12 STT 392** it has been categorically pronounced that service tax and sales tax/VAT are mutually exclusive. Further, in case of a composite contract (i.e. a contract which involves the transfer of materials as well as services) VAT cannot be levied on portion relating to value of service. Since the transfer of immovable property lies outside the purview of sales tax/VAT, it attracts levy of Stamp Duty.

Construction Services **largely covers two taxable services i.e. Commercial or Industrial Construction Services and Complex Construction Services**. A debate has been going in respect of Construction Services for a considerable period of time regarding the leviability of Service Tax. The genesis of debate lies in lack of unanimity in the prevailing practices regarding the time and style of transfer of ownership of property in question. Whereas in one situation the builder/promoter/developer seems to be working on behalf of the intending buyers, in another situation builder etc. appears to be working for himself.

In the above backdrop, Finance Bill 2010 has made following two broad proposals in respect of Builders’ fraternity which will **come into effect from a notified date after enactment of Finance Bill 2010:-**

1. Enhancement of Scope of Existing Relevant Taxable Services namely Commercial or Industrial Construction Services and Construction of Complex Service by virtue of insertion of an explanation.
2. Insertion of a new category of services under the category “Special Services provided by Builder etc.”

The above two budget proposals have been explained in greater depth in the ensuing paragraphs:-

1. Enhancement of Scope of Existing Relevant Taxable Services:-

“Construction of Commercial or Industrial Construction Services” and “Complex Construction Services” have been brought within Service Tax net w.e.f. 10-09-2004 and 16-06-2005 respectively. Before discussing the relevant explanation which intends to expand the scope of these services, it is desirable to discuss the prevailing different practices which have encouraged the Government to bring proposed changes. Keeping in view the easiness of understanding of readers, these divergent practices have been discussed under following headings & sub-headings:-

(A) When initial ‘Agreement to Sell’ leads to execution of ultimate ‘Sale Deed (this arrangement is popularly known as ‘BUILDER MODEL’)’ and its Service Tax Implications:-

In these cases the buyer and builder usually enter into an agreement which is popularly known as ‘*Agreement to Sell*’. In terms of aforementioned agreement the builder agrees to sell the mutually agreed property to the buyer at the mutually agreed price. The buyer more often than not agrees to make payment in agreed number of installments over a period of time. Thus, from the legal perspective, at the time of entering into ‘*Agreement to Sell*’ the buyer does not pay the entire consideration and the seller does not transfer the ownership of the property under consideration. Subsequently, at mutually acceptable date the buyer makes the payment of remaining amount and another document namely ‘**Sale Deed**’ is executed between the two parties. It is also worth mentioning that an appropriate amount of Stamp Duty (which incidentally varies from one state to another and varies on the basis of gender i.e. whether the buyer is a male or female) is paid on amount specified in ‘sale deed’. The sale deed represents the legal transfer of property from the Builder to Buyer.

Service Tax Implications:-

In **Circular No. 108/02/2009-ST** dated 29-01-2009 it has been clarified that the initial agreement between the promoters/builders/developers and the ultimate owner is in the nature of ‘*agreement to sell*.’ This case does not by itself create any interest in or change on such property in accordance with the provisions of the Transfer of Property Act The property remains under the ownership of the seller (in the instant case the promoters/builders/developers). The ownership of the property is transferred to the buyer only when full payment is received and sale deed is executed. Thus, any service provided by such seller in connection with the construction of residential complex till the execution of sale deed would be in the *nature of ‘self-service’* and consequently would not attract any service tax.

Earlier, the above view was also expressed in **Magus Construction Private Ltd. V UOI (2008) 15 STT 9** wherein it was held that when title in flat passes to buyer only on

execution of sale deed and its registration, payment made by prospective buyers in installments is against consideration of sale. Since it is not a case of construction on behalf of prospective buyers, service tax would NOT be leviable.

(B) ‘Sale of Undivided Portion of Land’ (popularly known as ‘Developer Model’) and its Service Tax Implications:-

In this arrangement i.e. Sale of Undivided Portion of Land’ an understanding is reached regarding the transfer of property rights between Developer on one hand and prospective buyers (including the person who provides ‘vacant land’ for the construction) on the other. Resultantly, foregoing arrangement transfers the property rights to the buyer without demarcating a specific portion which is to be given to different buyers. The basic purpose of entering into this arrangement is that it helps in saving the stamp duty as vacant land has less value as compared to constructed property.

Service Tax Implications:-

Since the vacant land (which is an immovable property) is immediately transferred from Developer to the concerned buyers, there are *no service tax implications* in this arrangement.

However, in this arrangement, many times a parallel instrument known as ‘*Construction Agreement*’ is entered between the promoter/Builder and Buyers. This aforementioned Construction Agreement will attract the levy of Service Tax because in this case the builder is doing construction on behalf of the concerned buyers.

(C) Outright Sale of the immovable property and its Service Tax Implications:-

In this situation the ENTIRE SALE CONSIDERATION is paid by the interested buyers subsequent to the entire completion/development of the residential complex /commercial construction, as the case may be.

Service Tax Implications:-

In view of the fact that the aforementioned contract is essentially for the sale of immovable property, the question of levy of Service Tax in this situation does not arise.

INSERTION OF NEW EXPLANATION FROM A DATE TO BE NOTIFIED AFTER ENACTMENT OF FINANCE BILL 2010:-

According to proposed new explanation 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. It should be kept in mind that according to the new explanation service tax WILL NOT be attracted only if ENTIRE PAYMENT is paid by prospective buyer or on his behalf AFTER COMPLETION OF CONSTRUCTION. Thus, in order to

avoid the possibility of levy of Service Tax both the following conditions should be satisfied cumulatively:-

- (i) The whole amount of consideration should be paid.
- (ii) The entire amount should be paid only after the completion of construction (including its certification by local authorities).

For instance, consider following simple situation:-

Sl. No.	Particulars	Amount/Date.
1.	Agreed Sale Consideration for buying a flat in a residential complex which falls under Complex Construction Services	Rs. 30 lakhs
2.	Date of Completion of residential Complex	17-09-2010
3.	Date of Certification of above residential complex by concerned local authorities	01-10-2010
4.	Date of agreement to sell between Mr. A(intending buyer) and MNO Ltd.(Builders)	05-06-2010
5.	Date of Execution of Sale Deed	13-11-2010

Whether there will be any Service Tax implications in each of the following independent situations:-

- (a) Mr. A makes payment of Rs. 10 lakhs on 05-06-2010 and Rs. 10 lakhs on 20-09-2010 and balance Rs. 10 lakhs on 13-11-2010.
- (b) Mr. A makes the entire payment of Rs. 30 lakhs on 25-09-2010.
- (c) Mr. A makes the entire payment of Rs. 30 lakhs on 13-11-2010.
- (d) Mr. A makes the payment in two installments on 13-11-2010 & 25-11-2010.

Keeping in view both the above essential conditions, service tax implications will be as under in each of above four situations:-

- (a) Service Tax will be attracted because part of payment will be made before the date of certification of above residential complex.
- (b) Service Tax is bound to be attracted in this situation as well because although full payment has been after date of completion of residential complex, the condition of payment after date of certification by concerned local authorities will not be satisfied.
- (c) Service Tax WILL NOT be levied in this situation because both the essential conditions have been satisfied.
- (d) Service Tax WILL NOT be attracted in this situation too. Although payment has been made in two installments but date of payment of both the installments is after the date of certification by concerned local authorities.

2.INSERTION OF A NEW CATEGORY OF SERVICES UNDER THE CATEGORY “SPECIAL SERVICES PROVIDED BY BUILDER ETC. FROM A DATE TO BE NOTIFIED AFTER ENACTMENT OF FINANCE ACT 2010”:-

It has come to the knowledge of the Government that in addition to the activities (for instance construction, completion and finishing, repairs, alterations, renovations or restoration of complexes) which fall within the purview of “Commercial or Industrial Construction Services” OR “Complex Construction Services”, the builders of residential or commercial complexes provide *other facilities* and charge separately for them. A few examples of the said facilities are given below:-

- (a) Prime/preferential location charges for allocating a flat/commercial space according to the choice of the buyer(i.e. Direction-sea facing, park facing, corner flat; Floor-first floor, top floor; Vastu- having bed room in a particular direction, Number-lucky numbers);
- (b) Internal or external development charges which are collected for developing/maintaining parks, laying of sewerage and water pipelines, providing access roads and common lighting etc.;
- (c) Fire-fighting installation charges; and
- (d) Power back up charges etc.

The above charges for other facilities do not form part of the taxable value for charging tax on construction. Since these charges are in the nature of service provided by the builder to the buyer of the property over and above the construction service, such charges are proposed to be brought under the new service namely ‘Special Services provided by the Builder etc.’ However, following charges have been specifically excluded from the scope of this new service:-

- (a) Charges for providing parking space;
- (b) Development charges to the extent they are paid to State Government/Local Bodies.
- (c) Any service provided by Resident Welfare Associations or Cooperative Group Housing Societies.

Further, these services do not include services covered under following taxable services:-

- (a) Management, Maintenance or Repair Services(65(105)(zzg)
- (b) Commercial or Industrial Construction Services (65(105)(zzg)
- (c) Complex Construction Services (65(105)(zzzh)

Valuation Issues:-

These have been discussed under following two sub- heads:-

(i)Suitable deduction towards the value of land:-A very interesting and important proposition which needs to be thoroughly appreciated is that of Valuation. What will be the value on which service tax should be levied? It is worth mentioning that in Delhi VAT there are relevant rules for segregating the **value of land**. However, in Service Tax

there are no corresponding rules for segregating the value of land (which is an immovable property & consequently attracts Stamp Duty.) In the measured opinion of the author from the Gross Amount of Contract, first of all amount should be appropriated (by devising a suitable mechanism) towards the cost of land. As the remaining amount is concerned following *two options* are available to concerned service provider:-

(a) *To avail the abatement of 67% in accordance with provisions of Notification 1/2006 dated 1-3-2006.* In other words, service tax is to be levied only on the 33% of the remaining amount (which at the prevailing rate of Service Tax of 10.3% works out to be 3.40% of the remaining amount).. However, there are certain essential conditions which are required to be complied with for availing the foregoing abatement. One of the conditions is that there is a restriction on availing Cenvat Credit in respect of Inputs, Capital Goods and Input Services.

(b) *To avail the benefit of Notification 12/2003 dated 20-06-2003* which provides exemption from so much of the value of all taxable services as is equal to the value of goods and materials sold by the service provider to the service recipient. Here, there is no restriction on availing Cenvat Credit in respect of Input Services but subject to the provisions of CENVAT Credit Rules, 2004. Thus, this option is comparatively better.

(ii) If payment is received prior to a notified date after enactment of Finance Bill 2010:-

Let us take a case of a particular builder DEF Ltd. which receives 80% of the agreed consideration before effective date on which abovementioned changes will come into force. Further, it is also assumed that by the effective date DEF Ltd. has completed only 50% of the stipulated construction work. In this situation on which amount service tax should be levied? According to one school of thought of professionals, service tax should be levied in respect of 50% portion which is yet to be completed at the effective date. On the other hand, as per another school of thought service tax should be levied in respect of 20% payment which is yet to be received as at the effective date particularly in view of that fact that in the new explanation emphasis has been placed on payment aspect. Since, this issue is very dicey and there is no unanimity of opinion, it would be in the fitness of things that a Department Clarification is issued at the earliest on the same. It is hoped that such clarification will go a long way in avoiding the scores of legal suits.

Conclusion:-

As a consequence of the above two broad changes, the prices of real estate sector are likely to further propel. The brunt of resultant increase will squeeze the pocket of ordinary non-business buyer who does not have the privilege of enjoying the CENVAT Credit in respect of service tax paid by him. And eventually, these two changes also prove beyond a shade of doubt that **“Kanoon Kay Hath Bauat Lambe Hotte Hai”**(i.e. **No one can escape from the law**) as well as **“Kanoon Kee Nigah Bahut Tez Hoti Hai”**(i.e. **Law has very sharp eye-sight**).
