Levy on Flats – Falls flat!

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By the time this article hits the press, much mortar would have already flown under the flats, about the recent circular of the CBEC clarifying certain aspects relating to the levy of service tax on "construction of residential complex". In this article, just an attempt is made to note various situations and understand the service tax applicability thereon. Incidentally certain apprehensions are also sought to be aired.

Situation I.

A builder / promoter / developer is constructing a residential complex having more than 12 residential units. With each prospective buyer, an agreement to sell is entered into and payments are received in installments depending upon the level of completion. After conclusion of the construction, a sale deed executed for the completed unit.

Applicability of the levy.

The present circular has clearly laid down that no service tax is payable in such cases. While holding so, the CBEC has observed that since the property remains that of the seller till completion of construction, the service is a self service.

Comments / Apprehensions.

The Hon'ble Supreme Court had the occasion to consider as to whether such cases would be construed as "Works Contracts" for the purposes of VAT and held that they would constitute works contracts, in the case of **K. Raheja Development Corporation Vs State of Karnataka – 2005 – 141 – STC 298.** Once it is recognized as works contract for VAT, the same shall be recognized as works contract for the purposes of service tax also. But, the correctness of this decision has been doubted in the case of **L & T Limited VS State of Karnataka – 2008-TIOL-186 SC** and the issue has been referred to LB of the Hon'ble Supreme Court.

If ultimately, the Raheja view is upheld by the Hon'ble Supreme Court, the present clarification that there is no service under this situation, would be rendered nugatory and the activity would be covered under "Works Contract". Unlike the scope of levy under "construction of residential complex service" where construction of "complex" alone is recognized as taxable service, under works contract "construction of residential complex or part thereof" is also a taxable service. As such, the works contract service rendered to an individual flat buyer (which is part of the complex), would be liable to tax.

But, the clarification issued by the CBEC, with regard to the second situation would be helpful to claim that even in such cases there would be no service tax levy, as the individual buyers are getting the flat constructed, for their "personal use".

Situation II.

The builder / promoter / developer is first entering into an agreement for sale of undivided portion of land to the buyer and also enters into a construction agreement for constructing a residential unit on such undivided portion of land. After completion of the construction, a sale deed is executed for the sale of UDS of land plus construction.

Applicability of the levy.

The CBEC has clarified now that in this type of cases also no service tax is payable, as the flat buyer is constructing the flat, for his "personal use" which is excluded from the definition of residential complex.

Comments / Apprehensions.

If the definition of "residential complex" is referred to, it may be observed that the exclusion for "personal use" is worded as "but does not include a complex which is constructed by a person directly engaging any other person for designing or planning of the layout, and the construction of such complex is intended for personal use as residence by such person". Hence, it may be observed that the personal use must be with reference to the "complex" itself, which is built by a person, for his personal use, so as to qualify for exclusion from the scope of thie levy. But, the benefit has now been extended to individual residential units also, in the circular. Moreover, as per the definition, the benefit of "personal use" would be available only if designing and planning is outsourced and the construction has to be done by the said person directly. But, in the circular, the benefit of "personal use" has been extended even if construction is outsourced to the builder / promoter / developer.

The clarification issued by the CBEC can also be supported that in so far as the individual buyer is concerned, the builder is not providing any service for construction of **residential complex,** but only service for construction of a **residential unit** to the individual flat buyers and hence there cannot be any levy of service tax. In other words, in as much as the taxable service reads as "any service provided or to be provided by a person to any other person in relation to construction of complex", the service tax would not be attracted if the service is rendered to any person, in relation to only an unit of such complex. Though the circular takes cognizance of such an argument, the clarification is not based on such interpretation, but on the basis of interpretation of the term "personal use".

Situation III

The builder / promoter / developer is engaging a contractor for constructing a residential complex.

Applicability of the levy.

The CBEC has clarified now that such contractors would be liable to service tax.

Comments / Apprehensions.

No qualms. The contractor cannot claim exemption on the ground of "personal use" as the builder / promoter / developer is not constructing the complex for his personal use, but for subsequent sale. Moreover, the contractor would be rendering the service to the builder / promoter / developer, in relation to a "residential complex", as the entire complex is being built for the builder / promoter / developer.

Situation IV.

The following situation, though not envisaged in the CBEC's circular, is also relevant.

The builder / promoter /developer is entering into a Joint Development Agreement with a land owner for construction of a residential complex. As per the agreement, the flats built, would be shared between the builder / promoter / developer and the landlord in agreed proportion. With regard to the flats belonging to the builder / promoter / developer, he would be selling the flats to individual buyers, under either of the mode described in (I) or (II) above. In any case, there is no service tax liability, as already clarified.

With regard to the flats meant for the landlord, the builder / promoter / developer is rendering the service of construction to the landlord. Since the land is owned by the landlord and the Joint Development agreement is only for construction, there is an element of service from the builder / promoter / developer to the landlord. The landlord is not getting the complex built for his "personal use" but only for resale. So, if the number of units meant for the landlord are more than 12, the builder / developer / promoter would liable to service tax on the service rendered to the landlord. The spirit of the circular would also support such view.

It may be noted that no money consideration is flowing from the landlord to the builder / promoter / developer in this regard. The consideration for the service is the right granted to the builder / promoter / developer, by the landlord to use that portion of land meant for him, for construction and sale of flats to individual buyers and sale of such land to the flat bueyrs. For example, in a land, if 50 flats are built and shared equally between the builder / promoter / developer and the landlord, the consideration for constructing 25 flats for the landlord would be the builder / promoter / developer's right to sell the UDS portion pertaining to his 25 flats.

Since the consideration is not in money, recourse has to be made to the Service Tax (Determination of Value) Rules, 2006 and as per Rule 3 (a) – it shall be based on value charged in similar cases, i.e. individual buyers.

Situation V.

A company /Government is building residential accommodation for its workers / staff by engaging the services of a construction agency. There was a news item on this subject some time back, which indicated that the Government appear to have clarified that in such cases the company / Government cannot be said to be constructing the residential complex, for its "personal use". Going by the concept of "personal use" as envisaged in this circular, it can also be claimed that even in such cases, the Company / Government is constructing the complex only for its personal use and no service tax is payable.

Before parting…

The definition of "works contract" under section 65 (105) (zzzza) of the Act covers **"construction of a new residential complex or part thereof".** As such, prima facie, the services rendered to an individual flat buyer, would be construed as service in relation to construction of a part of the residential complex and be liable to service. But, since the same has been clarified in the circular as being for "personal use", the same shall not attract the levy of service tax. It may be noted that the definition of the term "residential complex" under section 65(91a) ibid is applicable for the "residential complex" envisaged in the definition of "works contract" also. As such, the present clarification, though issued in the context of construction of residential complex service, would also be applicable to works contract services, in so far as it relates to construction of a residential complex or part thereof is concerned.