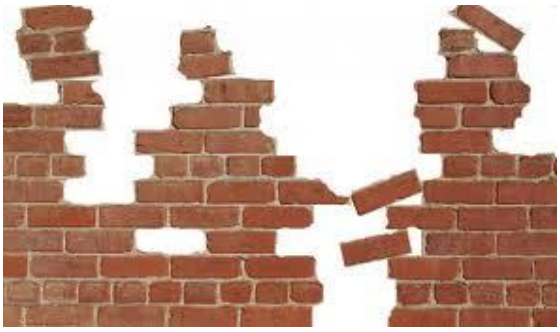

(By G. Natarajan, Advocate, Swamy Associates)

The complexities of the issues pertaining to the levy of service tax on construction related activities, especially residential construction, are bigger than the boulders and stickier than the concrete. Though the attempt of the Board in trying to clarify various issues vide its Circular 151/2/2012 Dated 10.02.2012 is laudable, it still falls short of the expectations and leaves further smog on the subject.

In this article, first an attempt would be made to highlight the areas which still crave for an answer and then attempt would be made to understand the present circular.

Personal use.

By and large and as also noted in the present Circular 151, there are two broad business models in the construction of residential complex.

(i) The undivided share of land (UDS) or the UDS along with a semi finished structure would first be sold to the flat buyer, which is a transaction of sale of immovable property. Further, a construction agreement would be entered to construct the flat of specified description between the builder and purchaser.
(ii) An agreement to sell the flat will be entered into and the consideration would be received in instalments. After completion of construction, the flat would be sold and registered in the name of the purchaser.

It may be noted that the first case involves a provision of service by the builder to the purchaser, whereas the second case is purely a transaction of sale of immovable property. While the former would attract the levy of service tax, the later was not. This was also clarified vide CBEC Circular No. 108/2/2009 Dt. 29.01.2009, as below:

> *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.*

But it may also be noted that the first case also would not attract service tax as the purchaser is getting the flat constructed for his personal use, which is excluded from the ambit of the levy. This has also been clarified so in the said same circular, as below:

> *Further, if the ultimate owner enters into a contract for construction of a residential complex with a promoter/builder/developer, who himself provides service of design, planning and construction; and after such construction the ultimate owner receives such property for his personal use, then such activity would not be subjected to service tax, because this case would fall under the exclusion provided in the definition of 'residential complex.*

The term "personal use" is also defined in Section 65 (91a) as

> *For the removal of doubts, it is hereby declared that for the purposes of this clause, —*
>
> *(a) "personal use" includes permitting the complex for use as residence by another person on rent or without consideration.*

Then what else is liable to service tax? This has also been clarified in the same circular as below:

> *However, in both these situations, if services of any person like contractor, designer or a similar service provider are received, then such a person would be liable to pay service tax.*

Another situation, where the taxability can arise is the landowner entering into a joint development agreement with the builder, where certain portion of the constructed area, represented by certain number of flats are handed over to the landowner and where the landowner intends to sell the flats and not retain them for his "personal use".

What emerges from the above is that the service provider by the builder to the ultimate buyer of the flat would not be taxable at all, as the ultimate buyer is constructing the said flat for his personal use.

If that be the position, the so called purpose of introducing the Explanation in the definition of these taxable services is without any reasoning. The reason is contained in the budget circular of 2010, which has also been taken note of by the Hon'ble Mumbai High Court, which upheld the validity of this Explanation. To quote from the circular,

> *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 parrallely 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."

When services provided by the builder to the purchaser itself is outside the ambit of the levy on the ground of "personal use", the purported reasoning of the introduction of the Explanation itself is flawed. Even after the introduction of Explanation, when a purchaser is entering into an agreement for sale and making periodical payments even before issue of completion certificate, though it is deemed as a taxable service, since it is for his personal use, it will not be taxable. Can the Explanation ignore the definition of "personal use" contained in the definition of "residential complex" and make sale of immovable property transactions as a deemed service, when the stated reason for such deeming fiction is non existent. If the intention is to tax the service provided by the builder to the purchaser, the exclusion for "personal use" should be removed.

In other words, prior to introduction of the Explanation, there was no lack of equity at all, as both the two types of transactions (referred to as (i) and (ii) above) were not taxable, i.e case (i) on the ground of personal use and case (ii) on the ground of self service. But, while introducing the Explanation it has been presumed that case (i) is taxable and only case (ii) was not. If the Explanation has the effect of nullifying the exclusion for personal use, then case (ii) now becomes taxable and case (i) remains outside the levy on the ground of personal use, still creating inequality.

Or is it the intention to allow the benefit of "personal use" only to the cases where a "residential complex" (having more than 12 residential units) itself is constructed by a person for his personal use (example – a company constructing a staff quarters) and not to the cases where an individual is constructing a residential unit for his personal use? If so, is it just and fair? Is it not contrary to Section 65 (30a), according to which construction of complex also includes construction of a part thereof?

Joint Ventures.

It is a common practice that a landowner and builder would enter into a joint venture and share the constructed area in agreed proportion. The UDS portion of land pertaining to the builder's portion would be sold and the amount would be appropriated by the builder. Further, the builder would also receive construction cost from the buyers. The builder would also construct landowner's share of constructed area and hand over the same to the landowner. As the landowner would not normally use his constructed area for his personal use, the service provided by the builder to the landowner is a taxable service. But no monetary consideration is flowing from the landowner to the builder, but the builder is given the right to sell his share of the UDS portion of land and retain the proceeds.

But, in many cases, the landowner asks the builder to sell his portion of constructed area also. Accordingly, the UDS land pertaining to landowner's share would also be sold by the builder, acting as a power of attorney of the landowner and a separate construction agreement would be entered into with the buyer. But the entire proceeds would be remitted by the builder to the landowner. In such circumstances, it is not clear whether the builder is providing service to the landowner (in which case, the service tax liability would arise) or to the purchaser (in which case, there would be no liability on the ground of personal use) or to both?

Works Contract Service.

Commercial or industrial construction service and construction of residential complex service were introduced with effect from 10.09.2004 and 16.06.2005 respectively. Subsequently works contracts was introduced as a separate taxable service from 01.06.2007, which also covered construction of complex and commercial or industrial construction activities. There is a view, though debatable, that prior to 01.06.2007, only pure service activities would be taxable and only from 01.06.2007, composite activities involving supply of goods and services, normally recognized as works contracts would become taxable. But, once works contracts is introduced as a separate taxable service, the construction activities undertaken by builders / contractors, which involves both supply and use of various materials like cement, steel, etc. as well as labour involved in construction would get classified only under works contract service. The existing taxable services of commercial or industrial construction {Section 65 (105) (zzq)} and construction of complex service {Section 65 (105) (zzzh)} would not cover activities in the nature of works contracts. This has also been conceded by the CBEC in its circular No. 128/10/2010 Dated 24.08.2010, in the following words.

> *As regards the classification, with effect from 1-6-2007 when the new service 'Works Contract service' was made effective, classification of aforesaid services would undergo a change in case of long term contracts even though part of the service was classified under the respective taxable service prior to 1-6-2007. This is because 'works contract' describes the nature of the activity more specifically and, therefore, as per the provisions of Section 65A of the Finance Act, 1994, it would be the appropriate classification for the part of the service provided after that date.*

Hence the existing services of construction of complex service and commercial or industrial construction service have only limited application now. It would cover the cases which are pure services, where the client / customer procures and supplies all materials. If that be the case, what is the relevance of various abatements prescribed for the service?

If that be so, what is the relevance of Explanation introduced under construction of complex service and commercial or industrial construction service, when no such Explanation was introduced under Works Contract Service?

The case where only an agreement to sell is entered into and the flat is later sold and registered, would not fall under works contract service, as there is no transfer of property in this case but only transfer of immovable property. This transaction may fall under the construction of complex service. But again the issue of "personal use" rears its head.

Now, let us look in to the clarifications issued vide Circular No. 151/2/2012 Dt. 10.02.2012.

Para.No.	Clarification	Analysis
2.1	Tripartite Business Model (Parties in the model: (i) landowner; (ii) builder or developer; and (iii) contractor who undertakes construction): Issue involved is regarding 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. Clarification: 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.	Builder / Developer is providing services to (i) Landowner and (ii) Individual buyers and this has been recognised.
2.1 (A)	(A) Taxability of the construction service: (i) For the period prior to 01/07/2010: construction service provided by the builder/developer will not be taxable, in terms of Board's Circular No.108/02/2009-ST dated 29.01.2009.	The said circular has dealt with the transactions between builder / developer and buyer alone under two models and has not at all dealt with the taxability of service provided by the builder / developer to the landowner which is not for the landowner's personal use. Now as per the present clarification, it can be concluded that there is no liability to service tax, prior to 01.07.2010 for any builder / developer in so far as services

		provided to landowners as well as buyers.
	(ii) For the period after 01/07/2010, 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.	Even after 01.07.2010, service provided to the buyers for their personal use are not liable to service tax, in as much as the statutory exclusion for personal use still remains. If the transaction model is sale of UDS and construction agreement, as clarified in the 2009 circular, there is no liability on the ground of personal use. But if the transaction model is agreement to sell, receipt of instalments and registration as complete unit, as per the Explanation it is taxable. So now also, there is no equity.
2.1 (B)	(B) Valuation: (i)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. 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).	According to this clarification, service tax in respect of services provided to the landowner should be paid at the time of handing over his portion of the flats. This is contrary to the provisions of the Point of Taxation Rules, 2011, for the period after introduction of the said Rules, according to which the ST has to be paid as per the provisions of the said Rules, applicable for continuous supply of services. Once the developmental right is given to the builder, the liability to pay ST will arise.
2.2	2.2 Redevelopment including slum rehabilitation projects: Generally in this model, land is owned by a society, comprising members of the society with each member entitled to his share by	Exclusion for "personal use" has been recognised here. For the period after 01.07.2010, the observations made under

	way of an apartment. When it becomes necessary after the lapse of a certain period, society or its flat owners may engage a builder/developer for undertaking re-construction. Society /individual flat owners give 'No Objection Certificate' (NOC) or permission to the builder/developer, for re-construction. The builder/developer makes new flats with same or different carpet area for original owners of flats and additionally may also be involved in one or more of the following: (i) construct some additional flats for sale to others; (ii) arrange for rental accommodation or rent payments for society members/original owners for stay during the period of re-construction; (iii) pay an additional amount to the original owners of flats in the society. <u>Clarification</u>: Under this model, the builder/developer receives consideration for the construction service provided by him, from two categories of service receivers. First category is the society/members of the society, who transfer development rights over the land (including the permission for additional number of flats), to the builder/developer. The second category of service receivers consist of buyers of flats other than the society/members. Generally, they pay by cash. <u>(A) Taxability</u>: (i) Re-construction undertaken by a building society by directly engaging a builder/developer will not be chargeable to service tax as it is meant for the personal use of the society/its members. Construction of additional flats undertaken as part of the reconstruction, for sale to the second category of service receivers, will also not be a taxable service, during the period prior to 01/07/2010; (ii) For the period after 01/07/2010, construction service provided by the builder/developer to second category of	para 2.1 would apply here also.

	service receivers is taxable in case any payment is made to the builder/ developer before the issuance of completion certificate. (B) Valuation: Value, in the case of flats given to second category of service receivers, shall be determined in terms of section 67(1)(i) of the Finance Act, 1994.	
2.4 2.5 2.6		No comments.
2.7	Joint Development Agreement Model: Under this model, land owner and builder/developer join hands and may either create a new entity or otherwise operate as an unincorporated association, on partnership /joint / collaboration basis, with mutuality of interest and to share common risk/profit together. The new entity undertakes construction on behalf of landowner and builder/developer. Clarification: Circular 148/17/2011-ST dated 13/12/2011, particularly paragraphs 7, 8, 9 apply *mutandis mutandis* in this regard.	In such models, it can no longer be argued that it is not a case of provision of service by one to other, but of a common business venture with profit sharing. Such transactions would also be liable to service tax.

Before parting...